



# The Israel Electric Corporation Ltd.

## Financial Reports

For The Year Ended  
December 31, 2015

### FILES INDEX

The financial reports, for the year ended December 31, 2015, are presented in a primary order.

Each chapter is numbered separately by its internal sequence.

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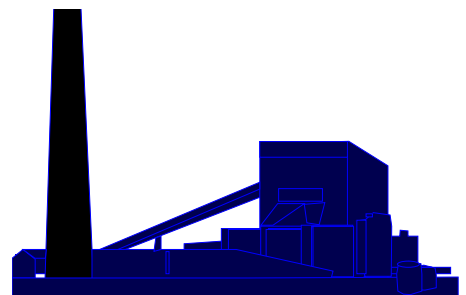


# The Israel Electric Corporation Ltd.

## Chapter A

### Description of the Company's Business Affairs

For the Year Ended  
December 31, 2015



## **Prominent Disclaimer**

This English translation of the **“Description of the Company's Business Affairs”** for the year ended December 31, 2015 ("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 <sup>1</sup>

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

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

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

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

The Company generates, transmits, distributes and supplies most of the electricity that is consumed in the Israeli national economy pursuant to the licenses that have been granted to it for each such type of operation, in accordance with the Electricity Sector Law, which have been extended over the years. The Company also engages in the setup of the infrastructures that are required for the stated operations and also operates as an electricity system administrator. In addition, the Company owns a license to transmit, distribute and supply electricity in the area of the State of Israel, which constitutes an “essential service supplier license” (as this term is defined in the Electricity Sector Law). In addition, the Company holds licenses for the generation of 78.6% of the total output of the power stations in the electricity sector for which generation licenses have been issued as of December 31, 2015<sup>2</sup>. The system administration activity is performed by the Company within the framework of the “the General License” (as this has been defined in Section 21.1.2) although it has not been given a special purpose license on this matter. See Section 21.1.2 for details.

The Company is a Government and public company and is regulated by a series of regulators, inter alia by the Electricity Authority which determines, inter alia, the electricity rates and the manner of their update, and this pursuant to the provisions of the Electricity Sector Law, and as detailed in section 7.11.1.1.

The licenses of the Company have been extended from time to time over the years. On November 30, 2015, the Economic Plan Law (Legislation Amendments for Implementation of the Economic Policy for the 2015 and 2016 Budget Year Law), 2015 (the “Arrangements Law”) was published in the Official Gazette, within which, inter alia, the Electricity Sector Law was amended and the licenses of the Company were extended until January 1, 2017, provided that the Company will operate pursuant to their provisions, the provisions of the Electricity Sector Law

<sup>1</sup> 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.

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

and the provisions of any other law. An additional extension of the licenses to a date later than January 1, 2017, will require the approval of the Ministers in consultation with the Electricity Authority and the Government Companies Authority and with the approval of the Economic Affairs Committee of the Knesset, and for a period not exceeding one year.

The shares of the Company were traded for a certain period<sup>3</sup> on the Tel Aviv Stock Exchange Ltd. (hereinafter: the “**Stock Exchange**”), but following a purchase offer that the State of Israel published on September 30, 1986 to the shareholders of the Company, which was accepted by a majority of the shareholders at the time, the shares of the Company ceased to be traded on the Stock Exchange. As of the date of the report, the Company has bonds (series 25), (series 26) and (series 27), which are traded on the stock exchange. Bonds (series 25) are backed by State guarantee and were originally issued according to a prospectus of the Company from June 26, 2012. Bonds (series 26) and bonds (series 27) are secured by a floating charge and were originally issued according to a prospectus of the Company of May 27, 2015. As of the date of this report, the State of Israel holds approximately 99.846% of the issued, paid-up share capital of the Company, and therefore, the Company is a “government company” as this term has been defined in the Government Companies Law - 1975, (hereafter: the “**Government Companies Law**”) and the Company and its operations are also subject to the provisions of that law. The balance of the issued and paid up capital of the Company, at a rate of approximately 0.154%, is held by approximately 120 individuals.

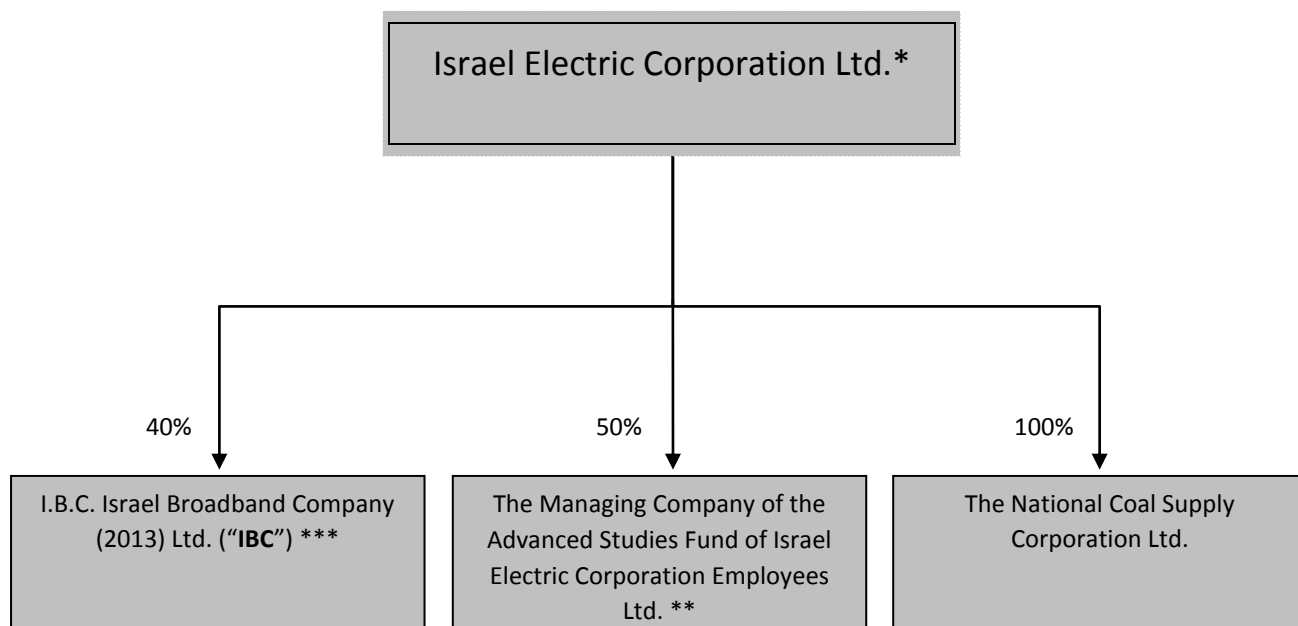
In February 2005, following an application that was made by the Company to the Companies Authority, in order to clarify the issue of the status of the Company as a public or private company, the Company was provided with an expert opinion by the legal adviser to the Companies Authority, according to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

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<sup>3</sup> The Company does not currently have in its possession information as to the time and manner in which the shares were offered to the public.



**1.2 Diagram of the holding structure of the Company**



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

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

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

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

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

For details regarding the structural change outlined under the Electricity Sector Law, publication of the draft of recommendations of the steering team for executing a reform in the electricity sector and the Electric Company (“**Steering Team’s Draft Recommendations**”), and the decisions of the Courts of Labor in this matter and regarding details relating to a letter that was sent by Mr. Uri Yogev, to Mr. Avi Nisenkorn, Chairman of the New National Labor Federation, regarding the “Position of the State regarding the Israel Electric Company Ltd.” (the “**Yogev Letter**”), and the letter which was sent on September 11, 2014 by Mr. Uri Yogev, Director General of the Government Companies Authority, and Mr. Kobi Amsalem, Director of Wages and Labor Agreements at the Ministry of Finance, to Mr. Avi Nisankorn, clarifying that the New National Labor Federation is required to respond to the Yogev letter concerning the financial changes which will be paid with respect to the implications of the planned changes in the Electric Company on the employees, and the changes which will be required in the existing collective agreements and existing collective arrangements, see notes 1.e and 1.f to the financial Statements of the Company as of December 31, 2015 (the “**Financial Statements**”).

During November 2015, the ministers assigned the Director General of the Ministry of Energy and the Director General of the Ministry of Finance with the task of starting a process to formulate the government’s position and to renew negotiations and talks for implementation of the reform in the electricity sector, with the participation of the relevant government entities, the Company and the representatives of the employees. On January 14, 2016, the Company received the decision of the National Court of Labor, under which the outline of the reform in the Company will be promoted by April 30, 2016. On March 2, 2016, an additional hearing was held at the National Court of Labor, in which it was decided that the parties will hold several meetings in order to advance the negotiations regarding the reform. Several meetings were held by the parties during recent months, but an agreed outline for the reform has not yet been formulated. The Company does not yet know if and how the aforesaid outline which will be finally formulated will be different from the Steering Team’s Draft Recommendations. For additional details regarding the above detailed Court decisions see Note 35 c. 7) 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 Company's estimations regarding the manner of implementation of the structural change and its cost, including the possibility of implementing a structural change in the Electricity Sector in accordance with the draft of recommendations of the Steering team, insofar as will be adopted, or in accordance with the Yogev Letter and decisions of the regulatory entities that are required with respect to this and with respect to the forecast of the Company with respect to the extension of its licenses and the period of extension, constitutes forward looking information, as per its definition in the Securities Law. This information as stated is based on future data, and its realization is not certain and is not under the control of the Company, but is dependent on receiving regulatory approvals and agreements, and on relevant legislation amendments, as far as will be required. In addition, this information is based on estimates of the Company as of the date of the report, and the position of the Company with respect to the manner of implementation of the structural change in the Electricity Sector. Such estimates may not be realized or may be realized partially or differently than expected (including that the Company may be required to implement the structural change as it is outlined in the Electricity Sector Law), due to, inter alia, the continued progress in negotiations between the parties and due to changes in the position of the Government, the Ministers<sup>4</sup>, the regulators who supervise the Company’s operations or the applicable law, all of which are not under the Company's control*

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<sup>4</sup> The “Ministers” - the Minister of Finance and the Minister responsible on behalf of the Government for the affairs of the Government Company (as of the date of the report, the Minister responsible for the affairs of the Company is the Minister of National Infrastructures, Energy and Water).

## **2. Fields of Activity**

The Company operates, as mentioned, as a single combined, coordinated system that engages 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 primary fields of activity, which are known as segments in the Financial Statements, in accordance with that which has been stated below<sup>5</sup>:

- 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<sup>6</sup> and substations<sup>7</sup>. The electricity transmission also includes connection transformers which transfer the energy from extra high to high voltage. In the substations, the energy is transferred to a medium voltage grid through output transformers. 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 36 and 39 to the Financial Statements.

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

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

## **4. Distribution of dividends**

- 4.1** For details of the assignment of profits and dividend distribution policy see Note 26 of the Financial Statements.
- 4.2** The Company did not distribute dividends in the two years preceding the date of the Report. On June 8, 2015, the Director General of the Government Companies Authority approved the decision of the Board of Directors of the Company concerning the assignment of its profits for 2014, under which dividends will not be distributed from the Company's profits for 2014.

## **4.3 Distributable profits**

The balance of the distributable profits of the Company as of December 31, 2015 is approximately NIS 14,712 million.

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<sup>5</sup> 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.

<sup>6</sup> A switching station is a station that has 400 kV input voltage or which is connected to a power station with an output exceeding 400 megawatts and with a 161 kV voltage.

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

## Part 2: Other Information

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

Details on variable costs and fixed costs by segments follow:

#### For the year ended December 31, 2015

	Data for 2015 – segments			
	In nominal million NIS			
	Generation	Transmission	Distribution	Total
<b><u>Fixed:</u></b>				
Wages .....	1,533	277	1,211	3,021
Depreciation .....	2,278	967	1,333	4,578
Financing.....	789	403	586	1,778
Others .....	2,659	1,557	629	4,845
	7,259	3,204	3,759	14,222
<b><u>Variable:</u></b>				
Fuels.....	8,269	-	-	8,269
	8,269	-	-	8,269
<b>Total assigned costs .....</b>	<b>15,528</b>	<b>3,204</b>	<b>3,759</b>	<b>22,491</b>

#### For the year ended December 31, 2014

	Data for 2014 – segments			
	In nominal million NIS			
	Generation	Transmission	Distribution	Total
<b><u>Fixed:</u></b>				
Wages .....	1,582	255	1,179	3,016
Depreciation .....	2,209	946	1,221	4,376
Financing.....	1,286	621	931	2,838
Others .....	3,200	1,167	306	4,673
	8,277	2,989	3,637	14,903
<b><u>Variable:</u></b>				
Fuels.....	7,873	-	-	7,873
	7,873	-	-	7,873
<b>Total assigned costs .....</b>	<b>16,150</b>	<b>2,989</b>	<b>3,637</b>	<b>22,776</b>

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 36 and 39 of the Financial Statements for details on the rules and assumptions based on which the division into operation segments was made and further information.

The Company foresees a decrease in its receipts in 2016 compared to 2015, exceeding NIS 3 billion (including VAT), due to decrease of the rate, decrease in electricity demand, and entry of private electricity producers into the electricity sector. The Company does not foresee a material impact on its profitability following the aforesaid decrease of its receipts. For additional details regarding the impact of the entry of private electricity producers see section 7.4.4 below.

*The information included in this report, and within the repost of the Board of Directors of the Company, regarding the Company's estimate of a decrease in its receipts in 2016, and the Company's expectations that the decrease of its receipts will not cause a material impact on the profitability of the Company, including with regard to the scope of the decrease and its reasons, is forward looking information, as it is defined in the Securities Law. This information is based on future data and forecasts of the Company whose existence depends on factors over some of which the Company has no control, such as electricity demands at a given time, scope and rate of entry of the private electricity producers into the electricity sector and the volume of their actual production, and the change in the electricity rate.*

See the explanations in Board of Directors' report section A.3 and A.4 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, 2015 ("**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 developments in the Company or on its business results as well as the implications in respect of them on the Company.

### **6.1 Regulation in the Company's fields of activity**

The operations of the Company are affected to a great extent by the regulation applying to its operations, including the provisions of the Electricity Sector Law and its regulations, pursuant to which it is given licenses for operations, the policy and resolutions of the Government (including resolutions of the Ministry of National Infrastructures, Energy and Water and the Ministry of Finance), the resolutions of the Electricity Authority (including with respect to the electricity charge rate that is fixed by the Electricity Authority and collected from the customers of the Company), the provisions of the Companies Law and its regulations (inter alia, regarding the manner of the Company's conduct as a public company), the provisions of the Government Companies Law and its regulations and resolutions of the Companies Authority (*inter alia*, on the matter of the conduct of the Company as a Governmental Company, the manner of adoption of resolutions by its organs, the manner of preparation of its Financial Statements, appointment of directors and special functionaries and so on), the provisions of the Natural Gas Sector Law – 2002 ("Gas Sector Law") and resolutions of the Natural Gas Authority ("Gas Authority"), provisions of the Antitrust Law, 1988 ("Antitrust Law"), and decisions of the Antitrust Authority and the General Director of the Antitrust Authority (pursuant to the Company being a monopoly or pursuant to its execution of agreements that require the receipt of approval from the antitrust control mechanism), the provisions of section 29 of the Budget Foundations Law, 1985 ("Budget Foundations Law") that requires the Company to receive the approval of the Director of Wages and Labor Agreements in the Ministry of Finance ("Director of Wages") in matters of wages and benefits for its employees, the provisions of the Securities law and its regulations, and the regulations and directives of the Securities Authority, the provisions of the Law of Promotion of Competition and Reduction of Centralization - 2013 ("**Centralization Law**"), and regulation pertaining to business licensing, planning and construction and environmental protection (see Sections 7.12, 8.8 and 9.10), and additional legislation, as also detailed in section 21.6 of this report. See Section 21 for details on restrictions to and regulation of the activity of the Company. See Section 1.3, section 28.3.7 and Note 1.e to the Financial Statements for details on the main points of the provisions of the Electricity Sector Law pertaining to a structural change.

### **6.2 Geopolitical and security situation in Israel and its surroundings**

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, unstable political situation in Israel or nearby countries, or deterioration in Israel's international trade relations, may materially harm the Company's operations. For additional details, see the risk factor in section 28.1.2.

### **6.3 Natural gas**

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

## 6.4 The effect of market data

### 6.4.1 Changes in the exchange rates

Because almost all of the revenues of the Company are quoted in NIS and approximately 65% of the long term financial liabilities of the Company, including permanent bonds and before executing hedging transactions were, as of December 31, 2015 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 (except for a loan to finance the gas transmission project which is not intended for unique use by the Company and includes deposits) in 2015 is 0.5% compared with the weighted devaluation rate in 2014 of approximately 9.5%. The fluctuations in the exchange rates affect the expenses of the Company (financial and others) and the outcomes of its operation. However, most of these liabilities are covered in hedging transactions using a hedging mechanism that is built into the electricity charge rate. See Section b 2) of the Report of the Board of Directors for additional details on the exposure of the Company to changes in exchange rates.

Additionally, the Company mainly purchases fuels in dollars, and the electricity rate includes recognition of the fuels expenses according to the exchange rate at the time of the normative consumption. The Company executes partial hedging of the exchange rate of some of the fuel payments with respect to the time gap between the date of the rate recognition of the dollar price and the actual payment date.

See Sections 7.11.2.1, 8.9.1 and 9.11.2 for details on the electricity charge rate.

### 6.4.2 Index changes

The majority of the capital costs and part of the operation costs recognized in the electricity rate are linked to the Consumer Price Index (the "Index"). The Company has expenses that are linked to the Index, which principally derive from the financial liabilities of the Company which are denominated in Index linked NIS currency, such that the exposure to the Index with respect to them is negligible. The Company is exposed to a real increase of the input prices the Company purchases regarding the rate recognition of this input as linked to the Index.

Nonetheless, with respect to the reporting periods beginning on January 1, 2015, including comparison figures for 2014, the Company is implementing the IFRS in full. Therefore, the adjustment of the Financial Statements of the Company to the Index was terminated, a fact that may cause erosion to the profitability of the Company in case of an increase in the Index.

In December 2015, the Electricity Authority<sup>8</sup> reached a decision regarding the charge rate treatment of the transition to nominal financial reporting which enables the Company to record, as of January 1, 2016, regulatory deferral accounts with respect to the linkage differentials due to the foreign capital. This record will provide a partial accounting response to the foreign capital erosion due to increase in the Index but does not resolve the erosion of the Company's equity.

For additional details regarding the transition to full implementation of the IFRS and its implications on the Company, see Note 28.3.3 below and Note 37 to the Financial Statements.

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<sup>8</sup> Within the Amendment to the Electricity Law, which entered into effect on January 1, 2016, a new authority, named the "Electricity Authority", was established at the Ministry of National Infrastructures, Energy and Water, instead of the Public Utilities Authority - Electricity and the Electricity Administration at the Ministry of National Infrastructures, Energy and Water. According to the aforesaid, in this report, the term "Electricity Authority" should be construed while paying attention to the dates it relates to - if it is about information relating to dates prior to January 1, 2016, it means the Public Utilities Authority - Electricity, and if it is about information relating to dates as of January 1, 2016 onward, it means the Electricity Authority which was established within the aforesaid Amendment to the Electricity Sector Law.

## **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<sup>9</sup> 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<sup>10</sup>. In addition, it was determined in the Government's decision of September 20, 2015 that generating electricity from renewable energies will constitute at least 13% of the total electricity consumption in 2025 and at least 17% of the total electricity consumption in 2030.

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<sup>11</sup> that was published, stands at 4,435 megawatts. If all of the project for which provisional licenses have been issued and that have won the State tender (except renewable energy projects whose energy availability depends on sunlight, water, etc.) materialize, they will constitute approximately 12% of the total installed generation capacity of the State of Israel.

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.

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

In addition, the State is operating to save consumption (reduce demand). Thus, among other things, the Ministry of National Infrastructures, Energy and Water is taking steps to increase the awareness of energy savings (for example by a campaign for the replacement of light bulbs to energy saving light bulbs, legislation that prohibits the use of incandescent bulbs, replacement of refrigerators or air conditioners that consume too much electricity and so on). The Company is also acting in accordance with this policy and is encouraging "intelligent consumption" of electricity<sup>12</sup>.

For details on the licenses that have been given to entrepreneurs and private electricity producers and their generation capacity as of the date of the report, and regarding electricity generation from renewable energies, as well as for additional details of the entry of private electricity producers into the field of electricity generation, including implications it may have on the Company, see section 7.4 and Note 35 a 4) to the Financial Statements.

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<sup>9</sup> Decision of the Ministerial Committee for Social and Economic Affairs (the Socio-Economic Cabinet) No. SE/43 of November 4, 2002.

<sup>10</sup> Government Resolution number 3484: Government policy in the field of energy production from renewable sources, of July 17, 2011.

<sup>10</sup> The Company does not have tools to estimate which of the projects will be established and when, if any.

<sup>12</sup> See the website of the Company: [www.iec.co.il](http://www.iec.co.il).



## 6.6 Raising finances

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

## 6.7 Prevailing weather conditions in Israel

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

Thus, an extreme weather occurrence befell the country in October 2015, which caused damages to the electricity grid and led to disruption in the electricity supply throughout the country. On November 1, 2015, the Minister of National Infrastructures, Energy and Water (the "**Minister**") appointed a team to examine the preparations and conduct of the Electric Company following the power interruptions which were caused due to the extreme weather, headed by the Director General of the Ministry of National Infrastructures, Energy and Water, Mr. Shaul Meridor. Furthermore, the Company CEO appointed an internal examination team to examine the aforesaid events, and additionally, the Chairman of the Board of Directors appointed a team on behalf of the Board of Directors, composed of the Strategy, Structural Change and Image Committee, to accompany and monitor the work of the aforesaid internal team and the learning process, implementation of conclusions, decision making in the Company and recommendations to external entities.

In March 2016, the Company received the final report of the aforesaid examination team which was appointed by the Minister. The Company is studying the report and its conclusions.

In light of the disruptions to the electricity supply as detailed above, three applications for approval of class actions were submitted against the Company. The first on October 27, 2015, in the amount of approximately NIS 240 million, the second on November 1, 2015, in the amount of approximately NIS 354 million, and the third on December 31, 2015, not denominated in an amount but estimated by the applicants at tens of millions of NIS. For additional details see Note 35b.1jj) to the Financial Statements.

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

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

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

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

### **7. The generation segment**

#### **7.1 General information on the generation segment**

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

The electricity generating system of the Company in Israel includes five steam driven power stations, which are powered by steam force that turns the blades of turbines, and which are spread along the country's shores, located in Haifa, Hadera (hereinafter: "**Orot Rabin**"), Tel Aviv (hereinafter: "**Reading**"), Ashdod (hereinafter: "**Eshkol**") and Ashkelon (hereinafter: "**Rothenberg**"). The steam driven power stations are powered by coal or natural gas as primary fuel, or fuel oil as secondary fuel. 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, 2015, the Company possesses and operates seventeen sites of power stations (of which five are steam driven power stations sites as mentioned above) with a total installed generation capacity of approximately 13,617 megawatts. The sites, which are located, in accordance with that which has been stated above, throughout the territory of the State of Israel, are located on land that is owned by the Company or leased to it by the State. Each of the sites of the power stations of the Company has a single unit or a number of separate units for electricity generation. As of December 31, 2015, the Company had sixty three generation units, of which eighteen are steam generation units; fourteen are combined cycle gas turbine units; sixteen are jet gas turbine units<sup>13</sup>, and fifteen are industrial gas turbine units<sup>14</sup>. For a breakdown of all of the generating units of the Company, their locations and generation capacities, see the following table in this section. 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 costs of generation per kilowatt hour, from the least costly to the most expensive, from among all the electricity generating options of the Company according to the terms of the contracts that it executed to purchase raw materials for electricity generation, is as follows: (A) generation by coal; (B) generation by natural gas in combined cycle units; (C) lower efficiency<sup>15</sup> 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<sup>16</sup>, the Company runs the generation units in accordance with the criterion of cost of fuels per generated kWh<sup>17</sup> and considering operational constraints. Therefore, the Company runs the units in accordance with the following priorities: coal powered steam generation units, natural gas powered combined cycle units, gas converted steam generation units, natural gas powered open gas turbine units, LNG and diesel oil. If need be, primarily in peak demand periods, the Company runs the diesel oil powered units: industrial gas turbines and jet gas turbines, whose operation may be initiated and stopped in a short time relative to the steam generation units, albeit at a higher cost of operation. The entity that decides on the mix of the operating stations at any time is the system management unit, which is located in the Company as of the

<sup>13</sup> 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 7.1.1.1 (B) for further details.

<sup>14</sup> A turbine that is run by industrial jet engines, which are diesel powered, with an option for conversion to natural gas operation.

<sup>15</sup> This term expresses the ratio between the amount of energy extracted and the amount of energy invested and is expressed in%.

<sup>16</sup> The demand curve expresses the demand for electricity during the hours of the day.

<sup>17</sup> Kilowatt hour (kWh). A "**kilowatt**" (kW) is a unit for measuring output. One kilowatt equals a thousand watts. A "**kWh**" is an energy unit that is equal to continuous consumption of a kilowatt for one hour.

date of the report, subject to the regulation that applies to the Company, which is regulated, inter alia, by the criteria and decisions of the Electricity Authority.

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

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

Despite the transition process to the use of natural gas for producing electricity and the conversion of the steam generation units to natural gas power, which started in February 2004 in accordance with what is stated below, the Company decided to maintain the ability of the steam driven power stations to be “dual-fuel”<sup>18</sup>, and they will be able to generate electricity using both natural gas and liquid fuel (this is in addition to “dual-fuel” stations that can be operated both by coal (as a main fuel) and by crude as detailed in section 7.1.1.1). This is in order to preserve their ability to generate electricity even during time of shortage in natural gas or because of a disruption in its supply.

As of December 31, 2015, the Company generates most of the electricity in the State of Israel, approximately 77% (compared with approximately 84% as of December 31, 2014), while the remaining electricity is generated by private electricity producers and small photo voltaic installations from which the Company purchases electricity at low rates. A few of them sell all of their output to the Company while others generate electricity for their own consumption and sell only their surplus generation to the Company. In accordance with that which has been stated above, it is the policy of the Government to increase competition in the Electricity Sector. For additional details see section 6.5. In addition, in accordance with the Electricity Sector Law, as an essential service supplier, the Company is committed to purchasing electricity that is generated by private electricity producers. See Section 7.4 for further information on private producers of electricity and the competition in the field of activity of electricity generation.

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<sup>18</sup> A generation unit that can be powered by at least two types of fuel.

A table follows that lists the generation units of all types, and the generation capacity in megawatts as of December 31, 2015, which is included in the Company's load monitoring and control system:

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

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

##### (A) Steam generation units

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

The dual fuel power stations, which are powered, as of the date of this report, by coal, involve a high investment and a long construction time, but when they are coal powered, the cost per generated kWh is low. After commencement of the flow of natural gas from the Tamar Reservoir, another part of the fuel oil generation units that have been converted to natural gas power has been run by natural gas. See Section 7.9.9.2 (A) for details on the Tamar reserve.

##### (B) Gas turbines

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

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

##### (C) Combined cycle generation units

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

As of the date of publication of the report, one steam addition (unit 4 at the Eshkol combined cycle) has not yet been granted a generation license by the Minister of National Infrastructures, Energy and Water despite the transfer of the information required by the Electricity Authority as a condition for granting a license.

#### 7.1.1.2 Generation with natural gas

As of December 31, 2015, approximately 57% of the total installed generation capacity of the Company is by units that may be powered by natural gas.

#### 7.1.1.3 Duration of use of the generation units

The Company periodically estimates the lifetime of its assets, based on international information and the past experience of the Company. The useful lifetime of a power station is approximately thirty years at least. The useful lifetime of gas turbines is approximately twenty five years for industrial gas turbines and approximately fifteen years for jet gas turbines. The Company maintains and invests in its generation units on a regular basis, including beyond their useful lifetime, in accordance with techno-economic viability and engineering considerations. Based on the information available to the Company with respect to the energy sector industry, the Company believes that the shutdown rates applicable to its units are similar relative to comparable electricity generators. For additional details, including as regards the Electricity Authority's decision of December 8, 2015, regarding the lifetime of the Company's coal powered units, see Note 2h to the Financial Statements for details.

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

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

As of the date of the report, the Company has 63 generation licenses that have been granted separately for each generation unit (hereinafter: the “**Generation Licenses**”). The validity of the Generation Licenses has been extended until January 1, 2017. Two of the aforesaid licenses (the license of generation unit 9 at the Ramat Hovav site which was converted to a combined cycle unit pursuant to the Electricity Authority’s decision of May 12, 2014 and March 2, 2015, and the generation license of unit 4 at the Eshkol site, whose output was increased and configuration amended pursuant to the Electricity Authority’s decision of October 26, 2015) will enter into effect after receiving the approval of the Minister of National Infrastructures, Energy and Water.

The revenues of the Company in the generation segment are affected by the electricity rate which is determined by the Electricity Authority in accordance with the Electricity Sector Law. For details regarding the electricity rate and the manner of its determination, see section 7.11 below.

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

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

The installed generation capacity of the Company as of December 31, 2015 is approximately 13,617 megawatts.

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

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

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

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

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

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

##### 7.1.6.1 **Entry barriers**

By the Company’s assessment, entities that operate with a significant production volume in the field of electricity generation are required primarily to make an initial investment of significant amounts of capital, whether by way of investment in shareholders’ equity or by way of banking or other financing, for the purpose of the construction of generation facilities, and are later required to have the financial strength for

the purpose of their regular maintenance. In addition, the field has complicated regulation, owing to which an entity that wishes to generate electricity is required to undergo a procedure for receiving an electricity generation license from the Electricity Authority (which is performed in a number of stages over a long period), to comply with strict quality requirements and standards, to receive permits with respect to environmental protection, the location of sites and the receipt of construction permits, to ensure the availability of raw materials and their costs. In addition, professional knowledge and experience in the field of electricity generation, a good reputation in the industry and availability of land for constructing the electricity generating facilities are important.

#### 7.1.6.2 Exit barriers

The regulations regulating the operations of the Company and the fact that it is an “essential service supplier license” holder, in accordance with the Electricity Sector Law and the provisions of its licenses, requiring it to generate electricity for the public as of whole, reliably and efficiently, in accordance with the terms of its license, are the primary exit barriers of the field of operation.

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

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

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

As of the date of the report, the field of electricity generation in Israel features a significant growth in the market share of private electricity producers. The Company generates most of the electricity in Israel and its competitors are the private electricity producers, whose installed production capacity as of December 31, 2015 is approximately 21.4% of the total installed production capacity in the State of Israel and is expected to reach approximately 25% during 2016.

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

### 7.2 Products and services

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

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

For details regarding the Company’s revenues from sales of electricity that were assigned to the generation segment in 2015 see section a.3.b) of the Board of Directors’ Report.

## 7.4 Competition

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

#### 7.4.1.1 General

In accordance with what has been stated, as of the date of the report, the Company generates, transmits, distributes and supplies most of the electricity consumption in the State of Israel and it was declared in January 1999 by the Antitrust Commissioner as a monopoly in the Electricity Sector, *inter alia*, in the following fields: supply of electricity – generation of electricity and its sale, transmission and distribution of electricity and provision of backup services for electricity consumers and producers. See Section 21.9 for further information on the declaration of the Company as a monopoly and the consequences of this declaration, and the Company's application to the Antitrust Authority in this matter.

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<sup>19</sup>. 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.

Accordingly, the Government set a guiding objective for generation of electricity from renewable energy at 10% of the electric energy needs of the State for 2020. In accordance with the Government resolution on this subject, this objective is expected to be achieved by generating electricity to an installed output of approximately 2,760 megawatts. In addition, there is a guiding intermediate objective of generation of 5% of electricity in Israel at the end of 2014 by renewable energies. As of December 31, 2015, this objective has not been achieved. This objective may be achieved by generation of electricity by generation units of an installed output of approximately 1,550 megawatts. The Government further decided to regulate the encouragement of the construction of facilities for energy production from renewable sources, in accordance with the objectives of the Government. With the intent of realizing this policy, it has been decided to direct the Electricity Authority to act within the framework of its authority in accordance with the Law, including by completing the update of charge rates and criteria to the extent required, by division into quotas in accordance with what was stipulated in the resolution. In addition, it was determined in the Government's decision of September 20, 2015 that generating electricity from renewable energies will be at least 13% of the total electricity consumption in 2025 and at least 17% of the total electricity consumption in 2030.

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)<sup>20</sup>, 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").

Following the publication of decision no. 914 of the Electricity Authority of December 10, 2014, regarding "Continued Rate Regulation for Private Conventional Electricity Producers Exceeding 16 Megawatts and Private Suppliers", the "Proposal of a Decision for a Hearing - Criteria for Implementation of decision 914 (chapters E and F)" was published on December 22, 2015, which was to address recent changes in the electricity sector, and the rate regulation for conventional producers in particular. This decision proposal enables a producer to choose between two rate arrangements set in this decision, one being a fixed

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<sup>19</sup> 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.

<sup>20</sup> The Book of Criteria is publicized for the public at the site of the Electric Company: <http://www.pua.gov.il/31-339-he/Electricity.aspx>



availability transaction with an essential service provider which is characterized by a high level of certainty for the producer and adequate expected profitability, and the other a bilateral transaction with a private supplier in which the producer will operate within demand risks in the electricity sector which are accompanied by a greater profit potential. Nonetheless, for combined cycles, at least 15% of the output will be supplied through agreements with private consumers and 85% of the output at the most will be at the disposal of the system manager. To the best of the Company's understanding, the purpose of the aforesaid decision proposal is to formulate a continued format and content for the rate arrangements for existing additional private producers, who are not within the incidence of the Electricity Authority's decision of 2008, which regulated the availability rates and energy for private conventional producers (potential producers who had not yet received a rate approval on the date of the decision and who will be entitled to a rate approval no later than January 1, 2019).

As it is an intricate decision proposal with material implications for the operation of the electricity sector, the Company is still studying the decision and many issues will be discussed together with the relevant professional entities in order to formulate the Company's reference to the matter.

Amendments to this decision were published on June 18, 2015, including update of parameters in the rate arrangement for the gas turbine, including providing a return of 12% for existing provisional license owners who will convert provisional licenses of combined cycle installations to open cycle installations. In accordance with the decision, the change is in view of an updated analysis of the sector's needs and examination of all the underlying considerations of the section of the law's objective.

In accordance with what will be stated below, as of the date of the report, the objective determined by the Government of Israel for increasing the generation capacity of private electricity producers is 20% of the installed generation capacity in the State of Israel by 2020 (not including renewable energies). Today, the total installed generation capacity of private electricity producers stands at approximately 21.4% (including renewable energies. Without the generation capacity of private electricity producers with renewable energies of 4.5%, the abovementioned datum is 16.9%) of the total installed generation capacity of the sector. The Company estimates that in 2016, the aforesaid generation capacity is expected to be approximately 25% (including renewable energies. Without the generation capacity of private electricity producers with renewable energies of 6.1%, the abovementioned datum is expected to be 18.9%).

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<sup>21</sup>, as follows:

- (A) To purchase electricity from private electricity producers in accordance with the regulations pursuant to the Electricity Sector Law and the license conditions of private electricity producers, at charge rates and in proceedings that are regulated in the regulations and rules<sup>22</sup> that were promulgated pursuant to the

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<sup>21</sup> The Electricity Sector Regulations (Conventional Private Electricity Producer) 2005 and the Electricity Sector Regulations (Cogeneration) 2004 state that transactions for purchasing electricity from producers shall be done by the system administrator (and not by a transmission license holder). The system administrator is defined in accordance with the Electricity Sector Regulations (Conventional Private Electricity Producer) 2005 and the Electricity Sector Regulations (Cogeneration) 2004, as follows: "The director of the supervision, control and command of loads center at the Electricity Authority, of the transmission license holder, or of a party that has received a license for system administration". The transmission license holder has been defined within the said regulations as follows: "An essential service provider license holder that has received a license to convey electricity, from a generation facility using electricity grid lines of high voltage and extra high voltage to a substation and that concentrates more than half of the transmission capacity in the electricity sector". As of the date of this report, the State has founded a system administration company that to the best of the Company's knowledge is inactive. Therefore the Company, as the transmission license holder, bears the duties that apply to a system administrator in accordance with the Electricity Sector Law and the relevant regulations, in accordance with the decision of the Ministers dated February 2009. Upon the commencement of the activity of the system administration company, the rights and liabilities of the Company in accordance with the agreements with these private electricity producers shall be converted.

<sup>22</sup> 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

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<sup>23</sup> 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.

#### 7.4.1.3 Private electricity producers

The private electricity producers operate pursuant to generation licenses that they have received as part of the undertaking of the State of Israel under tenders for the generation of electricity that have been published 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<sup>24</sup> to its resolution on the issue of the charge rate arrangements supporting financing for private electricity producers. The resolution was intended to provide an infant industry protection to private electricity producers and serves as an additional link in the government operation to create conditions to promote private entrepreneurship in the Electricity Sector. Within the framework of this resolution, the Electricity Authority has established, *inter alia*, as follows:

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

In its decision of June 3, 2013<sup>25</sup>, the Electricity Authority set the maximal quotas for various production technologies on which the above mentioned financing supportive arrangements will apply.

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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.

<sup>23</sup> “Supplier” – a holder of a license to sell electricity to consumers (supply license).

<sup>24</sup> Electricity Authority Resolution No. 1 of Meeting No. 268, which was held on July 19, 2009 on the matter of: “Charge rate arrangements that support financing for private electricity producers”.

<sup>25</sup> 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”.

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<sup>26</sup>. The costs incurred by the Company in respect of the purchasing of electricity and in respect of finance-supporting arrangements will be recognized as part of the rate.

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

Prior to the entry of private producers on a large scale, the Electricity Authority reached a decision on May 13, 2013, regarding the establishment of a temporary rate for the system's management services<sup>27</sup>. In accordance with a letter from the Head of the Economics Division of the Electricity Authority, which was received by the Company in January, 2013, the recognized cost of the administrative services for the system management is based on pricing operating cost and capital services of activities which the system administration must conduct according to the criteria determined by the Electricity Authority. The pricing will be based on identification of the costs components of the input which is attributed to the system management service in the various segments. The units comprising the system management service at the Electric Company are "Load Monitoring", "Technical Development Planning (TDP)" and "Statistics".

On August 6, 2015, the Electricity Authority reached a decision regarding the rates of the electricity system management services (system rates) including administrative costs of the system management services, back-up services and pan-systemic costs. According to this decision, inter alia, the Company is required to report the revenues and expenses of the system management services within a separate auditor's report which will be published on the website of the Company and the website of the Electricity Authority, and this is a condition for recognition of these costs.

On July 9, 2014, the private producer Dorad Energy Ltd. submitted a petition against the Electricity Authority, requesting the Authority to refrain from reaching a decision and conduct a hearing pertaining to the system costs rate: (1) as long as it does not have complete, detailed and full information regarding the types of services provided by the Electric Company and regarding the sums of the cost of those services being provided by the Electric Company, (2) as long as it does not have the ability and possibility to examine and audit the stated services and sums and inter alia, in order to determine if the sums are reasonable and required to provide the services, and (3) without the stated information being made available for review and professional examination by the private electricity producers, and at least as long as the Electric Company does not prepare audited financial statements according to the provisions of the law, including with separation into activity segments and profit centers". The Company and the State submitted their response to the petition. On July 12, 2015, the High Court of Justice decided to reject the petition, it being a premature petition (namely, before the Electricity Authority has reached a final decision in the matter), while reserving the petitioner's arguments.

On March 2, 2015, the Electricity Authority reached a decision (Guiding Rules) regarding the possession of control of generation licenses, within which it was determined that when the Authority will use its authorities pursuant to the law with respect to rate arrangements and granting licenses, it will operate in accordance with principles which were detailed in the letter of the Antitrust Commissioner pertaining to considerations of competition when granting electricity generation licenses. According to these principles, the Authority will use its stated authorities, inter alia, in light of the following guidelines: (a) the maximum output of generation

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<sup>26</sup> The Electricity Authority's resolution no. 1 from meeting 383, dated September 5, 2012 regarding: "amendment to the authority's resolution from meeting 375 dated June 4, 2012 regarding finance-supporting price arrangement for private electricity producers". The Electricity Authority's resolution no. 2 from meeting 375, dated June 4, 2012 regarding: "amendment to the authority's resolution from meeting 268 dated July 19, 2012 regarding finance-supporting price arrangement for private electricity producers".

<sup>27</sup> 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". The decision relates to the administrative services alone for the system management which constitute only part of the rates of the system management services as were published within the hearing of June 28, 2014.

installations using conventional technology and cogeneration technology which will be held or controlled by a person will not exceed 1600 MW; (b) a person will not hold or have material control of a dominant market share of one generation technology; and (c) a person who will hold 10% or more of the stated means of control of a license or a material means of control will be deemed for the purpose of this decision to be holder of the entire output. The validity of the stated decision is two years from the date it was made.

On March 23, 2015, the Electricity Authority reached a decision with respect to the principles of recognition of gas costs from private producers operating with natural gas, within which principles were determined pursuant to which costs with respect to agreements to purchase natural gas will be recognized for an essential service provider. Within this decision, the Authority determined, inter alia, that it will not recognize costs with respect to gas agreements which exceed the costs recognized for the Electric Company, including the linkage mechanisms which were determined within the Company's option transaction with the Tamar partnership. For details of the stated option transaction see Note 34.a.1) to the Financial Statements.

For details regarding the determination of a temporary rate for system management service, as set in the decision of the Electricity Authority regarding the determination of rates for management services of the electricity system, which was implemented from September 13, 2015, as well as for details of petitions submitted to the High Court of Justice against the Electricity Authority and the Company concerning the implementation of the aforesaid rate, see Note 3e. to the Financial Statements.

#### 7.4.2 **Types of private electricity producers**

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”<sup>28</sup> transmission system.

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

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

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

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

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<sup>28</sup> The regulation applying to a private electricity producer OPC Rotem Ltd. (“**O.P.C**”), although the facility is conventional, because it won a tender that was published by the State, the provisions that apply to it are the provisions of the tender.

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

Amendments to this decision were published on June 18, 2015, including update of parameters in the rate arrangement for the gas turbine, including providing a return of 12% for existing provisional license owners who will convert provisional licenses of combined cycle installations to open cycle installations. In accordance with the decision, the change is in view of an updated analysis of the sector’s needs and examination of all the underlying considerations of the section of the law’s objective.

- B) Private electricity producers that generate using cogeneration facilities – facilities that produce from one energy source, simultaneously, electrical energy and useful thermal energy (that is mostly used for industrial and private purposes). Usually connected to the “high voltage” transmission system: facilities that are located on the premises of consumers and that supply steam and energy to them. In May 2008, the Electricity Authority published a resolution<sup>29</sup> on the matter of charge rates for the purchase of energy from cogeneration facilities whereby the charge rates for producers were determined based on the technology of the facility and the annual energy quantity sold to the essential service provider. These charge rates were revised as part of the resolution of the Electricity Authority dated January 21, 2013. With respect to cogeneration producers that are connected to the grid by high voltage, there is a restriction as to the sold quantity, according to the length of the transaction period with the system administrator. With respect to producers that are sold by medium or low voltage lines there is no restriction and they are allowed to sell all of the energy generated at the facility. On January 11, 2015, the decision of the Authority was published, extending the validity of the previous decision until December 31, 2015. Additionally, this decision determined a new and unique arrangement for the cogeneration producers that are at risk of a situation in which the demand for steam decreases. An additional Authority resolution was published on August 6, 2015, extending the validity of the aforesaid decision until December 31, 2016.
- (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

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<sup>29</sup> Resolution No. 1 of Meeting No. 211 of the Electricity Authority dated May 1, 2008, in the matter of “charge rates for purchase of energy from cogeneration facilities”.

partial, these producers sell their energy to the system administrator only. Some of these producer facilities will be connected to the transmission system and some to the distribution system. In a Government Resolution dated July 17, 2011, on the subject of the Government policy in the field of energy production from renewable sources (Decision No. 3484), quotas were set for production using various renewable energies, which constituted a continuation of a previous resolution on the subject dated January 29, 2009, and was based on a policy document of the Ministry of Energy for combining renewable energies in the electricity generation array in Israel. In the Government Resolution of October 22, 2014<sup>30</sup>, additional quotas were added for electricity installations with photovoltaic technology by way of shifting from the quotas of renewable energy production technologies that are not photovoltaic. Additionally, and in accordance with this resolution, the decisions of the Electricity Authority were published on January 11, 2015, and November 5, 2015, dealing with "Regulating surplus regarding criteria and rates for decentralized electricity production for self-consumption and transferring surplus to the grid through small installations with photovoltaic technology, in an output not exceeding 50 KW", and which determine regulation aimed at bridging the existing gaps between the installed scope of photovoltaic electricity producing installations for self-consumption and the Government's targets as defined in the above detailed Government decisions, by regulating the "surplus" not used during the regulation by the Electricity Authority of photovoltaic installations for self-consumption during the years 2008-2014.

It is noted that purchase of electricity from renewable energies, as well as the rest of the electricity purchases from private electricity producers, is fully covered in the electricity rate. The Electricity Authority recognizes an advance for the Company with respect to total expected electricity purchases for the coming year on the basis of forecasts and subject to costs control. On the consecutive annual update date, the recognized costs are retrospectively recognized in accordance with the actual electricity costs for that year. The gap between the forecasts and the costs actually paid is included within the framework of the compensation mechanism with respect to a delay in the update.

As a rule, the charge rates that the renewable energy producers receive are significantly higher than the charge rates that other private electricity producers or the Company receive. The charge rates that are given to owners of renewable energy electricity facilities range from approximately 230 agorot per kWh to approximately 45 agorot per kWh, compared with the weighted generation component of the Company which, as of the date of the report and in accordance with the decision of the Electricity Authority of September 7, 2015, is approximately 26.52 agorot per kWh alone.

- (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.

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

#### 7.4.3.1 **General**

In accordance with the Electricity Sector Law, the Company, as an essential service supplier, is required to purchase electricity from a private electricity producer. As has been elaborated above, in accordance with the Electricity Sector Law, a private electricity producer is a party that has received a generation license (*that is*, has started to run the generation facility)<sup>31</sup>. 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

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<sup>30</sup> Government Resolution number 2117 of October 22, 2014, in the matter of "Implementing the Government targets for electricity production by renewable sources - discussion of the appeals regarding the decision of the Ministerial Committee for Promotion, Development and Implementation of Renewable Energies".

<sup>31</sup> 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.

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<sup>32</sup>. The provisional license holder must satisfy the milestones for building the facility as elaborated in the provisional license. Only after they are all fulfilled and the facility has been built is it given a generation license by the Electricity Authority, which is given effect by the approval of the Minister.

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

As of the date of publication of the report, the total output of entrepreneurs with provisional licenses that have been issued to them by the Electricity Authority with producers that have won a tender stands at approximately 4,435 megawatts using various electricity generation technologies, divided as follows:

- (A) The volume within the framework of provisional licenses of conventional producers – approximately 1,448 megawatts.
- (B) The volume within the framework of provisional licenses of cogeneration producers – approximately 777 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 1,570 megawatts.

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

#### 7.4.3.3 Producers with generation licenses, including self generation and photovoltaic installation owners of up to 50 kilowatts without a generation license (namely, producing electricity in practice)

A significant entry of private electricity producers into the electricity generation field began from the second half of 2013. The installed generation capacity volume of private electricity producers constitutes, as of December 31, 2015, approximately 3,718 megawatts (of which approximately 785 megawatts in renewable energies), constituting approximately 27.3% of the total installed generation capacity of the Company which, as set forth, is approximately 13,617 megawatts<sup>33</sup>. As of December 31, 2014, the installed generation capacity volume of private electricity producers was approximately 2,552 megawatts (of which approximately 596 megawatts in renewable energies), as of December 31, 2013, the installed generation capacity volume of private electricity producers was approximately 1,093 megawatts (of which approximately 359 megawatts in renewable energies).

In the year ended on December 31, 2015, the Company purchased approximately 4,383 million kWh from private electricity producers, compared with approximately 1,833 million kWh purchased in the year ended December 31, 2014. The average price that the Company paid to owners of private production facilities in 2015 (including small photovoltaic facilities) was approximately 60 agorot per kWh compared with approximately 93 agorot per kWh in 2014. 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 2015 constitutes

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<sup>32</sup> Section 4 of the Electricity Sector Law grants the Electricity Authority power to issue licenses for activities in the electricity sector and to establish their conditions. The Rules of the Electricity Sector (Transactions with Essential service Provider) 2000 and following them also Conventional Generator Regulations and the Cogeneration Regulations, have stated that a provisional generation license is a temporary licenses that is given for the purpose of construction of a generation facility, while, upon the fulfillment of the prescribed conditions (including fulfillment of milestones as stipulated in the provisional license and in the regulations) and the provisions of the law, that person shall be issued a generation license.

<sup>33</sup> On January 4, 2016, an additional producer with a license for an installed output of approximately 126 megawatts began its commercial operation.

approximately 8.7% of the electricity that the Company supplied in 2015, as compared to 3.7% of the electricity that the Company supplied in 2014.

The Company estimates that the generation capacity of the private electricity producers out of the installed production capacity (installed output) in the sector, including with renewable energy, is expected to be as follows: approximately 25% in 2016 and approximately 25.8% in 2017. Notwithstanding the aforesaid, there is uncertainty as to the activation dates of the new private electricity producers, which are primarily dependent on entities that are not connected to the Company.

As of the date of the report, three private electricity producers, whose maximum output is 2,238 megawatts, have begun their commercial activation, as well as an additional number of private electricity producers whose maximum output is smaller, and numerous medium and small sized photovoltaic facility owners which are connected to the distribution grid (high or low voltage). Following are details regarding four of the private electricity producers whose maximum output is the largest among all the private electricity producers the Company has contracted with as of the date of the report:

- (A) In August 2010, the Company executed an agreement with Dorad Energy Ltd. regarding the purchase of available production capacity and energy of approximately 860 megawatts, and supply of infrastructure services, and it began its commercial activity on May 19, 2014. Its commercial outline is selling most of the electricity to end consumers and to sell the surplus electricity on the basis of price bids to the system manager.
- (B) In May, 2012, the Company executed an agreement with Dalia Power Energies Ltd. regarding the purchase of available production capacity and energy of approximately 912 megawatts and the provision of infrastructure services, which began its commercial operation in its two units on July 7 and September 3, 2015, respectively.
- (C) On July 6, 2013, OPC began its commercial operation, and the maximum output of the OPC combined cycle is 466 megawatts. As of the date of the report, the combined cycle can operate with natural gas and can also operate with diesel oil for 200 continuous hours. To the best of the Company's knowledge, the commercial outline of OPC is selling most of the electricity to end users (private consumers) and selling electricity surplus, on the basis of a normative rate competition.
- (D) In August, 2013, the Company entered into an agreement with P.S.P Investments Ltd. with respect to purchase of pumped energy in the availability and energy method (300 megawatts output), and its commercial activation is expected to begin in 2019.

As of the date of the report, approximately 360 big customers, purchasing electricity from approximately 2,750 consumer locations<sup>34</sup>, transferred to purchase electricity from private suppliers. The Company estimates that the decrease in the volume of production the Company as a result of the transfer of these customers to private producers is approximately 9 billion kWh in a complete year (less sale of electricity to private producers). Furthermore, the Company estimates that in 2016 and onward, this process is expected to continue, although the Company has no certainty at this stage as to the number of customers who will transfer to private electricity producers and the stated implications on generated and sold kilowatts and revenues of the Company in the medium and long term.

A number of power stations of private electricity producers are expected to begin commercial activity during 2016, with a total output of approximately 690 megawatts.

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<sup>34</sup> 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 customers of whom not all of their consumption locations are transferring to the private producers).



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

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

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

#### (B) **Impact of the competition on the Company's profitability**

As detailed in section 7.11.1, the major rate components in the generation segment are the fuels costs, capital services costs and operating costs.

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

Within the regulation presently existing, the Company's profitability is derived from the structure of its active assets, and therefore it is not expected to be materially damaged as a result of the entry of private producers.

#### **Impact on the Company's profitability in the generation segment:**

- Fuels costs - the Company is not expected to be damaged by the entry of the private electricity producers, since its income from this component is determined in accordance with its actual production volume. Insofar as the electricity production volume of the Company will decrease, the fuels costs will decrease, including in relation to the Take or Pay mechanism (for details see section 7.9.9.2(a) and Note 35.a.1) to the Financial Statements), and accordingly so will the Company's income, and therefore the above mentioned will not have a material impact on the profitability of the Company.
- Costs with respect to capital services - the income from this component is predetermined for the generation segment, pursuant to the cost of the assets recognized for each of the active generation units of the Company, and therefore, a decrease in the production volume does not damage the Company's income and its profits from capital services. However, since the costs are determined in accordance with the active assets of the Company and are not dependent on kWh, every decrease in the production volume of the Company will cause an increase in the rate per produced kWh and damage to the Company's ability to compete with private producers. This exposure was partially solved with the publication of the system rates.

It should be noted that insofar as the volume of the assets recognized for the Company within the rate will decrease as a result of the entry of private producers, the total profit concerning this component will decrease accordingly.

- Operating costs - the Electricity Authority determined that the operating costs recognized at the rate base in Agorot per kWh will be separated into a fixed cost and a variable cost at a ratio of 88% fixed cost and 12% variable cost. The variable operating costs will be calculated every year so that the abovementioned rate will be multiplied by the quantity of kWh generated, net, for every year in the Company's units, while the fixed operating costs will be calculated so that the abovementioned rate will be multiplied by the installed megawatts of that year. The operating costs and the division between fixed and variable cost will be examined when determining a new rate base for the generation

segment. This manner of recognition applies from June 1, 2013 and until the determination of a new rate base.

In view of this, the fixed operating income of the Company is not harmed as a result of a decrease in the volume of its generation, and there is no material damage to the profitability of the Company in the operating component as a result of the entry of private electricity producers.

- Electricity purchases from private electricity producers and renewable energies are fully covered in the electricity rate which is updated every annual update - the Authority recognizes an advance for the Company with respect to the total electricity purchase expected for the coming year, and retrospectively compensates the Company with respect to the gap between the forecast and the costs of the electricity purchase which materialized in practice, subject to cost control. The aforesaid may have a flow impact as a function of an increase in the volume of purchases of electricity from private producers.

**Impact on the Company's profitability in the transmission and distribution segments:**

According to the present transmission and distribution rates, which are based on the July 2002 rate, the income in these segments is advanced by the volume of sales, energy transmission, in the grid's segments. Accordingly, every decrease in these segments, which derives mainly from an increase in the quantity of private producers who do not use the transmission and distribution infrastructure of the Company, will cause damage to the income and profit in the grid's segments.

Nonetheless, according to the recommendations in the report by the Navigant consulting company (as detailed in section 8.9.2 below), if and insofar as will be implemented in practice, the transmission and distribution rates will be based on the volume of investments and operating costs of the Company, subject to cost control. Namely, income for the Company will be set in accordance with the amount of its investments and operating costs in a manner which will reduce the exposure to non-coverage as a result of a decrease in the volume of sales in the grid's segments.

**Impact on the Company's profitability in the supply segment:**

The Company's income in the supply segment presently constitutes merely 2% of its total income and is advanced in accordance with the number of customers of the Company. Assuming that the income from this segment will also be determined in future in accordance with the level of investments and operating costs of the Company, subject to cost control, similarly to the transmission and distribution segments, then the profitability from this segment is also not expected to be materially damaged by the entry of private producers who also operate as suppliers,.

**Impact of the various types of private producers on the Company's operation:**

- The private electricity producers who sell electricity to the Company have an impact on volume of the Company's operation in the generation segment alone.
- The private electricity producers who also operate as suppliers and sell electricity to end users have an impact on volume of the Company's operation in the generation and supply segments only.
- The independent electricity producers who do not use the Company's infrastructure have an impact on the entire operation of the Company, in all the four operating segments.

The rate mechanism which exists at present should ensure that the costs recognized for the Company will not be materially damaged as a result of entry of private producers. Nevertheless, the entry of private producers in ever growing numbers is expected to reduce the scope of operations of the Company and increase the reserve levels in the sector.

The exposure of the Company, if any, to a situation in which the generation units it owns will no longer be required by the sector in the long term, as a result of a massive entry of private producers and increase of the volume of reserves in the sector beyond that which is required, has not yet been handled. The Company

estimates that it will be compensated with respect to stranded costs, insofar as will be created in future, even if legislation amendment will be required for this.

*The estimates of the Company regarding the expected decrease in the volume of actual electricity generation by the Company, as well as the implications which may be caused by the entry of private electricity producers into the generation, transmission and distribution, and supply segments, and the estimate of the Company that it will be compensated with respect to stranded costs, insofar as will be created, constitute forward looking information, as its definition in the Securities Law, which is based on information available to the Company as of the date of the report, as well as on forecasts of the Company whose fulfillment depends on factors over some of which the Company has no control, such as: the volume of entry of private electricity producers into the electricity sector, the manner in which the rate will be determined, and the costs that will be recognized for the Company in practice.*

- (C) Insofar as the Company is required to serve as a backup electricity source in the case of the failure of private electricity producers to supply electricity to consumers, it is required to maintain high levels of generation capacity as a reserve; in accordance with the explanatory remarks of the decision of the Electricity Authority of May 6, 2013<sup>35</sup>, the Electricity Authority is expected in future to set backup rates that will apply retroactively from June 1, 2013, as well as to examine the issue of the decline of the energy produced by the Company as a result of the entry of private electricity producers. The Company applied to the Electricity Authority regarding the subject of the backup rates as stated above and demanded that the capital and operational costs with respect to the production units that serve as backup will apply to all the consumers in the economy, such that a cross subsidization will not be created between the Company's consumers and the consumers of the private producers, and in order that the revenues of the Company with respect to fixed capital and operational expenses will not be harmed due to the decrease in the production volumes in light of the entry of the private electricity producers into the electricity generation field. Additionally, the Company demanded that a rate will be set with respect to the provision of backup services for the grid's segments.

For details regarding determination of a temporary rate for the system management service, as determined in the decision of the Electricity Authority regarding rate determination for management services of the electricity system, which was implemented as of September 13, 2015, and for details of petitions submitted (separately) to the High Court of Justice by Paz Refinery Ashdod Company Ltd. and Hadera Paper Company Ltd. against the Electricity Authority and the Company regarding the implementation of the aforesaid rate, see Note 3e. to the Financial Statements.

- (D) Within the framework of implementation of the provisions of the law and of Government Resolutions, the Electricity Authority encourages the entry of private electricity producers into the Electricity Sector. Within this context, a safety net and preferential conditions have been extended to the private electricity producers, covering, *inter alia*, the use of the transmission and distribution system of the Company and a commitment of the Company to serve as a backup source in the case of failure of private electricity producers to supply electricity to consumers. In view of these preferential conditions and the policy of the Government, there is real uncertainty regarding the scope of competition the Company can expect in future from the private electricity producers and regarding its ability to compete with the private electricity producers in the generation segment.

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

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<sup>35</sup> 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".

(E) Further to the aforesaid, in order to comply with the policy of the Government, the Electricity Authority has established arrangements that allow renewable energy generation facility owners to be compensated by higher electricity charge rates than those that are paid to the Company. However, any increase in the costs for the Company as a result of payments to the owners of renewable electricity facilities will be recognized by the Electricity Authority within the framework of the charge rate. Accordingly, the expenses that will ensue from the transition of the Electricity Sector to “greener” electricity generation will be included within the framework of the charge rate so that the consumers bear the surplus costs. Until publication of the decision with respect to system costs of August 6, 2015, these costs were included in the transmission rate and at present are included within the system rates. Notwithstanding that which has been set forth above, a time gap may form until the Company expenses are covered by the charge rate. As aforesaid, the impact of this cash flow gap is not expected to be material.

*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, 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,. 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 generation capacity, in megawatts, that is included in the load monitoring and control system of the Company,) and the peak demand, in megawatts, in 2015 and in 2014:

	<b>For the year ended on December 31</b>	
	<b>2015</b>	<b>2014</b>
	<b>megawatts</b>	<b>megawatts</b>
Company’s installed generation capacity	13,617	13,617
Peak demand throughout the sector	(*) 12,905	(**) 11,335
Of which: generation by the Company	10,065	9,440
Generation capacity available in the sector at peak demand times	13,797	13,255

(\*) This peak demand was measured on September 9, 2015.

(\*\*) This peak demand was measured on June 29, 2014.

## 7.6 **Fixed assets, land and facilities**

### 7.6.1 **General**

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

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

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

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

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

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

The number of sites mentioned above that are used for all of the activity of the Company is extensive, including approximately 17 power stations; approximately 140 substations and switching stations; approximately 13,000 transformer rooms; approximately 900 pylons for which the Company is required by law to pay municipal tax as well as thousands of additional pylons on real estate regarding which the Company has no rights in the land and approximately 150 administrative logistic sites, and in total approximately 13,500 properties with rights in the land, which include dozens to hundreds of facilities and properties of various kinds.

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

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

	<b>Name of site</b>	<b>Location</b>	<b>Type</b>	<b>Area of the site in m<sup>2</sup></b>	<b>Land rights</b>
1	Rothenberg Power Station	Ashkelon	Power station	1,442,600	Most of the area is leased from the Israel Land Administration (ILA) until 2032, some till 2054 (regarding the three lease contracts, the Company has an option for extension of the lease by 49 extra years; The small part of the area is by authorization from EAPC until 2017
2	Reading Power Station	Tel Aviv	Power station	227,861	Most of the area is being leased from the State of Israel and its other part was expropriated by the Company. With respect to this property, there is an outline plan under advanced proceedings, whereby large areas of the land are scheduled for expropriation, which if approved will require the Company to relocate facilities from the areas scheduled for expropriation, which will require the Company to make significant

	Name of site	Location	Type	Area of the site in m <sup>2</sup>	Land rights
					investments. The Company has filed its objections to this plan.
3	Haifa Power Station	Shemen Beach, Haifa	Power station	355,964	Owned by the Company, except a certain plot being leased from ILA until 2016
** 4	Hagit Power Station	Next to Elyakim Interchange	Power station	735,844	About half of the area is being leased from ILA until 2051; the rest is owned by the Company (some of the ownership rights have not yet been registered to the title of the Company)
5	Gezer Power Station	Next to Neshet plant in Ramla	Power station	451,200	The rights of the Company to this property have yet to be regulated. The Company is conducting negotiations to sign a lease agreement with the ILA.
6	Eshkol Power Station	Ashdod	Power station	470,055	Owned by the Company
7	Orot Rabin Power Station	Hadera	Power station	2,024,940	About half of the area is owned by the Company (ownership rights have not yet been registered to the title of the Company; about a fifth is being leased from ILA until 2040; the rest is being leased from the Caesarea Development Fund under two contracts, one until 2042 and the other until 2048. There is a cautionary remark to the benefit of the Company in the Land Registration Bureau for all of these lease agreements. An area of approximately 71,000 m <sup>2</sup> of land is used by H2DI Ltd. for seawater desalination purposes.
* 8	Substation <sup>36</sup> and gas turbine Raanana	Raanana Industrial Zone	Power station	27,631	Owned by the Company
** 9	Ramat Hovav Gas Turbine	Ramat Hovav Industrial Zone	Power / switching station	251,960	For a lease of approximately 200,000 m <sup>2</sup> from ILA by two contracts until 2028 and 2029 (there is an option for the Company to extend the lease by 49 years more); for an additional approximately 50,000 m <sup>2</sup> of the area 3 lease contracts until 2058 plus an option for 49 years more.
* 10	Atarot substation and gas turbine	Atarot Industrial Zone	Power station	38,194	Leased from ILA until 2022 (there is an option for the Company to extend the lease by 49 years more). The lease rights are registered at the ILA only.
* 11	Kinarot substation and gas turbine	North of Tiberias	Power station	29,870	About half of the area is being leased from Mekorot <sup>37</sup> . The rest is under authorization from Mekorot.
* 12	Hartov substation and gas turbine	Beit Shemesh Industrial Zone	Power station	28,470	Leased from ILA in three agreements until 2018, 2020 and 2021 (there is an option for the Company to extend the lease by 49 years more).
13	Alon Tavor	Alon Tavor	Power	142,660	Leased from ILA until 2039 (there is an option

<sup>36</sup> Substation.

<sup>37</sup> 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.

	Name of site	Location	Type	Area of the site in m <sup>2</sup>	Land rights
	Gas Turbine		station		for the Company to extend the lease by 49 years more). There is a cautionary remark to the benefit of the Company at the land registration bureau.
* 14	Eitan substation and gas turbine	Moshav Eitan	Power station	41,704	The lease rights to this property are from the ILA and were valid until 1996. The lease is registered in the Land Registration Bureau until 2295.
* 15	Eilat substation and gas turbine	Eilat	Power station	67,600	Leased from ILA until 2028 (there is an option for the Company to extend the lease by 49 years more). Lease rights registered
* 16	Tzafit substation and gas turbine	Tzafit	Power station	232,970	Most of the area is leased from ILA until 2034 (there is an option for the Company to extend the lease by 49 years more); the rest is by authorization from Moshav Mevo Beitar
* 17	Caesarea substation and gas turbine	Caesarea	Power station	228,500	Subleased from the Caesarea Development Fund until 2048. The rights of the Company are registered with the Caesarea Development Fund. For part of the lease contracts a cautionary remark to the benefit of the Company has been registered at the Land Registration Bureau.
<b>Total area:</b>				<u>6,798,023</u>	

\* 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 20h to the Financial Statements.

For details of Alon Tavor land betterment tax of November 28, 2013, and the Tzafit land betterment tax of July 13, 2014, see Note 35 b.9)c) to the Financial Statements.

## **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 and with the approval of the Minister of Finance, 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 and with the approval of the Minister of Finance, 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 and with the approval of the Minister of Finance, to prescribe to such a license holder a Development Plan that it must act by. The Company is committed to full observance of the Development Plan as part of its duties as an essential service supplier, *inter alia* in accordance with Section 17(A)(4) of the Electricity Sector Law, Section 19 of the Electricity Sector Law and the terms of its license. The Company must execute the Development Plan as the Minister prescribes, from time to time, and meet the schedules prescribed therein.

In accordance with the Electricity Sector Regulations (Terms and Procedures for Granting Licenses and Obligations of the License Holder) - 1997, an essential service supplier license holder will submit an annual work

plan and a multi-annual work plan to the Electricity Authority. Additionally, in accordance with the stated regulations, a transmission or distribution license holder will submit to the Minister once every five years a Development Plan with respect to its operation in accordance with the License. The Company is complying with the stated provision with respect to the submission of a development plan.

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

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

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

The main goal of the planning of the generation system in the long term is to constitute a basis for making practical decisions with respect to the addition of the generation units that are required in the system, their type, output, date of operation and location, while determining an optimal mix of fuels that is required for powering them. Most of the planning includes coping with the uncertainty relating to the following technological and economic parameters: the future demand for electricity, the anticipated prices of fuel, technical and economic parameters of the technologies which can be integrated in future in the generation system, competitive factors and more. Therefore, planning is commonly carried out for various future scenarios and includes a comprehensive risk analysis as part of the system development optimization process. In view of what was stated above, there is a constant need for periodical updates of the Development Plan and for a sensitivity analysis of the changes that occur in assessments in relation to the input data, and may be subject to changes, possibly material in nature. Usually the Company shows the minister a Development Plan for the generation system for twenty (20) years and more. The Minister, after consulting the Electricity Authority and with the approval of the Minister of Finance, is permitted to approve updates and additions to the Development Plan from time to time.

In accordance with a Government resolution of June 2008<sup>38</sup>, as adopted in Section 60(D5) of the Electricity Sector Law, the Electricity Authority may, with the Minister's approval, grant production licenses regarding power stations that are included in the development plan that was approved by January 1, 2009, and according to the development plans for the generation segment which were approved by the Minister after September 1, 2009, only the power stations which were included in the Development Plan until September 1, 2009, are included.

#### **7.7.3 Electricity demand forecast:**

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

Because the planning range of the generation system is particularly long and involves a high level of uncertainty with respect to the future economic situation of the State of Israel and with respect to climatic conditions, the

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<sup>38</sup> Government Resolution No. 3705: draft of the Electricity Sector Law (Amendment No. 8) - 2008 – approval of the resolution of the Ministerial committee for Legislation and Law Enforcement Affairs, dated June 30, 2008.



risk analysis of the generation system development needs to take into consideration a variety of electricity demand forecasts<sup>39</sup>.

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

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

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

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

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

In accordance with the Development Plan for the generation system, 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 the natural gas deposits off Israel's shores, and based on a decision of the Minister<sup>40</sup>, the previous planning proceeding of Project D as a coal power station has been stopped (that took place at the Committee for National Infrastructures), and Project D is planned to be built as a dual fuel power station, combining a steam part and a gas turbine, that will be powered by natural gas and that may also be coal powered (a planning proceeding at the National Planning and Construction Council). The review of the dual fuel power station of "Project D" was presented for examination by the Ministry of Environmental Protection on December 25, 2013, and presented to the staff of the Ministry and representatives of the Ministries of Energy and Interior on January 15, 2014. Following the request of the Chairman of the Board of Directors of the Company, a discussion was held on March 2, 2015, at the Minister's, regarding the future of the project, in which the Company presented the importance of the project on the one hand and its financial difficulties on the other hand. A decision as to how to advance the project has not yet been made.

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<sup>39</sup> 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.

<sup>40</sup> Approval of the Development Plans for the electricity sector dated December 15, 2010.

For details of the decision of the Board of Directors to freeze Project D see section 7.7.7. For details of the implications that may apply to the Company and its managers in case of breach of the development plan, see section 21.1.5. For additional details of Project D see Note 35b.9b) to the Financial Statements.

#### 7.7.5 Emission reduction plan

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

#### 7.7.6 The major projects in the generation segment

The following are the major projects of the Company within the Development Plan in the generation segment (data in NIS millions):

Project name	Scope of expected comprehensive investment*	Scope of Investment until the Balance Sheet Date **	Budget completion rate	Remainder of Investment
Installation of sulfur scrubbers FGD Orot Rabin units 5-6***	1,370	1,099	80%	271
Emission reduction (PM) Orot Rabin units 5-6	637	519	80%	118
Emission reduction (SCR) Orot Rabin units 5-6	945	726	80%	219
Installation of sulfur scrubbers FGD Rutenberg units 1-2***	1,453	728	50%	725
Emission reduction (PM) Rutenberg units 1-2	660	309	50%	351
Emission reduction (SCR) Rutenberg units 1-2	931	388	40%	543
Emission reduction (SCR) Rutenberg units 3-4	1,108	216	20%	892
<b>Total emission reduction</b>	<b>7,104</b>	<b>3,985</b>	<b>60%</b>	<b>3,119</b>

\* The total investment in the "Scope of expected comprehensive investment" column is an updated estimate for 2016 whose preparation has not yet been completed and which as of this date has not yet been approved by the Board of Directors of the Company. Additionally, it is clarified that it is only an estimate, which even if approved, may change from time to time, inter alia according to the progress of the project, the duration of the project, and costs the Company will bear with respect to it. Additionally, the total investment is less costs with respect to remeasurements and capitalization of interest during construction.

\*\* The "Scope of Investment until the Balance Sheet Date" column is composed of cumulative performance until the end of 2013 in December 2013 prices, and performance for 2014 - 2015 in current prices, pursuant to the IFRS principles.

\*\*\* Including water supply for emission reduction at Orot Rabin and Rutenberg.

The synchronization dates and operation of the emission reduction installations in general of the units detailed above are: Orot Rabin unit 5 – July 2016, Orot Rabin unit 6 – February 2017, Rutenberg unit 1 – October 2017, Rutenberg unit 2 – May 2018, Rutenberg unit 3 – March 2019, Rutenberg unit 4 – October 2018.

For additional details regarding the emission reduction projects of the above detailed units see Note 3.f. to the Financial Statements.

The Company finances the execution of the Development Plan from its current cash flow and through issue of debentures and financing agreements it engages in from time to time. In 2012, a financing agreement was signed between the Company and the LBBW and KFW banking consortium which is intended to finance the procurement contract in the SCR emission reduction project for units 5-6 at the “Orot Rabin” power station and for units 1-4 at the “Rutenberg” power station. The stated agreement provides the Company with a financing facility of approximately EUR 150 million. The estimated financing period is approximately 16 years and is divided into an approximately 4 year period of utilizing the financing and an additional approximately 12 year repayment period.

The Company is committed pursuant to the Electricity Sector Law to execute the projects in the Company’s Development Plan, which was approved by the Minister.

The position of the professional staff of the Electricity Authority is that the comprehensive investment budget for the stated emission reduction project, as approved in 2013, constitutes a base for the cost control. Should the Company expect material deviations from the budget which was approved for this matter in 2013 as stated, it should apply with an advance notice to the Electricity Authority for approval of the deviation. The Electricity Authority will examine the reasonableness and justification of the deviation. The recognition of the project will commence on the actual activation date of each unit.

For details of the decision of the Electricity Authority of December 8, 2015, regarding recognition of costs of installations for reducing emissions at Orot Rabin 5-6 and Rutenberg 1-4, and the petition submitted by the Company against the Electricity Authority on this matter, as well as for details regarding the Electricity Authority’s letter of January 4, 2016, addressed to the Company, and the letter of the Electricity Authority to the Director General of the Ministry of Energy of November 29, 2015, see Note 3 f. to the Financial Statements.

#### **7.7.7 The development budget of the generation segment for 2016**

In its meeting of October 2, 2014, the Company applied to the Minister, requesting to change the Development Plan, in light of the lack of progress in the reform process in the electricity sector and the large scope of investments required for “Project D” and the Company’s paramount need to take drastic actions to reduce costs. Within this, the Company requested to freeze the entire operations to establish “Project D” (that was planned to end in 2020-2021), not to include the project in the work plan and budget of 2015 and not to include investments in the project in the five-year financial plan of the Company.

According to the instruction of the Board of Directors of the Company, the Company approached the Minister and requested to change the development plan in accordance with the above mentioned. As of the date of the report, his answer has not yet been received. For details of the implications that may apply to the Company and its managers in case of breach of the development plan, see section 21.1.5.

In 2015, a sum of NIS 1,255 million was invested in the generation segment in current prices, including investment works in the active power stations and periodic renovations of the power stations (after remeasurements deduction)<sup>41</sup>.

Pursuant to the decision of the Board of Directors, the development budget for the generation segment for 2016 is NIS 1,451 million (after remeasurements deduction), a cut of approximately NIS 174 million compared to the original development budget for the generation segment for 2015.

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<sup>41</sup> Remeasurements is a term attributed to a net accounting datum related to actuarial measurements and estimates. For additional details see Note 2.u.1) to the Financial Statements.

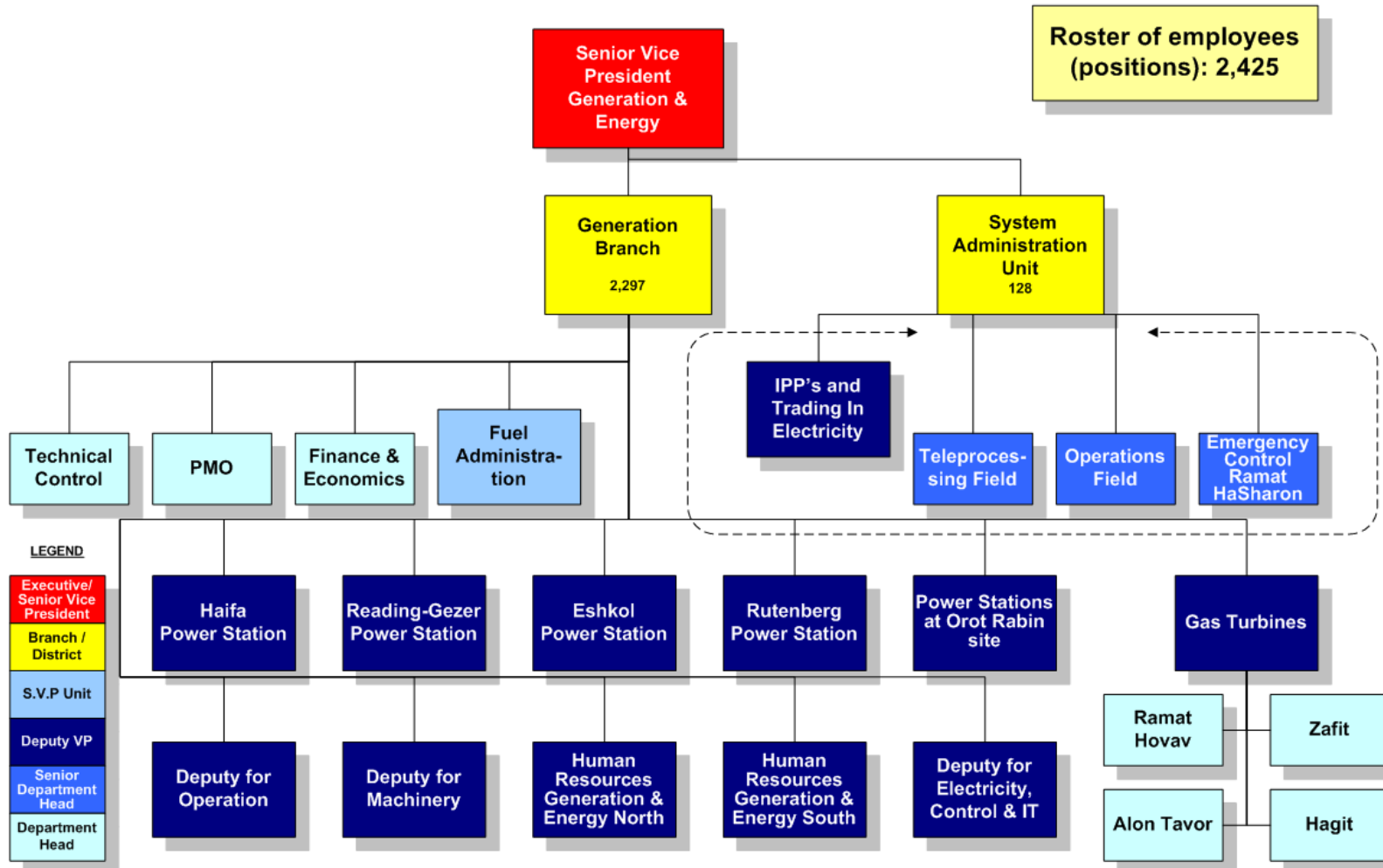
*The estimates that have been described above with respect to the Development Plan for the Electricity Sector – generation segment and the expected development budget for 2016, constitute forward looking information, as per its definition in the Securities Law, which is based on the forecasts and assumptions described above, which the Company has as of the date of the report. This information includes forecasts, subjective assessments, estimates and other plans of the Company is based on future figures whose materialization is not certain and that are not under the exclusive control of the Company.*

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

7.8 **Human capital**

The organizational structure of the generation segment:

**Field of Activity – Generating Segment (including System Administration)**



As of December 31, 2015, the generating segment employs 2,239 permanent workers and 186 temporary workers, compared with 2,342 permanent workers and 205 temporary workers as of December 31, 2014. The number of employees relates to the organizational assignment in the generation branch and the division of production and energy, and does not include employees who are assigned to other branches who work for the segment. See Sections 13.4 and 13.6 for details on benefits and the nature of the employment and transaction agreements with workers of various kinds, the investment of the Company in training and instructing and further information.

## 7.9 Raw materials and suppliers

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

7.9.2 The table below shows the distribution rate of generation (in percent) by the types of fuels that have been used in the generating segment for electricity generation in 2015 and 2014:

	<b>For the period</b>	
	<b>January – December</b>	
	<b>2015</b>	<b>2014</b>
Coal	57.6%	58.2%
Natural gas*	40.3%	41.1%
Liquid gas*	1.3%	0.6%
Diesel	0.7%	0.1%
Fuel oil	0.1%	0.0%
<b>Total</b>	<b>100%</b>	<b>100%</b>

\* The calculation of the estimate of distribution of the electricity generation according to its sources (Tamar reserve and LNG) was executed according to the ratio of fuel quantities received from these two sources, under the assumptions that all the gas from LNG is consumed by the Company for the generation of electricity, and that all the units operating with natural gas are operating with a similar efficiency.

Fuel expenses constitute the biggest operating expense of the Company and constituted approximately 46.2% of the operating expenses of the Company in 2015 compared with approximately 47.4% in 2014.

7.9.3 The table below shows the total costs of fuels (including attributed salary costs) that were used for the generation of electricity in the generating segment in 2015 and 2014:

	<b>Year ended on December 31,</b>	
	<b>2015</b>	<b>2014</b>
	<b>in NIS million</b>	
Coal	3,607	4,002
Fuel oil	86	46
Fuel oil impairment	50	95
Natural gas	3,820	3,380
Liquid gas	471	419
Diesel	400	90
Methanol	6	7
<b>Total</b>	<b>8,440</b>	<b>8,039</b>

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

7.9.4 The following table shows the average costs of fuels used by the Company for 2015 and 2014:

<b><u>Power stations powered by:</u></b>	<b>Year ended on December 31</b>	
	<b>in agorot per kWh</b>	
	<b>2015</b>	<b>2014</b>
Coal	12.36	13.30
Fuel oil	147.18	359.28
Natural gas*	18.74	15.89
Liquid gas*	71.81	136.36
Diesel	110.23	216.62
Methanol	158.35	150.86

\* Relative distribution on an energetic basis according to an identical calorific value for both types of gas.

A table showing the reductions in prices in 2015 and 2014, follows, for primary raw materials that the Company uses:

<b><u>Power stations powered by:</u></b>	<b>Year ended on December 31</b>	
	<b>Average annual cost per ton</b>	
	<b>in nominal NIS</b>	
	<b>2015</b>	<b>2014</b>
Coal*	338	366
Fuel oil	4,836	10,234
Natural gas**	1,280	1,148
Liquid gas**	3,824	5,528
Diesel	4,403	5,431
Methanol	2,256	2,366

\* A ton of coal is calculated according to a calorific value of 6,244 calories per ton.

\*\* A ton of gas is calculated according to a conversion factor of 52.4 units of MMBTU per ton.

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

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

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

See Section 16 for details of the material outputs of the Company.

## 7.9.6 Coal

In each of the twelve (12) month periods ended on December 31, 2015 and 2014, the Company consumed approximately 10.7 and approximately 10.9 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 the renewed 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 Company has a right to cancel the agreement at any time by giving one year’s advance notice. The consideration that is paid by the Company is calculated based on cost plus agreed profit, and is subject to the price of coal approved for the Company by the Electricity Authority.

The average cost per ton of coal in 2015 stood at approximately NIS 338 per ton, compared with approximately NIS 366 per ton in 2014. The decrease in the aforesaid cost derives from a decrease in the coal prices in the world.

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

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

None of the Company’s coal suppliers supplies more than 30% of its total annual coal purchases. The Company estimates that the Coal Corporation 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<sup>42</sup> 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<sup>43</sup>, while the purchase price includes the costs involved in the sea transport of the coal.

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

On January 1, 2016, the Company received the directive of the Minister of National Infrastructures, Energy and Water, under which the coal generation units will be operated such that the volume of electricity generation at these units will be decreased by 15% in an annual calculation relative to the electricity generation in these units in 2015.

It was written in this directive that the Electricity Authority will be instructed to assimilate the surplus cost with respect to this directive in the electricity rates.

According to the Minister’s directive, the decrease will be executed in accordance with the terms of operation detailed in it, including that the operation of all the coal units will be executed with the minimum required, and

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<sup>42</sup> 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.

<sup>43</sup> 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.



if the Minister announces a special state in the electricity sector, the restriction will be lifted until the end of the special state.

For additional details see section 7.12.2.4 below.

For information regarding the rate recognition for the emission reduction project, see Note 3 to the Financial Statements.

#### 7.9.7 **Fuel oil**

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

In each of the twelve-month periods that ended on December 31, 2015 and December 31, 2014, the Company consumed approximately 17.8 and approximately 4 thousand tons of fuel oil, respectively. The average cost per ton of fuel oil as of December 31, 2015 stood at approximately NIS 4,836, compared with approximately NIS 10,234 as of December 31, 2014.

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

#### 7.9.8 **Diesel oil**

In each of the periods of twelve months that ended on December 31, 2015 and 2014, the Company consumed approximately 90.8 and approximately 17 thousand tons of diesel oil, respectively.

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

The Company has no dependence on any diesel supplier.

The average cost per ton of diesel oil was approximately NIS 4,403 in 2015, compared with approximately NIS 5,431 in 2014.

#### 7.9.9 **Natural gas**

##### 7.9.9.1 **General**

In 2015, the Company consumed approximately 2.9 million tons of natural gas at an average adjusted cost of approximately NIS 1,280 per ton, compared with approximately 3 million tons of natural gas in 2014 at an average adjusted cost of approximately NIS 1,148 per ton. The decrease in the gas consumption resulted from the increase of the installed capacity of private electricity producers and generation units' load order by the system management unit.

As of the date of the report, the Company has two sources for the supply of natural gas – the "Tamar" field which started to supply gas at the beginning of April, 2013 and an LNG ship with a capability of changing the LNG inside it to natural gas. The "Leviathan" reserve which is situated close to the "Tamar" reserve constitutes a potential gas source for future use. According to public information that the Company has, the estimated quantity of gas in the Leviathan reservoir is double that of the Tamar field<sup>44</sup>. 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 2015, approximately 97% of the natural gas that served the Company for the generation of electricity was supplied to the Company from the "Tamar" field and approximately 3% was supplied to the Company as liquid gas by the gasification ship that is attached to the marine buoy situated west of the Hadera coast.

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<sup>44</sup> The data on the estimated gas quantities in the Leviathan reserve is external public data published by Delek Drilling Limited Partnership, which is one of the reserve rights owners. The correctness of this data has not been examined or assessed by the Company.

#### 7.9.9.2 Contracts for the purchase of natural gas

##### (A) "Tamar" Field

For details of the agreement contracted by Company with the owners of the rights of the "Tamar" license (in this section - "**Agreement**"), including with regard to the amount of gas purchase by the Company within the Agreement, the options for its extension, and the manner of determining the price of gas in the Agreement, see Note 35.a.1) to the Financial Statements.

##### The Take or Pay Mechanism

The agreement includes a "Take or Pay" mechanism under which the Company is obliged to pay for a minimal amount of natural gas, even if this amount was not consumed in each of the years of the agreement (the "**TOP Mechanism**"). For additional details see Note 35.a.1) to the Financial Statements. The Company examines, currently and prior to publication of the Company's periodic reports for every quarter, if the minimum annual gas quantity with respect to which the Company has to pay the Tamar partnerships according to the TOP mechanism existing in the gas purchase agreement is expected to be larger than the quantity the Company expects it will consume in practice each year, in the years of the agreement.

The estimates of the Company regarding payments for gas it will be required to bring forward, are based on models for the years 2016-2028 which were prepared by the Company. These models assume a series of dynamic fundamental assumptions which may change from time to time, and which include, inter alia, estimates regarding the average price of coal at the relevant period, the price of gas in the Company's and the private electricity producers' gas purchase agreements, and changes which may occur to them, the rate of the Company's gas consumption, the rate of throughput from the Tamar reserve, changes in demand for electricity in the sector, usability of and mix of the various generation units in the Company's generation array, inter alia as a result of the plan to renovate Company generation units, impact of the emission reduction plan, terms of business licenses and personal orders applicable to the generation sites, generation reduction in some of the Company's coal fired power stations following the directive of the Minister of National Infrastructures, Energy and Water of January 2016 under which the coal fired generation units will be operated such that the electricity generation rate in these units will be decreased by 15% in an annual calculation compared to the electricity generation volume in these units in 2015 (see Note 1.g.2) to the Financial Statements) (the "**Minister's Directive**"), the rate of gas consumption in the electricity sector in general, as well as the regulation which determines the order and volume of loading the generating units of the sector (the "**Base Scenario**").

In addition, the Company executed sensitivity analysis of various fundamental assumptions which lie at the base of the base scenario which was adopted by the Company, inter alia regarding the execution dates of the emission reduction project and replacement of certain power stations, changes in gas throughput from the Tamar reserve, a decreasing sectorial throughput from the Tamar field and limitations of generation from the Tamar field, the extent of changes in electricity demand in the sector, the price of gas in agreements with the Tamar partnerships, the price of gas of the private electricity producers compared to the Company's gas price, coal price, forecast of entry of private electricity producers into the electricity sector, a more than expected increase in the generation volume of private electricity producers, and delay in development of an additional gas reserve.

The Company is conducting ongoing talks with the Tamar partnerships regarding the gas purchase agreement and its implementation, and on November 19, 2015, a letter was received from the Tamar Partnership (the "**Letter**"), pursuant to which, inter alia, they confirm that if, at the date of termination of the agreement, the Company will have a right to use unused gas with respect to which the Company paid the Tamar Partnership according to the TOP mechanism ("Make-Up Aggregate"), the Company will be permitted to extend the period of the agreement until utilization of the Make-Up Aggregate, and this according to the mechanism determined in the Letter.

The Letter is subject to the approval of the Director General of the Antitrust Authority (if required by the provisions of the law), and the consents of the financing banks of the Tamar Partnerships, and it further determines that if the stated approvals will not be received within reasonable time, the parties will discuss an alternative mechanism which will enable the Company to utilize the Make-Up Aggregate after termination of the agreement. On December 13, 2015, the Company delivered a notice to the Antitrust Authority regarding the aforesaid Letter, within which the Company notified the Antitrust Authority that according to its understanding, the update of the mechanism for extending the agreement's period does not constitute a material change requiring permission from the Antitrust Authority. Within the Company's notice to the Antitrust Authority, the Company requested that if the position of the Antitrust Authority is different from the Company's position as aforesaid, the Antitrust Authority will inform the Company of this. To the best of the Company's knowledge, the Tamar partnerships also sent a similar letter to the Antitrust Authority. As of the date of publication of the report, the Company has not received any notice from the Antitrust Authority concerning this issue.

Based on the aforesaid, and in light of results of analysis of the Company's gas consumption forecasts, according to the base scenario adopted by the Company and subject to the existence of the fundamental assumptions at its base, the Company estimates that it is not expected to bring forward payment with respect to gas within the TOP mechanism. The change in the Company's estimates compared to the Company's estimates in the financial statements for the third quarter of 2015, under which the Company expected that it will be required to bring forward payments under the TOP mechanism in the amount of approximately NIS 800 million, derives mainly from the expected reduction in the generation volume of some of the Company's coal fired generation units pursuant to the Minister's Directive.

In addition, according to most of the sensitivity analyses performed by the Company, the Company will not be required to bring forward payments with respect to gas within the TOP Mechanism. However, in some sensitivity analyses there may be payments brought forward by the Company under the TOP Mechanism, and mainly in a situation of small growth in electricity demand compared to the Company's estimate, there may be payments brought forward of up to approximately USD 450 million accumulated throughout the period of the agreement, and in a situation in which a change in the Company's gas prices compared to the gas prices of the private electricity producers, as taken in the base scenario, will not materialize, payments of up to approximately USD 250 million accumulated throughout the period of the agreement might be brought forward. It should be noted that the scenarios at the base of the sensitivity analyses may occur simultaneously and accordingly, in such a case, the extent of the Company's exposure to bringing forward payments under the Take or Pay Mechanism may be greater. The Company estimates that there is low likelihood of this possibility occurring.

Bringing forward the payments under the sensitivity analyses detailed above will be used against gas consumption until the end of the period of the agreement according to the mechanism detailed in the Letter.

The Company is examining the additional actions and contractual means at its disposal in order to significantly reduce the potential exposure deriving from the TOP Mechanism.

*That stated in this report and in the Financial Statements regarding the Company's estimates and forecasts pertaining to the Base Scenario, and the sensitivity analyses detailed above, and the possibility of them occurring simultaneously, and purchase of gas which will be used at a later date, and including with regard to the fact that bringing the payments forward under the above detailed sensitivity analyses will be used against gas consumption until the end of the period of the agreement pursuant to the mechanism detailed in the Letter, the Company will consume, until the end of the period of the Agreement, all the gas quantities with respect to which it will pay, is forward looking information as per its meaning in the Securities Law. These estimates may not materialize or may materialize in another manner and scope than the Company's expectations, inter alia as a result of circumstances which are not fully controlled by the Company including the sector's electricity demands, the average price of coal at the relevant period, the price of gas in the Company's and the private electricity producers' gas acquisition*

*agreements, and changes which may occur in them, the rate of actual throughput from the Tamar reserve and generation limitations from the Tamar field, the rate of gas consumption by the Company in particular and rate of gas consumption in the electricity sector in general, changes in the demand for electricity in the sector, cancellation or non-extension of the Minister's Directive, the date of development of an additional gas reserve, serviceability and mix of the various generation units in the Company's generation array, inter alia as a result of the plan to renovate the Company's generation units, the impact of the emission reduction plan including with respect to the date of executing replacement of some of the Company's power stations, business license terms and personal orders applying to the generation sites, and the rate of gas consumption in the electricity sector in general, the mix of the generating units of the Company as will be from time to time, changes in gas prices pursuant to agreements with the Tamar partnerships, the regulation which determines the order and extent of loading the generating units of the sector, and the possibility of the Company selling surplus gas which will require approvals from regulatory factors and as of the date of the prospectus, there is no certainty that they will be granted, and subject to the law.*

(B) Importation of liquefied natural gas (LNG)

In response to the peak demand and reliability of the gas supply even after the commencement of its production from the "Tamar" field, in February 2011, the Minister gave the Company approval to promote an infrastructure project to purchase liquefied natural gas ("LNG"). In accordance with the aforesaid Minister's decision, the Israel Gas Lines Ltd. ("IGL") 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 leased by the Company, which has the ability to gasify the liquefied natural gas onboard ship and to pump it directly into the national transmission system through a buoy, is connected. For this purpose, in September 2012, the Company entered into an agreement to lease a gasification ship from the Hadera Gateway LLC, and in October 2013 the Company extended it until October 2017, in return for a decrease of the leasing fees at a rate of 23%. On January 28, 2016, the Board of Directors of the Company decided to extend the lease of the gasification ship by five additional years (namely until 2022), and the Company has the option to terminate the engagement by advance notice of 24 months. As of the date of publication of the report, the approval of the Electricity Authority for extending the engagement period as aforesaid has not yet been received, including with regard to recognition of the costs resulting from this.

The LNG supply began on January 26, 2013. The maximum gas quantity which can be transferred from the buoy to the transmission system through the pipeline is 590,000 cubic meters per hour.

As of the date of beginning of supply of natural gas from the "Tamar" field in April 2013, LNG is used during a break or malfunction in the gas supply from the "Tamar" field, when the gas quantities supplied from "Tamar" are not enough to meet the electricity demand of the Company, or during high demands in the gas sector which may harm the survivability of the electricity system.

The cost of leasing the ship, including gas loss and additional expenses involved in operating the ship (except for the cost of purchasing the liquid gas) amounted in 2015 to approximately USD 70 million .

The Electricity Authority recognizes, 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 indirect, as were expressed in agreements with suppliers, subject to cost control.

During 2015, the Company purchased 3 LNG cargos at a total volume of approximately 280 thousand cubic meters and in a total sum of approximately USD 70 million.

(C) EMG

In August 2005, the Company executed an agreement with EMG. The agreement included a tripartite agreement between the Company and the Egyptian gas companies EGAS and EGPC (together: the “**Egyptian Gas Companies**”) and the EMG Company, in which the Egyptian companies undertook to provide the EMG Company with the gas it had committed to supply to the Electric Company.

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

For details regarding disruptions in the gas supply, the decision of the Company’s Board of Directors decision to enter into an international arbitration process and its commencement, the arbitrators’ award received on December 4, 2015, the application to appeal submitted by the Egyptian Gas Companies and the Company’s response to the Superior Court in Switzerland, see Note 35.b.5)b) to the Financial Statements.

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

In November 2004 an agreement was signed for the construction of part of the natural gas transmission system, between the State of Israel, the Company and IGL and four 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 34.b.1)a) to the Financial Statements of the Company.

(E) 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 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).

(F) Sale and marketing of surplus gas

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

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

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

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

On November 29, 2015, the Company received an update to the approval of the Gas Authority, under which the Company may also sell natural gas to a holder of a license to construct and operate a transmission system for operating needs. For additional details regarding the approval of the aforesaid Gas Authority, its conditions and the principles set in it, see Note 35.a.1).

It should be noted that on July 27, 2015, the Antitrust Authority notified the Company that it may view gas nomination beyond the quantities required for the Company for actual electricity generation in its facilities as abusing a monopolistic status, and that it is of the opinion that given the capacity restriction of the infrastructure transmitting the gas to the transmission system, gas nomination in surplus quantities which are not for a specific use known in advance by the Company may raise competitive apprehensions in the electricity generation sector, as a result of unnecessary reduction of the quantity of natural gas that will be available for private electricity producers.

#### **7.10 Working capital; inventory**

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

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

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

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

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

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

### **7.11.1 General**

#### **7.11.1.1 The manner of determining the charge rate**

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

- (a) The charge rates shall be determined based on the principle of cost, considering, inter alia, the type and standard of services. Each price shall reflect the cost of the particular service, without any price decreasing at the expense of increasing another.
- (b) With respect to the cost, an adequate return on capital rate shall be taken into account, considering the rights and duties of an essential service supplier license holder. The law does not define what an adequate return on capital rate is.
- (c) For the purpose of setting the charge rates, the Electricity Authority shall perform cost control actions for the essential service supplier license holder. The Electricity Authority is entitled not to take into account, for setting charge rates, expenses, in part or in full, which in its opinion are not required for fulfillment of the duties of the essential service supplier license holder. In implementing the cost principle for the purpose of setting the charge rates, the Electricity Authority will be recognizing the costs deriving from the policy principles set by the Minister in the field of the electricity sector pursuant to section 57a. of the Electricity Sector Law.

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

A "rate base" should be determined every few years. When determining a "rate base", the Authority determines the manner of its update. A separate "rate base" is determined for every activity segment. The bases of the transmission and distribution rates came into effect in July 2002 and have not been updated since then. Until the updating of the transmission and distribution rates, which according to the decision of the Electricity Authority will retrospectively apply from April 1, 2012, the Company receives advance payments for these segments. The new generation rate base came into effect, as stated, in February 2010 (see section 7.11.2.1 below).

## 1. Manner of calculating the costs

### a. **Fuels costs:**

The fuels basket is composed of the following components:

- Approved normative fuels quantities are based on running a sectorial model which simulates the generation system operation and includes all the expected unit characteristics and demand. The fuels basket recognized in the rate for a certain year is calculated twice - the fuels basket is calculated on the date of the annual update for the current year on the basis of demand forecasts and on the following annual update date it is recalculated retroactively in accordance with demand that materialized in practice.
- Recognized fuels prices based on costs at current price.

### b. **Operating and maintenance costs**

The recognized sum is determined on the basis of the reporting in the Company books, with execution of adjustments.

- In the generation segment - according to the average of the years 2002 - 2006
- In the transmission and distribution segments - according to the data of a representative test year - the year 2000

### c. **Capital costs:**

The recognized capital costs are determined on the basis of the recognized active assets. The following are the major capital cost components:

- Depreciation
- Return on equity
- Return on foreign capital

## 2. Manner of determining the recognized assets:

- In the transmission and distribution segment - the recognized assets were determined on the basis of the book costs in 2000 with execution of adjustments
- In the generation segment, the recognized assets were determined on the basis of the Company's active generation units pursuant to a future outline.

For the rate recognition, the generation units were divided into two groups:

"Old units" - units which were activated before December 31, 2002 and the recognition of costs with respect to them is based on the costs in the Company books.

"New units" - units which were activated after this date and the recognition of costs with respect to them is normative.

## 3. Depreciation

The recognition of the depreciation costs in the various segments is according to the recognition of assets:

- In the transmission and distribution segments - on the basis of the book costs in 2000.
- In the generation segment - the recognized assets and capital services with respect to each of the generation units of the Company, with generation units which were activated before December 31, 2002 and defined as "Old units", for whom the assets costs are recognized in the books. Generation units activated after December 31, 2002 are defined as "New units", in which the construction costs are normatively recognized



#### 4. Return on equity and return on foreign capital:

Return on equity and return on foreign capital were determined normatively. Within this framework, a normative financial leverage was determined, according to which 1/3 of the assets are financed by equity and 2/3 by foreign capital.

- Return on equity:  
The recognized rates of return, net, on equity:  
Generation segment - 7.62%  
Transmission segment - 5.5%  
Distribution segment - 6.2%
- Return on foreign capital:  
There is a normative division of the financing basket of the foreign capital according to the following components:  
NIS (linked) financing basket  
Increased interest NIS financing basket  
Hedged financing basket

The following is a table describing the normative financing composition and the cost of capital as of 2015:

	<b>Financing basket composition</b>	<b>Cost of capital</b>
NIS financing basket	70%	4.13%
Increased interest NIS financing basket	21%	5.29%
Hedged financing basket	9%	4.13%

The cost of capital is updated every year by weighting the return rate recognized in the previous year with the marginal cost of capital of the passing year.

The resolutions of the Electricity Authority with respect to the setting of the charge rate bases state that every few years, the Electricity Authority is supposed to establish a charge rate basis for a certain test period (a period in which the charge rate basis will be valid). The charge rate basis has a number of components, some applying to all activity segments and some relevant to only a certain segment. The electricity charge rates for the various consumers are set in accordance with the type of consumption and the supply voltage. The main charge rate types are: uniform charge rate (domestic, general, street lighting and low voltage and high voltage bulk) and load and time charge rates (low voltage, high voltage and extra high voltage). The electricity charge rate that is derived from the charge rate basis is updated during the test period through regular updates and annual updates in the manner explained in section 7.11.1.2 below.

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

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

Prior to the adoption of final material resolutions by the Electricity Authority with respect to the charge rates and the Criteria<sup>45</sup>, the Electricity Authority has to publish a resolution proposal for public response (hearing), and to publish its financial resolution on the matter of the charge rates only after the time that is prescribed for responses.

<sup>45</sup> For details of the Criteria see section 7.4.1.1.

For details regarding the adjustment of the rate to the implications for the financial reporting in accordance with the international accounting principles see Note 3.d. to the Financial Statements.

For details regarding the emission reduction project at the coal powered power stations see Note 3f. to the Financial Statements.

#### 7.11.1.2 **Update of the charge rate**

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

a) Annual update - Every year, the Electricity Authority is supposed to carry out an annual update of various components of the costs recognized for the Company in the rate, according to variability of various components in the Company's input basket. The components which the Electricity Authority is required to update are: capital costs of assets recognized in generation, return rates, composition of the financing basket, fuels mix, fuels costs update, purchase of electricity, incentives, consumption distribution update, and more.

In May 2015, the Electricity Authority's decision was published, pursuant to which the date of the annual rate update will be postponed, so that the annual update date will be in the month of July of each year.

b) Current rate update - the following parameters have the following updating formulas:

- The recognized fuels costs are linked to the changes in the fuels price.
- The foreign capital costs are linked to the CPI.
- The operating costs are partially linked to the CPI and partially linked to the average index of a position of an "employee" in the economy.
- The other components are linked to the CPI.

The current update is executed twice a month.

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. For additional details see note 3 of the financial statements.

Because the charge rate for consumers is not updated in practice following each update as detailed above, a gap forms between the revenues for the actual charge rate and the stated 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 15.j to the Financial Statements.

#### 7.11.1.3 **The progress of the recognized costs from year to year**

##### a) In the transmission and distribution segments

The recognized costs vary from year to year according to the sales of the segment. Conversely, "reduction coefficients" are deducted from the recognized cost.

The reduction coefficients in these segments were frozen as of April 2012.

##### b) In the generation segment

The capital costs are determined pursuant to a future outline, so that a recognized cost is determined every year for that year according to normative dates of the beginning of activation of the generation units.

The recognized operating costs are advanced, as of June 2013, according to the change in the installed capacity of the generation units. A "reduction coefficient" of 2% a year is deducted from the operating costs. As of January 1, 2015, the reduction coefficient was suspended until determination of a new rate base for the generation segment.

#### **7.11.1.4 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.

#### **7.11.1.5 Discounted social charge rates**

For details on discounted social rates, see Note 15.g. to the Financial Statements.

#### **7.11.1.6 The current electricity charge rate**

(a) The current electricity charge rate entered into force on September 13, 2015. The uniform domestic charge rate (namely, houses serving for residence only, houses of worship and structures that serve for agricultural needs) is 45.58 agorot per kWh (not including Value Added Tax). The general uniform charge rate (namely, structures serving for workshops, industry or commerce, including educational and cultural institutions, absorption centers, structures serving associations and non-profit organizations, clinics, hospitals, hotels, government offices and structures connected with a temporary connection) is 46.96 agorot per kWh (not including Value Added Tax).

(b) Annual update –

On September 7, 2015, the Electricity Authority published a decision regarding an annual update for 2015. The decision determined, inter alia, that the electricity rate will be decreased by 5.89% on average as of September 13, 2015, relating to the rate that entered into force on February 1, 2015, and a rate of 1.5% of this decrease derives from determination of a system rate. For additional details see Note 3 a to the Financial Statements.

(c) Regular update –

In the decision of the Electricity Authority of January 21, 2015, pertaining to the 2014 regular update, it was determined that a regular update will be executed when one of the following conditions are fulfilled, according to the earliest:

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

#### **7.11.1.7 Reporting to the Electricity Authority**

On January 15, 2015, the Electricity Authority published a decision on “The implementation of the obligation to report on the Israel Electric Corporation Ltd. - generation, delivery, distribution, supply segments and general reports” in which, inter alia, the Authority imposed on the Company regular annual, quarterly and monthly reporting obligations.

In accordance with the aforesaid decision, the Company is required to deliver to the Electricity Authority, in fixed format and dates, quantitative, financial, technical and professional data pertaining to all the activity of the Company, and its purpose is to regulate and facilitate the interface between the Company and the Electricity Authority, to create a comprehensive reporting format for the Company, to save in detailed data requirements from the Company from time to time and thus to streamline the work processes with the Company and assist the Authority in determining and updating the rate and regular follow-up of deviations from the rate framework. Most of the data is required to be reported on June 1 of each year, regarding the passing year.

On February 9, 2015, after conducting a public hearing proceeding, the Electricity Authority published a decision under which the Company will be required to annually report to the public regarding the gaps between the actual expenses in that year and the Company's income from the electricity rate, according to activity segments, in accordance with the format presented in the decision.

The decision entered into force as of the date of publication of the Financial Statements for 2014, and as agreed with the Electricity Authority, the report for 2014 was reported within the annual financial statements of 2014 as were published anew by the Company in connection with the prospectus of the Company of May 27, 2015<sup>46</sup>. Additionally, the Company delivered a report for 2013 to be commented on by the Electricity Authority.

On March 1, 2015, the Company applied to the Electricity Authority, requesting a solution for the Company's inability, at this stage, to meet some of the data requirements in the required reporting format. From the Company's point of view, extensive preparations are required, which will include development of supporting information systems and allocation of management resources, in order to meet the reporting requirements. At the same time, as of March, 2015, several reports which included data required for 2013 and 2014 were delivered to the Electricity Authority.

On October 26, 2015, the Electricity Authority reached a decision regarding "The implementation of reporting obligations on the Israel Electric Corporation Ltd. - system management segment". The decision includes details of the required reports by the system manager, including guidelines regarding their submission, with the attachment of a declaration signed by the system manager, details of the required dates according to the frequency of the reports, details of the reports which will be published for the public, and instructions regarding the authority and sanctions the Electricity Authority has in case of delay in submitting the data. The reporting requirements include extensive chapters with data regarding generation and consumption, financial reports and demand management.

#### **7.11.2 The generation segment charge rate**

##### **7.11.2.1 General**

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

According to the remarks of the then Chairman of the Electricity Authority in Appendix A to the resolution of the Electricity Authority on the update of the charge rate basis (Charge Rate Basis Book) it is stated that the resolutions of the plenum of the Electricity Authority were determined while balancing between the need of the Company to establish and operate its generation array in the upcoming years while maintaining its financial strength on the one hand, a policy that has been expressed by increasing the recognition of the capital and operating costs, and the right of the electricity consumers to a decrease in charge rates due to a reduction in the costs of the fuels as a result of the increased use of natural gas on the other hand. The Electricity Authority noted that within the framework of some of its resolutions, 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. As of the date of the report, an updated charge rate basis for the generation segment has not been published.

The current 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 current generation charge rate basis does

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<sup>46</sup> For additional details see the Company's Immediate Report of May 26, 2015 (reference no.: 2015-01-027924).

<sup>47</sup> 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.

not cover all the costs of the Company with respect to its operations in the generation field for the years 2010-2014. For additional details with respect to the position of the Company regarding the charge rate basis for the generation segment see note 3.b.3) in the Financial Statements.

The Company approached the Electricity Authority and requested to retroactively apply the new generation charge rate basis from January 2015, but received a response that the charge rate determined in the charge rate basis book in 2010 is valid.

#### **7.11.2.2 Components of the generation charge rate base**

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

##### **7.11.2.2.1 Calculation of the fuels mix**

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

Within the decision of the Electricity Authority pertaining to the 2015 annual update, the final fuels mix for 2014 and the forecasted (not final) fuels mix for 2015, respectively, were calculated on the basis of a sectorial model based on a load curve for the entire sector.

##### **7.11.2.2.2 Recognized assets and depreciation**

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. As part of annual updates, some of the additional costs beyond the normative base for the Haifa combined cycles and the potable water array for the Alon Tavor steam addition were recognized for the Company. Within the 2015 annual update, the Electricity Authority conclusively rejected the Company’s request to recognize additional costs of the Gezer combined cycles and the Alon Tavor steam addition.

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

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

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

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

#### 7.11.2.2.4 Financing costs (recognized return rate)

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

##### (a) The hedging mechanism

The purpose of the hedging mechanism in the charge rate is to prevent acute fluctuations in the profitability of the Company in periods of major differences between the rate of change in the Consumer Price Index and the rate of change in the exchange rate, because the assets of the Company are adjusted to the Index while a major portion of them is financed by foreign currency loans. In the view of the Electricity Authority, in recent years, there has been a development in the local financial markets for capital raising and for financial markets for derived financial instruments for hedging of exchange rate risks, and therefore it has been decided to cancel the hedging mechanism. Accordingly, according to the new charge rate base book for the generation segment, the previous hedging mechanism has been cancelled, but a new hedging mechanism has been established, which was supposed to be gradually cancelled within three years, until 2013.

In accordance with the decision of the Electricity Authority of September 16, 2013<sup>48</sup> and sequel decisions of the Electricity Authority as were received within the 2014 and 2015 annual updates, it was determined that the outline of cancellation of the hedging mechanism that was determined in the decision of the Authority detailed above, of February 1, 2010, regarding the generation rate base, is frozen, and therefore the rate hedging rate is frozen at a rate of 9% of the foreign capital that was determined at the rate base, until a new rate base is applied to the generation segment.

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

#### 7.11.2.2.5 The operational costs

In the past, the operational costs that were recognized for the test period were derived from the average operation costs according to the financial statements of the Company for 2002-2006 while separating labor costs and other costs and after performing certain adjustments, in accordance with the increase in sales, and a depreciation coefficient of 2% per year was applied to these recognized costs. According to the decision of the Electricity Authority of January 21, 2015, a change has occurred in the manner of recognition of the operating costs, such that they were divided into fixed costs (at a rate of 88% of the total operating costs) and variable costs (at a rate of 12% of the total operating costs). It was also determined in the stated Authority's decision that the fixed cost will be advanced according to installed megawatts and the variable cost will be advanced according to net generation. The manner of recognition as detailed above will apply from June 1, 2013, until a new rate base is determined for the generation segment. According to the Electricity Authority's decision of September 7, 2015, the reduction coefficient has been suspended as of January 1, 2015 until a new rate base will be determined for the generation segment.

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<sup>48</sup> Decision no. 4 from meeting no. 413, of September 16, 2013, with regard to "continuation of freezing of the rate hedging mechanism of the Electric Company".

#### 7.11.2.2.6 Pension costs

Through to the date of publication of the final resolutions of the Electricity Authority, the recognized costs of operation for the generation segment shall include the pension costs in accordance with the amendment published in 2009 and the recognized asset cost in the generation segment of the combined cycle generation units whose operation commenced after 2002 ("the New Units") shall only include costs of accumulating pensions of third generation employees. The costs shall not include actuarial pension costs of first generation employees, second generation employees or third generation employees (relating to electricity at Company employees' rate, 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 Electricity Authority has not yet completed its examination pertaining to rate recognition in the Company's pension costs. There is partial recognition only of the pension costs in the current rate. Upon the adoption of a final resolution on the matter of recognized pension costs of first and second generation employees and pension costs for electricity at Company employees' rate, gift for holidays and bonuses of third generation employees, this component shall be updated accordingly.

From time to time, the Company delivers data to the Electricity Authority on the matter in accordance with the requirements of the professional team of the Authority.

The Company estimates that at the end of the process, the Authority will approve the full pension costs as these costs are an integral part of the wage components which are backed-up by various agreements and approved by the relevant regulators (subject to the decisions of the Director of Wages with respect to the wage irregularities).

In a class action hearing against the Company pertaining to the pension issue, the Court determined that the Electricity Authority should discuss the issue and reach its decision in this matter by April 2016. For additional details see Note 35b.2)a)(1) to the Financial Statements.

#### 7.11.2.2.7 Development and assembly costs

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

#### 7.11.3 **Emission reduction project at the coal fired power stations**

On December 8, 2015, the Authority published a decision regarding recognition of costs of installations for reducing emissions at the Orot Rabin generation units 5-6 and the Rutenberg generation units 1-4, pursuant to which, inter alia, extension of the life of the coal units to 25 years from the date that each coal unit returns to operation.

The Company estimates that this determination regarding the extension of the life of the coal stations is expected to have a negative impact on the Company's cash flow until 2025 (in a material annual financial volume), in relation to the situation before the aforesaid decision, in which the Company's revenues from capital services with respect to these generation units were calculated according to their original life (namely, before the extension of the economic life by 25 years which begin on the date that each coal unit returns to operation). This trend is expected to change commencing from 2026 and until the end of 25 years from the date of operating the installations, so that an improvement will occur in the Company's cash flow in this aspect.

*The information included in this report of the Company regarding the Company's estimate concerning the impact of the extension of the coal stations' life on the Company's cash flow constitutes forward looking information as this term is defined in the Securities Law. This information is based on forecasts and estimates which exist in the Company as of the date of the report and which may not materialize or materialize partially or in a different*

*manner than expected, inter alia due in light of the fact that their materialization depends on various factors, some of which are not controlled by the Company.*

For additional information regarding the emission reduction project at the coal fired power stations, and regarding the Electricity Authority's decision of December 8, 2015, see Note 3f. to the Financial Statements.



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

### **7.12.1 Environmental hazards and environmental regulation – general**

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

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

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

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

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

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

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

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

## 7.12.2 **Air**

### 7.12.2.1 **The Clean Air Law**

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

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 has submitted an application for an emissions permit with respect to it by March 1, 2015. For new facilities or significant changes in existing facilities that will be activated until that time, the Company will have to receive an emissions permit as a condition for their operation. As of the date of this report, the Company completed the submission of applications for emission permits for all the generation sites.

To date, airborne emission permits have been received for the Alon Tavor and Tzafit sites.

In addition, an airborne emission permit has been received for units 1-4 at the Orot Rabin site, whose provisions will enter into effect if these units will be converted to natural gas. As of the date of this report, units 1-4 are handled in discussions held between the Ministry of National Infrastructures, Energy and Water and the Ministry of Environmental Protection. The decision concerning the future of the units is expected to be expressed within the emission permit which will be provided to all the generation units at the Orot Rabin site (for additional details see section 7.12.2.4).

The Company is in contact with the Ministry of Environmental Protection regarding this issue.

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 March 2016. The regulations may affect the planning of future projects of the Company and the operation of existing facilities, but the Company does not have the ability to presently estimate the extent of the stated impacts and whether they will have a material impact on it.

In September 2014, the Ministry of Health announced the classification of exposure to air pollution, including particulate matter (PM) air pollution, as carcinogenic to man. This followed a similar classification by the World Health Organization. At this stage, the Company is not required to take additional actions or means beyond those already taken by it to reduce airborne emissions. The Company is monitoring developments in this matter.

In September 2015, the Government adopted resolution 542 pertaining to greenhouse gasses emission reduction and optimizing the energy consumption of the economy. For additional details see Note 1c.5) to the Financial Statements.

In December 2015, the Climate Change Conference was held in Paris, within which the State of Israel submitted to the U.N. a national goal to reduce emissions by the year 2030. The Government is expected to prepare a national action plan to meet the reduction undertaking which was submitted. The Electric Company is a significant factor in the balance of the greenhouse gas emissions of the State of Israel. Notwithstanding, at this stage and prior to publication of the national action plan, the Electric Company is unable to evaluate the

implications which may result from the goal declared by the State. The Company is following the developments in this matter.

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

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

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

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

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

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

According to the provisions of the Clean Air Law, the provisions of the emission permits, when given to the Company, will replace the provisions of the Lateral Order with respect to that site.

In January 2016, a clarification meeting was held in the Southern District of the Ministry of Environmental Protection, in light of the Ministry of Environmental Protection’s claim of the Company’s alleged non-compliance with the provisions of the personal order concerning monitoring and reporting obligations at the Rutenberg power station and due to failures which caused interruptions in the generation units. The Company has various defense arguments and it raised them during the meeting.

In March 2016, the Company received an invitation for clarification due to failures which resulted in interruptions in the generation unit at the Ort Rabin site. The Company has various defense arguments and it is preparing for the clarification meeting.

For details of the emission reduction projects see section 7.12.2.4.

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

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

During March 2013, the supply of natural gas from the Tamar reserve to the national electricity system began. As of 2012, the Company also began purchasing liquid natural gas (LNG). In November, 2014, the Ministry for Environmental Protection issued provisional instructions that, subject to certain conditions, enable the use of liquid fuel, in a situation in which it is required in view of the limitations in the gas supply and transmission, and in order to maintain the survivability of the system.

#### 7.12.2.4 **Emission abatement plan**

Within the framework of the lateral order, the Company is required as stated, *inter alia*, to work towards the reduction of emissions into the air in the Company’s coal powered power stations. These are very complex

and complicated projects in the aspects of planning and engineering, which are executed and which will be executed in future in active, crowded generation sites abundant with active infrastructures.

The advancement of the emission abatement project encountered difficulties and obstacles due to events totally beyond the control of the Company, inter alia unexpected difficulties with the various work contractors of the project, the Zuk Eitan operation, and restrictions from the field of labor law. In view of that stated, the Company applied to the Ministry of Environmental Protection, requesting to postpone the project dates.

In February 2015, the Ministry of Environmental Protection sent a draft of the emission permit for the Rutenberg site, and it included, inter alia, milestones for implementing the emission abatement plan at this site and a new requirement to comply with a strict value for particle emission. The Company applied to the Ministry of Environmental Protection and the Ministry of National Infrastructures, Energy and Water, and held meetings with the relevant ministries, within which the Company presented its position and requested that the target dates of the project will be postponed, and interim dates will not be set, and delivered its response, including, inter alia, a proposal for planned shutdown dates and completion dates for the Rutenberg 1-4 projects.

In June 2015, the terms of the business license of the Orot Rabin site were updated, and they included, inter alia, updated dates for implementation of the project in units 5 and 6. In addition, the duty to submit a plan to abate emissions in the interim period until the project's completion, and to shorten the projects' schedules, as well as to prepare a comprehensive plan to abate emissions in units 1-4 at the Orot Rabin site, was imposed on the Company.

In the context of units 1-4 of the Orot Rabin site, it is noted that presently the conversion of the units to gas is anchored in the instructions of the Minister of National Infrastructures from 2011, and this conversion is part of the emission reduction project at the site, but according to the letter of the Director General of the Ministry of Infrastructures of May 2015, the recommended alternative of the Ministry of National Infrastructures, Energy and Water for these units is coal powering with scrubbers, and in light of this she intends to recommend to the Minister of Infrastructures to change his stated instruction and to determine instead an instruction of operating in this manner.

In view of the aforesaid, the Company applied to the Director General of the Ministry of National Infrastructures, Energy and Water, requesting a coordinated decision by all the relevant government ministries regarding the future of these units and regarding the need for an excess emission reduction plan in view of its possible implications.

Following the update of the terms of the business license of Orot Rabin in June 2015, in July 2015, the Company presented the Ministry of Environmental Protection with alternatives to the schedules for completing the project at units 5 and 6 at the Orot Rabin site as required in the additional terms, and also requested a decision coordinated with all the relevant regulators regarding the treatment of units 1-4 at the Orot Rabin site. In October 2015, the Company received a warning letter and summons to a hearing with respect to an alleged violation of the additional terms in the business license of the Orot Rabin site, due to the alleged non-compliance of the Company with the schedules for submitting the emission abatement plan during the interim period. The Company has complaints regarding the proportionality and reasonability of the decision of the Ministry of Environmental Protection to summon it to a hearing and it has raised them with the Ministry.

The Company received the Ministry of Environmental Protection's notice in November 2015, pursuant to which the hearing is suspended until the examination of the information submitted by the Company is completed. As of the date of this report, the suspension of the hearing remains unaltered.

The Company continues its dealings with the Ministry of Environmental Protection, to present its position and to advance a decision in these issues.

Insofar as the Ministry will hold a hearing, and the Company's arguments will not be accepted during the hearing, the Company is exposed to enforcement proceedings by virtue of the Business Licensing Law and the Clean Air law, including sanctions and financial penalties.

In December 2015, the Koor Metals Ltd., which serves as a subcontractor in the emission reduction project, received a suspension of proceedings order and it was appointed with trustees. The Company notified the Ministry of Environmental Protection of concern of a delay in the schedules and is continuing to examine the impact on the projects' progress.

Following discussions and correspondence with the Ministry of Environmental Protection, in December 2015, the Company received an additional amendment to the business license terms of the Orot Rabin site. The additional terms anchor, inter alia, the framework for the continued implementation of the emission abatement project at the Orot Rabin site, subject to execution of the emission abatement plan in the interim period until the completion of the project (the "Ethereic Bubble Plan"). The Company is working diligently on an update of the Etheric Bubble Plan as determined in the additional terms.

*The estimate of the costs of the aforesaid plan is forward looking information, as this term is defined in the Securities Law. This information is based on the estimates existing in the Company as of the date of the report, and which may materialize partially or in a manner other than that anticipated, and this, inter alia, in view of the fact that their materialization depends on various factors that in part are not under the control of the Company.*

In February 2016, during execution of an operating action within the proceeding of introduction into utilization, the operation of unit 5 of the Orit Rabin site was interrupted due to failure. The failure was checked and treated and the unit was reactivated in the beginning of March. Following this, in March 2016, the Company applied to the Ministry of Environmental Protection, requesting that this unit's date of introduction into utilization will be updated accordingly. The approval of the Ministry of Environmental Protection to this request was received in March 2016.

In February 2016, the Company received letters from the Ministry of Environmental Protection, pertaining to completion of documents for the applications for emission permits at the Rutenberg power station and at Orot Rabin. Within the letters, the Company was required, inter alia, to submit a plan for the manner of complying with the emission values at units 1-4 at Orot Rabin, a plan to reduce excess emission which will be caused as a result of the updated schedules for implementing the emission abatement plan at the 1-4 generation units at Orot Rabin and Rutenberg, as well as detailed milestones for installing the emission reduction measures. The Company submitted the requested information and is in contact with the Ministry of Environmental Protection regarding this.

Operating the coal powered generation units without measures to reduce emissions after the set dates will constitute a violation of some of the environmental laws which apply to the Company. If the Company will choose to cease the operation of the generating units in order to refrain from this violation, this may materially affect the Company's fuels mix and costs and even the reliability of the electricity supply.

*The Company's estimate, pursuant to which the Company might not meet the schedules set for it regarding the emission abatement project and the implications this may have, and the Company's estimates regarding the effect of the Company's fuels mix and costs and reliability of the electricity supply, is forward looking information, as this term is defined in the Securities Law. This information is based on forecasts and estimates existing in the Company as of the date of the report, and which may not materialize or may materialize partially or in a manner other than that anticipated, and this, inter alia, in view of the fact that their materialization depends on various factors that in part are not under the control of the Company, including the fuels costs as will be in practice.*

#### **Directive of the Minister of National Infrastructures pertaining to reducing the use of coal**

In January, 2016, the Company received the directive of the Minister of National Infrastructures, Energy and Water (of December 31, 2015), according to section 10 (c) of the licenses of the coal powered generating units at the Orot Rabin and Rutenberg power stations and the Rutneberg power station in favor of reducing the pollutants emissions and maintaining the energy security in operating the coal powered units (the "Minister's Directive").

The Minister's Directive determines that the coal powered generating units will be operated such that the electricity generation rate in these units will be reduced by 15% in an annual calculation relative to the electricity generation volume in these units in 2015. The reduction will be divided among the Orot Rabin and Rutenberg power stations at the ratio range of between 50:50 to 40:60.

According to the Minister's Directive, the reduction will be executed according to the operation terms included therein, including that the operation of all the coal powered units will be executed as minimally as will be required and that in the event that the Minister will announce a special state in the electricity sector, the restriction will be lifted until the special state is over. The Company is studying the Minister's Directive and its implications. For details regarding the initial estimates of the Company concerning the possible impact of the Minister's Directive on the possible exposure of the Company to the "Take or Pay" sum, see Note 35.a.1) to the Financial Statements.

The Company applied to the Ministers of Environmental Protection and National Infrastructures, requesting that they work in accord when determining the provisions regarding the manner and extent of reducing the electricity generation at the coal powered units. The Company added that the existing situation, according to which two sets of provisions on the same subject which are incompatible with each other are imposed on the Company, is an unreasonable situation which may not be operationally feasible and may result in unnecessary financial expenses. Following this, talks are conducted between the relevant ministries and the Electric Company concerning the implementation of the Minister of National Infrastructure's Directive and the relation between it and the directive of the Ministry of Environmental Protection to reduce excess emissions.

The Company estimates that although it invests many efforts and resources in order to advance the emission abatement project, there exists a possibility that the Company will not meet the schedules for completing the project (primarily due to external circumstances beyond its control) and it will be forced to apply to the relevant regulators and request their postponement. Insofar as following these applications the Company will not receive suitable extensions, failure to meet the schedules may be contrary to some of the environmental laws applicable to the Company, and may result in criminal or administrative legal proceedings against the Company and its managers.

For information regarding the rate recognition for the emission abatement project see Note 3 to the Financial Statements.

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

#### **7.12.2.5 Airborne emissions of coal dust and fly ash**

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

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

During October and November 2015, a number of employees were summoned for questioning regarding violation of the business license terms pertaining to installing measures to reduce dust emission from unloading coal.

The Company is taking a series of steps to advance the projects and is in touch with the Ministry of Environmental Protection.

#### 7.12.2.6 **Prevention and reduction of air pollution from vehicle fleet**

In September 2014, the Company received instructions under the Clean Air Law for Prevention and Reduction of Air Pollution from its heavy vehicle fleet (10 tons and above). The instructions determine, inter alia, an average particle emission target for the vehicle fleet, instructions for a gradual increase of the percentage of vehicles that use alternate means of propulsion, recording of greenhouse gas emissions and training drivers to drive economically. In February 2016, a summary report for 2015 was submitted in accordance with the instructions.

Within the individual instructions, there is a duty to use alternate propulsion, pursuant to which by July 1, 2016, one percent of the Company's fleet of vehicles will use alternate means of propulsion. The Company applied to the Ministry of Environmental Protection, requesting to postpone this date until the development and legislative proceedings are completed and proceedings for licensing and establishing compressed natural gas fueling stations are arranged. The response of the Ministry of Environmental Protection was received in March 2016, under which the Ministry refuses the request to postpone the set dates and it attaches great importance to the creation of initial demands as a tool for assimilating the use of pollution reduced alternate means of propulsion in the Company. The Company is studying the Ministry's response and examining its steps.

#### 7.12.3 **Land and water**

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

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

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

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

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

As part of the Company's activities to fulfill the conditions required in its business licenses, the Company has prepared a multi-annual plan for executing tests of the intactness of the fuel installations it possesses at a cost of approximately NIS 150 million spread multi-annually. The plan was approved for implementation within the current work plans of the Company.

In May 2012, during a routine filling of the tank at the Haifa power station with diesel oil, a spillover of diesel oil from the tank to the spill containment pallet was identified. The Company delivered an immediate notification of the event to the Ministry of Environmental Protection and acted to pump the diesel oil from the spill containment pallet. Most of the fuel was pumped and cleared and the Company is continuing the pumping, rehabilitation and periodic monitoring operations. All the operations are executed in accordance with the instructions of the Ministry of Environmental Protection.

Following the immediate report of March 2014 regarding the leakage of diesel oil at the Hagit site<sup>49</sup>, the Company is in constant contact with the relevant authorities and is acting in accordance with their instructions in this matter. The Ministry of Environmental protection is examining the incident, including the summons of employees for questioning by the green police.

In August 2015, the Company received the approval of the Ministry of Environmental Protection for the plan it submitted to manage the risk at the Hagit site. The plan includes, inter alia, measures to monitor the possible exposure routes which may cause pollution of the environments of the site and taking preventive action. The Company is operating in accordance with the approved plan and is in constant contact with the relevant authorities.

In July 2015, the Company received a summons to a hearing, which has not yet been conducted, pertaining to leakages discovered in the Lakhish River area from a crude oil pipeline which was built in the 70s of the previous century. The Company prepared a historical examination of the stated oil pipeline and presented its findings to the Ministry, according to which, inter alia, the Company has not used the pipeline for over 35 years, and therefore the leaking oil has no connection to its operation.

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

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

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

#### **7.12.5 Effluents**

During the course of the generation of electricity, industrial effluents are formed in the generating segment facilities. The industrial effluents at coastal power stations are exploited, after treatment, for reuse for the purposes of the station, and those which are not exploited for reuse are dumped into the sea in accordance with the offshore discharge permits that are given to each site pursuant to the Prevention of Sea Pollution from Land Sources Law.

Following that stated in section 7.12.12, as part of a combined (integrated) environmental regulation for all the sites of the Company, as well as part of the offshore discharge permits for individual stations, it is possible that the Company will be required to improve the existing means in the effluents treatment facilities in the various sites. This may involve costs that may be significant.

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

#### **7.12.6 Hazardous materials**

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

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<sup>49</sup>See immediate report of March 3, 2014 (ref. no.: 2014-01-004494).



#### 7.12.7 **Asbestos**

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

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

#### 7.12.8 **Planning and construction**

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

##### **NOP/10/a/3 - Reading Power Station**

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

The plan was discussed in January 2014 by the National Council for Planning and Building, which decided to transfer the plan that was presented, subject to conditions, to approval by the Government. In March 2016, the Ministerial Committee for Housing Affairs (the Housing Cabinet) approved the plan. The Company is studying the possibilities at its disposal concerning the aforesaid decision.

In January, 2014, an order was received from National Council for Planning and Construction, to prepare a new National Outline Plan that will enable continued operation of the site under certain conditions after 2020 as well. As of the date of this report, the survey of the impact on the environment and preparation of the Plan's documents have been completed.

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

#### 7.12.9 **Preservation of the coastal environment and prevention of marine pollution**

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

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

In June 2014, the Company received a summons to a hearing on an alleged pollution of the coast with coal leachates from the Rutenberg power station. It is a spill of water mixed with a quantity of approximately 1 Kg. of

coal powder that reached the sea through the drainage canals. According to the summary of the hearing, the Company carried out engineering actions to prevent the drainage of leachates from the coal quay out of the station. In February, 2016, the Company updated the Ministry of Environmental Protection of the implementation of the engineering solution in accordance with the approved plan.

In January, 2016, additional terms were received for the business license of the Orot Rabin site, which impose a duty to install racks in the two small cranes at the site. According to the terms, a detailed plan has to be submitted to the Ministry of Environmental Protection by May, 2016, and the installation has to be completed, so that their operating work will commence no later than January, 2018. The Company is studying the implications of the extra terms.

In October, 2015, following a failure in the docking system of a ship at the Ashdod port and weather conditions, the ship disengaged from its docking place and thus damage was caused to the flexible pipe. Marine pollution was not identified at the site. The Company reported immediately and at its own initiative and acted in accordance with the instructions of the Ministry of Environmental Protection. Several employees were summoned for questioning in this matter.

#### 7.12.10 **Fly ash**

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

In December 2014, the Director of the Prevention of Noise and Radiation Section at the Ministry of Environmental Protection announced that based on classification he executed in 2008, under which he beholds the fly ash as radioactive waste, and in accordance with regulation 5 of the Hazardous Materials Regulations (Radioactive Waste Disposal), 2002, he is instructing the Company to remove coal ash from its power stations while giving precedence to cement industry, so that the Company has to transfer to the cement industry all the bottom coal ash with completion of up to 800,000 tons of fly ash and the surplus quantity of coal ash can be transferred to the cement industry (in this section - the “**Instruction**”). The Company delivered its reaction to the Director of the Prevention of Noise and Radiation Section at the Ministry of Environmental Protection and also applied to the General Counsel of the Ministry of Environmental protection. In this framework, the Company detailed, inter alia, its position that the use of coal ash in the cement industry as is carried out in Israel and elsewhere in the world does not involve any risks and therefore there is no reason to give such an Instruction. This position of the Company was not accepted. The Company estimates that implementation of the instruction may cause, inter alia, a decrease in the flexibility of removing the coal ash from the stations and may lead to accumulation of surplus ash at the Company sites.

On March 23, 2015, the Company received a petition submitted to the High Court of Justice by Shafir Structures & Industries Ltd. against the Supervisor of Environmental Radiation in the Ministry of Environmental Protection and against the Company in this matter. In April 2015, the High Court of Justice ruled that entry into effect of the Instruction by the Supervisor of Radiation will be suspended, until the date of submission of the State’s response to the petition.

Furthermore, in April 2015, the Company received the petition of the Israeli Association of Manufacturers of Ready-Mixed Concrete against the Supervisor of Radiation of the Ministry of Environmental Protection, the Electric Company and the Coal Ash Administration. Within this petition, inter alia, an order was requested to instruct the cancellation of the Instruction of the Supervisor of Radiation, an interlocutory order to suspend the validity of the Instruction until a decision is reached in the petition, and consolidation of the two petitions.

In April 2015, the High Court of Justice reached a decision to consolidate the hearing of the two petitions.

In November 2015, a meeting was held at the Ministry of Environmental Protection, at which the Company presented its position with respect to the Supervisor’s instruction. According to the decision of the High Court of Justice, the State has to submit an update notice within 90 days after the meeting, and later on a new date will be set for submitting the responses on behalf of the State and the Electric Company to the application for an order nisi and for granting an interlocutory order.

It was also determined that the temporary order will continue to be in effect until another decision is reached.

*The estimate of the Company with regard to the implications that may be for the implementation of the Instruction constitute forward looking information, as is defined in the Securities Law, which may not materialize or may materialize in a different manner than the manner expected by the Company, and this, inter alia, due to the demand for coal ash in the cement industry and the results of the petitions.*

#### **7.12.11 Business Licensing**

Most of the power stations of the Company operate pursuant to business licenses that have been given permanently and ancillary conditions that are updated or renewed from time to time. These were intended to regulate, *inter alia*, the operation of the station with the goal of reducing or preventing environmental risks and hazards. The Company is acting to regulate the business licenses for the remaining generation sites and for other licensable items in accordance with the provisions of the law and the requirements of the authorities, the regulation process for some of them being at advanced approval stages. The operation of the sites of the Company without a business license constitutes a violation of the Business Licensing Law and may lead to the termination of the operations of the business. See Section 21.8 for further information on the Business Licensing Law and the state of licensing of the various licensable items at the Company.

#### **7.12.12 Integrative licensing**

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

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

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

In September 2015, the Company received the Integrated Environmental Licensing Law Memorandum, 2015, which desires to assimilate the objectives of the integrative licensing described above in legislation. The Company delivered its comments to the law memorandum to the Ministry of Environmental Protection.

#### **7.12.13 Ionizing radiation**

In October 2015, the Company learnt of the Ionizing Radiation Law Memorandum, 2015, which seeks to regulate the environmental aspects of dealing with ionizing radiation, including provisions regarding regulation of dealing with ionizing radiation, imposing obligations on the various entities dealing with it, supervision and enforcement. The Company delivered its comments to the Ministry of Environmental Protection.

#### 7.12.14 **Material events or matters with respect to environmental protection**

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

#### 7.12.15 **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 35b. to the Financial Statements.

#### 7.12.16 **Company policy in environmental risk management**

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

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

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

#### 7.12.17 **Environmental costs and investments of the Company in environmental protection**

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

<b>NIS million, current prices (after remeasurement deduction)</b>	<b>Twelve months ended on December 31</b>		
	<b>2013</b>	<b>2014</b>	<b>2015</b>
Total investment in environmental protection facilities	Approx. 765	Approx. 915	Approx. 956
Current costs (without depreciation)	Approx. 83	Approx. 91	Approx. 89

##### (A) **Investments during 2015**

In 2015, the Company invested approximately NIS 950 million, in environmental protection aspects in the generating segment (in addition to approximately NIS 6 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 2015 within the framework of costs of operation of the power stations and ancillary expenses to fuels, approximately NIS 88 million for compliance by the production system with environmental protection requirements (in addition, a total of approximately NIS 1 million which are not attributed to the production system). The Company estimates that the environmental costs that the Company bore in 2015 were invested mostly in future prevention and reduction of environmental damage and the rest was invested in environmental repair and restoration.

(B) Budget for 2016

The Company is allocating in its budgets money for compliance with environmental conditions and laws. For 2016, the Company allocated within its current operation and development budgets a total of approximately NIS 1,125 million (after remeasurement deduction) for compliance with environmental protection requirements including, among others, waste treatment, acts to protect fauna and flora, the air, land, underground water and surface water, effluents treatment, protection from radiation and noise reduction.

(C) Emission abatement budget

Within the framework of the approved development budget for 2013, without interest at the time of construction, the Company has allocated a total investment budget in an amount of approximately NIS 5.6 billion (in 2014 budget prices) for the emission reduction project (the above mentioned investment does not include the investment in the water supply launchers project for the emission reduction installations for which the estimate of costs amounts to approximately NIS 22 million less costs with respect to remeasurements, and also does not include the investment in the emission reduction projects in Orot Rabin 1-4), *inter alia* for the purpose of installation of airborne pollutant emission abatement devices from the Orot Rabin and Rothenberg sites ("primary devices", removers and construction of catalytic devices). As of the date of publication of this report, the total investment budget for 2013, as detailed above, is the last budget which was approved by the Company CEO and Board of Directors in this matter.

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

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

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

**7.13 Legal proceedings**

With respect to other pending legal proceedings against the Company, including proceedings for the generation segment, see Note 35b. to the Financial Statements. For details with respect to legal proceedings in which the Company is the plaintiff in the proceedings see section 23.

## **8. The transmission and transformation segment**

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

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

The electricity transmission and transformation activity is conducted under a license that the Company has received "for transmission, distribution, supply, sale and trade of electricity". This license, and all activities involved, was extended, as mentioned, along with other licenses that the Company possesses, until January 1, 2017.

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

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

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

The Company has three types of substations: (1) permanent; (2) temporary, and (3) mobile. The mobile substations are stationed at various sites adjacent to the load center or at existing substation sites, usually until the construction of a permanent substation in the area, for a period (at planning level) 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 or extra high voltage. The operational and maintenance responsibility of the high voltage and extra high voltage in these stations lies with the Electric Company.
- Old substations that are owned by a consumer of high voltage (enable to intake a private producer too after examination and accommodating the private substation to the new conditions).

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

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

under a license received by the Company for “transmission, distribution, supply, sale and trade of electricity”. The validity of this license, including all the activities included in it, was extended until January 1, 2017. As stated, the Company was not issued with a separate license for the transmission and transformation activity and the activity is therefore executed under the version of the united license that relates to several activities. See Section 21 for details on restrictions, legislation, regulation and special constraints applying to all of the activity of the Company. See section 8.9 for details regarding the electricity rate in the transmission and distribution segments. See Note 1 e to the Financial Statements for details of the provisions of the Electricity Sector Law regarding the structural change.

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

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

- (A) Due to the increase in the generating capacity in the national economy, whether by private energy producers or by the Company, and the increase in the reserve<sup>50</sup> of the electricity generating ability, the Company anticipates that it will be required to build additional switching stations and high and extra-high voltage lines, as well as upgrading existing power transmission lines to stronger ones.
- (B) In addition the Company expects that due to the constant increase in demand for electricity, it will be required to build additional substations and to increase transformation at existing switching stations and substations.
- (C) The Company is acting consistently in order to reduce the costs of the construction of substations, by building outdoor substations (*that is*, a station in which switching equipment in the high voltage regulator and transformers are external and located on the premises of the station) and reducing the costs of all of the station components. However, due to the strict environmental requirements, the Company is expected to build internal substations (*that is*, a station in which all electrical equipment is enclosed in a building and isolated by gas) of larger scale. In addition, there are demands on the part of outside parties to bury overhead transmission lines underground and divert existing lines within the framework of “intelligent avoidance” policy, which is application of reasonable measures for reducing magnetic field levels where possible.
- (D) The construction of a larger number of private switching stations and substations by private electricity producers and high voltage and extra high voltage customers will lead to a greater investment of working hours of Company staff in introduction of utilization that the Company is required to make in the operating premises under its responsibility for the installations of the private producer or consumer, for tests and maintenance, because the tests that are related to the connection of the substation to the transmission system can only be conducted by the Company by virtue of it being an essential service provider in the transmission field..
- (E) Changes in the Criteria for the level, standard and quality of service provided by a licensed essential service supplier in the field of transmission, which are determined by the Electricity Authority, may 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 may 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.

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<sup>50</sup> This refers to the difference between generation ability and the demand for electricity at that time from consumers.

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

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

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

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

- (A) Continued short term deployment of high output (75 MVA<sup>51</sup> instead of 50 MVA) transformers with short current limiters at the substations within metropolises, increasing the volume of capacitor batteries and adapting them to the distribution grids. Increasing and updating the arrays connected to the distribution grid for their adaptation to the transformation ability at new substation sites. Furthermore, replacements are planned of transformers at existing substations to new transformers including the ancillary equipment, as noted with regard to new stations.
- (B) Deployment of new technologies in the transmission field, such as ACSS wires with high thermal ability compared to a regular wire with the same cross-sectional area, which are used for increasing the transmission capacity of existing transmission lines to avoid the construction of new lines.
- (C) Laying of underground cables of 2,000 mm<sup>2</sup> cross section.
- (D) Information security equipment in the field of computerization and communications for substations.

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

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

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

##### (A) Entry barriers

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

##### (B) Exit barriers

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

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<sup>51</sup> MVA – megavolt ampere. Voltage measurement unit.



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

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

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

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

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

### 8.2 **Products and services**

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

In addition, according to the Book of Criteria, the Company also supplies maintenance and operating services at the substations of private electricity producers as regards connection at high voltage and extra high voltage.

### 8.3 **Segmentation of revenues of products and services**

For details of Company revenues from the sale of electricity assigned to the transmission segment in 2015, see section a.3.b) of the Report of the Board of Directors.

## 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<sup>52</sup> of the Company follows:

Date	400 kV lines km of circuit	161 kV overhead lines km of circuit	115 kV lines km of circuit	161 kV underground lines <sup>53</sup> km of circuit
December 31, 2015	759.5	4,497	106.3	123.6
December 31, 2014	741.2	4,469.5	114.5	109.4

On December 31, 2015, the installed output of 161/400<sup>54</sup> MVA connection transformers<sup>55</sup> stood at 12,175 MVA. On December 31, 2014, the installed output of 161/400 MVA connection transformers stood at 10,300 MVA.

### 8.4.2 The transformation system:

On December 31, 2015, the transformation system consisted of 201 substations (of which 48 substations were owned by high voltage consumers), compared to 196 substations that had transmission systems, it had on December 31, 2014 (of which 43 substations were owned by high voltage consumers).

On December 31, 2015, the installed transformation ability was approximately 20,396 MVA (including approximately 3,190 MVA across substations for high voltage consumers), compared with an installed transformation ability of approximately 19,901 MVA (including approximately 2,915 MVA across substations for high voltage consumers) as of December 31, 2014.

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, 2015 and 2014:

Year \ Substation type	Switching station	Substation	Private	Total
December 31, 2015	11	142	48	201
December 31, 2014	10	143	43	196

The material changes in the transmission and transformation system that occurred in 2015 are:

The establishment of substations at Yahalom and Giv'at Shaul;

Establishing the Ayalon switching station;

Transformation additions at Na'aman, Yavne, Ramat Gan and Atidim;

Entry into use of private substations at Ashdod Energy, Haruvit, Halutziyut and Ketora;

Removing Jerusalem B substation from use;

Entry into use of the "Across Gush Dan" project, mainly aimed at thickening and increasing the reliability of the transmission system by 400 kV in the center of the country;

Entry of 75 megawatts transformer into the Atidim and Ramat Gan sub-stations

<sup>52</sup> In general, there is more than one transmission line between any two pylons, known as a "circuit" and measured in km

<sup>53</sup> Underground.

<sup>54</sup> A connection transformer changes voltage levels within the transmission system (from 400kv to 161 kv).

<sup>55</sup> The transmission system has three voltage levels: (1) extra high voltage- 400 kv; (2) high voltage system of 161 kv and (3) a high voltage system of 115 kv (and old system whose use is decreasing).

## 8.5 Fixed assets, land and facilities

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

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

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

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

\* 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 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 13 c to the Financial Statements for details on the type of rights of the Company to these properties.

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

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

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

The Development Plan for the transmission and transformation system is submitted for approval by the Minister once a year<sup>56</sup>. The duration of the Development Plan as stated is for a period of five years. Due to the long time required for advancing projects in the transmission and transformation field, considering the proceeding required for environmental and statutory purposes and receiving construction permits, the Company is preparing a Development Plan for ten years, with a semi-annual update (in view of changes in the demand forecast, a need for accommodating projects of private entrepreneurs, problems in advancing infrastructure projects and more), from which the five year Development Plan that is submitted as mentioned for the approval of the Ministry is derived.

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

### **8.6.2 Main assumptions and restrictions underlying the Development Plan**

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

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

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

The Company is acting to implement a Government resolution dated January 2009<sup>57</sup> that addresses the transition to the generation of electricity from renewable energy to a volume of 10% before 2020 and in this context it operates to connect each renewable energy entrepreneur that has applied to it for connection, for making a feasibility study or a connection review, in accordance with the criterion “high voltage connection” of December 2012.

Within this framework, in accordance with the resolutions of the Electricity Authority, the Company has published a large number of feasibility studies of the various initiatives for generation of electricity using

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<sup>56</sup> As detailed above, the Minister’s approval regarding the development plan will be given in consultation with the Electricity Authority and the consent of the Minister of Finance.

<sup>57</sup> Resolution No. 4450.

renewable energy. The Company has incorporated in the outline plans of the entrepreneurs strips for connection to the transmission system and is advancing plans for the construction of a second 400 kV line with a north - south route whose purpose is to allow for the accommodation of renewable energy generation facilities to large scales in southern Israel.

On the issue of the Government tender for solar power stations at Ashalim, the Company is advancing the construction of a joint switching array and 161 kV line for the reception of the energy that will be generated. The plan provides for the connection to the regulator of a photovoltaic facility with an output of 30 megawatts as well as two thermal solar facilities. A photovoltaic facility with an output of 37.5 megawatts was recently connected to the 161 kV system at Neot Hovav, and an additional large photovoltaic facility with an output of 40 megawatts was recently connected to the system at Qetora and Halutziyut.

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. In accordance with the demand of the Ministry of Infrastructures, Energy and Water and with the consent of the Minister for Environmental Protection, and after examining alternatives, the National Committee for National Infrastructures, in its meeting of March 3, 2014, adopted the combined alternative (that includes burying the line at the Ramon Crater area). The Company has submitted an outline plan for the route that is partly above ground and partly underground in accordance with the decision of the committee as stated.

#### 8.6.3 **Development of the transmission system**

In accordance with the Company's Development Plan, in 2016-2020, the Company is planning to add to the high voltage (400 kV) transmission system approximately 23 km of circuitry, conditional to the conclusion of statutory proceedings for the approval of the lines. As of the date of the report, the Company is within the schedule that was described in the Development Plan. See Sections 8.6.1 and 21.7 for details on the statutory proceedings.

In 2016-2020, the Company is planning to add approximately 613 km of upper circuitry to the high voltage (161 kV) transmission system. In addition, approximately 945 km of circuitry will be upgraded, rebuilt or relocated, and approximately 75 km of underground cable circuits are scheduled to be added.

#### 8.6.4 **Development of 400/161 kV transformation system**

The Development Plan of the Company for 2016-2020 includes: the continued enlargement of the Ayalon Switching Station with 3 connection transformers and a total output of approximately 1,950 MW (the switching station entered into utilization in 2015) as well as the construction of the Galil Switching Station with 2 connection transformers and a total output of approximately 1,150 MW and the construction of the Atidim Switching Station with 3 connection transformers and a total output of approximately 1,950 MW in 2020. At the end of 2020, the Company is due to have twelve 400/161 kV switching stations with a total output of approximately 16,075 MVA.

#### 8.6.5 **Development of 161 kV transformation ability**

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

Within the Development Plan of the Company, approximately 17 permanent substations with a total transformation ability of approximately 1,784 MVA are planned to be added in 2016-2020. At the end of 2020, there are expected to be approximately 178 substations with a total transformation ability of approximately 19,078 MVA (permanent, temporary and portable). In addition, at the Ayalon substation a high voltage capacitor battery with an output of 220 MVar will be installed.

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

In 2015, a sum of approximately NIS 680 million (after remeasurement deduction) was invested in the development of the transmission and transformation segment. In accordance with the decision of the Board of Directors, the development budget of the transmission and transformation system for the year 2016 is approximately NIS 674 million, a cutback of approximately NIS 48 million compared with the original development budget of the transmission and transformation segment for 2015.

The following are the major current and expected projects of the Company in the transmission and transformation segment (data in NIS millions):

Project name/identification	Scope of expected comprehensive investment*	Scope of Investment until the Balance Sheet Date**	Budget completion rate	Remainder of Investment	Expected activation date
Yavne substation	260	98	0.4	162	06/2019
Ramat Gan substation	118	93	0.8	25	06/2016
Nahariya switching station	107	11	0.1	96	07/2019
Faran-Yotvata line	150	121	0.8	29	04/2018
Eitan_Be'er Sheva line	162	21	0.1	141	12/2019
Caesaria-Tnuvot line	169	19	0.1	150	12/2018

\* The total investment in the "Scope of expected comprehensive investment" column is an estimate for 2016 which as of this date has not yet been approved by the Board of Directors of the Company. Additionally, it is clarified that it is only an estimate, which even if approved, may change from time to time, inter alia according to the progress of the project, its continuation, and costs the Company will bear.

\*\* The "Scope of Investment until the Balance Sheet Date" column is composed of cumulative performance until the end of 2013 in December 2013 prices, and performance for 2014 and 2015 in current prices, pursuant to the IFRS principles.

The Company is committed pursuant to the Electricity Sector Law to execute the projects in the Company's Development Plan, which was approved by the Minister.

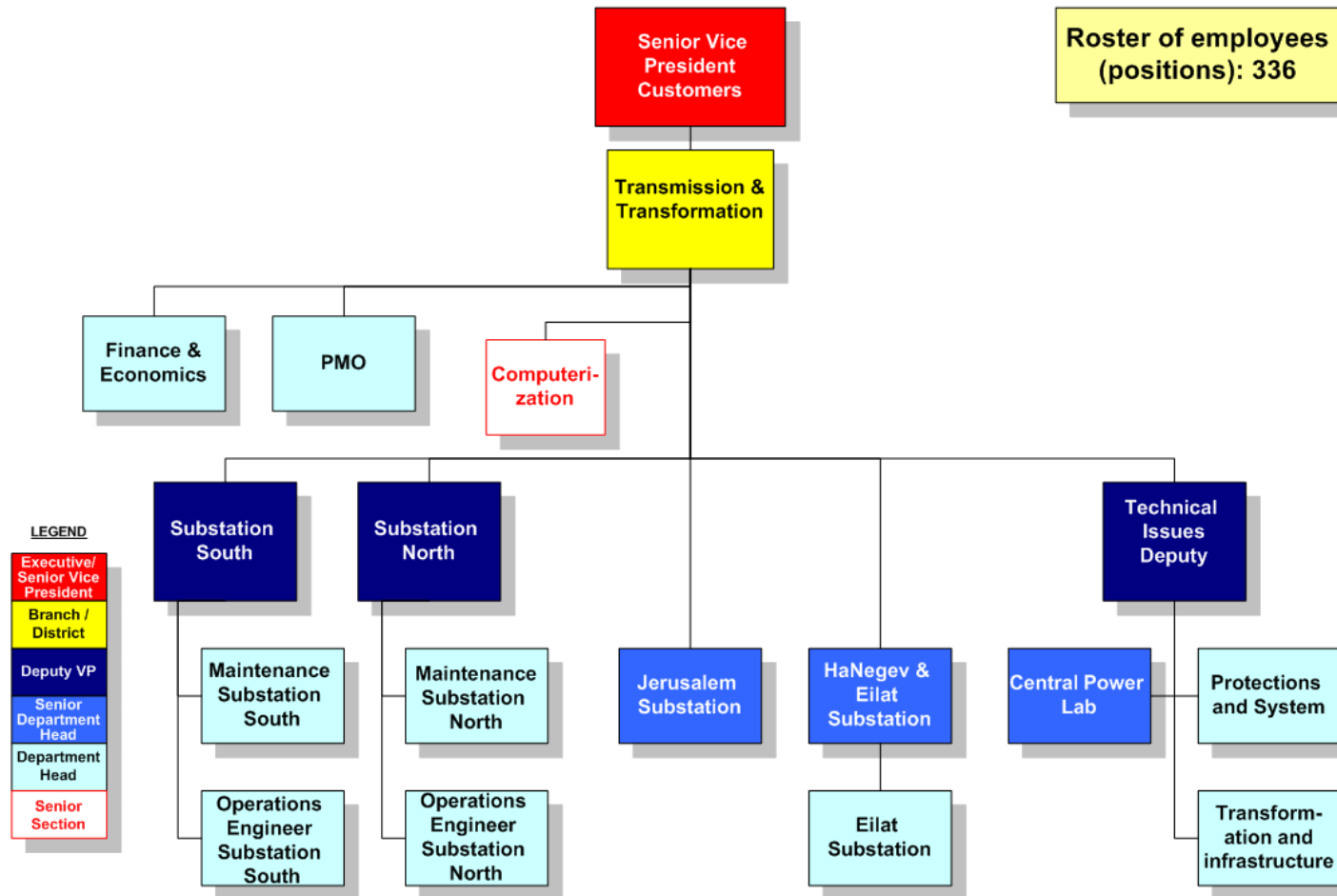
According to the existing transmission and distribution base rates, the manner of recognition of the costs is normative. The recognized costs are based on the comprehensive costs for the transmission and distribution segments which are recorded in the 2000 Financial Statements, plus an increase in electricity sales and less streamlining (which was frozen in April, 2012) and plus advances provided to the Company as of April, 2012. Therefore, the rate recognized for these segments has no specific recognition of the cost of a substation or line or any other project constructed by the Company, but only as derived from the recognition mechanism mentioned above for all the assets of the segments.

*The above mentioned with respect to the Development Plan of the Company for the transmission and transformation segment and with respect to the expected development budget for 2016 is forward looking information, as per its definition in the Securities Law. This information includes forecasts, subjective estimates and other plans of the Company and is based on future data, whose materialization is uncertain and is not under the exclusive control of the Company. The main factors that may affect non-materialization of the forward looking information or changes occurring in the estimated schedule for its execution in accordance with the description above include: a change in the expected growth rate in the demand for electricity, implementation of a change in the future organizational structure of the Electricity Sector and of the Company (see Notes 1e and 1f to the Financial Statements); future Development Plans that the Minister will approve for the transmission and transformation segment; difficulties in securing licenses and/or changes in regulation in the environmental protection and licensing field; the absence of appropriate charge rate coverage and the ability of the Company to raise the financing required for executing the Development Plan.*

8.7 Human capital

The organizational structure in the transmission and transformation segment:

**Field of Activity – Transmission Segment**



As of December 31, 2015, the transmission and transformation segment has 300 permanent employees and 36 temporary employees in the transmission and transformation section, compared with 305 permanent employees and 43 temporary employees in the transmission and transformation section as of December 31, 2014 (The number of employees relates to organizational assignment and does not include employees assigned to other sections and working for the benefit of the segment, such as transmission grid line operation staff, who are organizationally assigned to the distribution districts and vice versa – see Section 9.8).

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

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

### **8.8.1 Environmental risks and environmental regulation – general**

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

### **8.8.2 Land**

The Company is diligently laboring on actions to prevent soil pollution from its transmission and transformation installations, including actions to install oil spill enclosures for transformers, for transformers that do not have enclosures

### **8.8.3 Hazardous materials**

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

### **8.8.4 Business licensing**

See Section 21.8 for details on this subject.

### **8.8.5 Material events or matters with respect to environmental protection**

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

### **8.8.6 Material legal or administrative proceedings with respect to environmental protection**

See Note 35 B to the Financial Statements on the issue of legal proceedings with respect to the transmission and transformation segment.

See Note 35 b 8 to the Financial Statements with regard to legal proceedings pertaining to the transmission and transformation segment and letters of indemnity that will be given by the Company pursuant to section 197 of the Planning and Construction Law.

### **8.8.7 The policy of the Company in environmental risk management**

See Section 7.12 for details on this subject.

### **8.8.8 Environmental costs and investments of the Company in environmental protection**

See Section 20.8 for details on this subject.

## **8.9 Restrictions and regulation over the corporation's operation in the transmission and transformation segment**

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



## The electricity rate for the transmission and distribution segments

### **8.9.1 The current electricity charge rate**

The electricity charge rate for the transmission and distribution segments was set in accordance with the resolution of the Electricity Authority dated July 1, 2002 on the issue of “the electricity charge rates and the Criteria for 2002-2005 and their manner of update”<sup>58</sup> (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.

For details regarding a petition filed by the Company to the Supreme Court against the Electricity Authority, regarding an update of the transmission and distribution rates, see section 8.9.2.

#### **8.9.1.1 Manner of determining and updating the charge rate**

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

#### **8.9.1.2 Main components**

##### **(1) Recognized active assets and depreciation**

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

##### **(2) Financing costs (return on assets)**

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

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

##### **(3) Costs of operation**

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

##### **(4) Pension costs**

Within the operational and capital 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, based on costs in the books in 2000.

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<sup>58</sup> 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”.

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 inputs<sup>59</sup>; 2.5% for the inputs of the high voltage distribution segment<sup>60</sup>; 3.7% for inputs in the low voltage distribution segment<sup>61</sup>; and 2% for the inputs of consumer costs that are included in the transmission and distribution segments (at all voltage levels). Notwithstanding, the Electricity Authority decided to freeze the depreciation coefficients in the transmission and distribution segments commencing from April 1, 2012, and until the determination of a new rate base for these segments.

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

Within the framework of the planned raising of the charge rate<sup>62</sup> by 8.9%, which took effect on April 1, 2012, following a resolution of the Electricity Authority dated March 22, 2012, on the “spread of increase of electricity charge rates for the years 2012-2014 in a period of problems in the supply of natural gas to the energy sector in Israel”, an addition to the recognized cost was included in the transmission and distribution segment, contributing approximately 1.2% to the electricity charge rate. The addition is in the amount of approximately NIS 300 million in current terms.

The rate increase in 2013 included an additional advance in the amount of approximately NIS 100 million a year (in current terms) as an addition to the recognized cost of the transmission and distribution rates. In its decision of January 21, 2015<sup>63</sup>, the Electricity Authority increased the stated sum for 2015 by an additional approximately NIS 300 million (in current terms) so that at present the supplement to the recognized cost of the distribution and transmission segment is approximately NIS 700 million (in current terms) in total.

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

In addition, it has been determined that the depreciation coefficients will be suspended starting from April, 2012.

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

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

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

On March 2, 2015, a letter was received from the Authority, including the response off the Navigant Company to the Company’s reaction and the Company delivered its reaction on March 16, 2015. In October 2015, an updated

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<sup>59</sup> Not including high voltage consumer costs: fixed payment in the electricity bill and payment for expanded services that are collected from consumers.

<sup>60</sup> Not including high voltage consumer costs: fixed payment in the electricity bill and payment for expanded services that are collected from consumers.

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

<sup>62</sup> Resolution No. 1 of Meeting No. 367 of the Electricity Authority dated March 22, 2012.

<sup>63</sup> Resolution No. 4 of Meeting No. 452 of the Electricity Authority dated January 21, 2015, regarding “Summarizing resolution for electricity rates for Electric Company consumers in 2015”.

report was received from Navigant, before the Authority's plenum formulated its position in preparation for the hearing regarding the grid's rate basis. For additional details see Note 3c. to the Financial Statements.

On November 30, 2015, the Company filed a petition to the Supreme Court in Jerusalem, sitting as the High Court of Justice (in this section - the "**Court**"), to provide orders nisi against the Electricity Authority. Within this petition, the Court was requested to provide an order nisi directed to the Electricity Authority, instructing it: (a) to publish a lawful public hearing within 45 days for a new rate base, updated in the transmission, distribution and electricity supply segments, on the basis of the costs of the Electric Company in these segments from the year 2000 onward (including recognition of past costs with respect to these years, and including recognition of costs which the Authority postponed handling thereof, as part of the last rate base book from 2002), in accordance with the provisions of the Electricity Sector Law; (b) to reach a decision within 60 days from the date of publication of the hearing for the public, to grant a binding effect to the new rate base within the decision, as will be updated following the aforesaid hearing, and (c) to refrain from any reduction of the electricity rates until the new rate basis enters into effect. The Court was requested to grant orders nisi as aforesaid, and after a hearing to instruct on turning them into absolute orders.

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

#### 8.9.2.1 **Setting of rate for electricity system management services** (system costs)

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

For details regarding electricity distribution and supply licenses see Note 3.k to the Financial Statements.

For details of changes and updates to the consumption criteria see Note 3m. to the Financial Statements.

#### 8.10 **Legal proceedings**

See Note 35 b to the Financial Statements.

#### 8.11 **Raw materials and suppliers**

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

## **9. The distribution segment**

### **9.1 General information on the distribution segment**

#### **9.1.1 Structure of the field of activity and changes occurring therein**

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

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

The distribution segment has the Marketing Division and five districts, which cover the entire country, through which most of the work and service relations between the Company and its companies are held, whose number as of the date of this report is approximately 2.67 million.

It is noted that the Company also attributes the electricity supply and sale operation of the Company to the distribution segment.

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

The activity of the Company in the distribution segment, like its other fields of activity, is subject to legislative restrictions, such as those prescribed in the provisions of the Electricity Sector Law and the Government Companies Law, and constraints related to the issue of licensing and requirements for permits from various government authorities and offices such as the Electricity Authority, the Companies Authority, the Ministry of National Infrastructures, Energy and Water and the Ministry of Environmental Protection and emergency and Development Plans in the Electricity Sector. The activity of electricity distribution is carried out under a license that the Company has received for "transmission, distribution, supply, sale and trade of electricity". This license and all of the activities therein have been extended to January 1, 2017. In accordance with the above, the Company has not had a separate license issued for the distribution activity and therefore the activity is carried out in accordance with the text of the consolidated license that relates to a number of activities. See Sections 1.3 and 21 for details on these aspects of the activity of the Company and the various restrictions. See Note 1 e to the Financial Statements for details of the provisions of the Electricity Sector Law regarding the structural change.

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

The Company estimates that there are various factors that may affect the volume of activity and profitability of the field, such as changes in the volume of electricity consumptions and changes in electricity charge rates. Additionally, the increase of the production capacity of the sector, whether by private electricity producers or by the Company, requires an increase of the distribution and transmission system.

#### **9.1.4 Technological changes that may materially affect the field of activity**

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

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

The Company estimates that the business success of the distribution segment depends, *inter alia*, on the level of demand for electricity, the costs of maintenance and operation of the distribution facilities, recognition of the total revenues required for the distribution of electricity within the electricity charge rate and the ability of the

distribution segment to improve its structural and technological efficiency. No change has occurred in these factors in the report period.

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

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

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

##### Entry barriers:

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

##### Exit barriers:

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

### 9.2 **Products and services**

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

### 9.3 **Segmentation of revenues from products and services**

For details of Company’s revenues from sale of electricity assigned to the distribution segment in 2015 see section a.3.b) in the Report of the Board of Directors.

### 9.4 **Competition**

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

See Note 1.e to the Financial Statements with respect to the provisions of the Electricity Sector Law that state restrictions to possession of licenses in general and for the distribution section in particular. In addition, on the plane of activity of supply and sale of electricity of the Company, there are private electricity producers that hold a supply license in addition to their generation license that has been given to them and that therefore also serve as suppliers to end consumers that transact with them directly and receive electricity from them rather than the Company. As has been stated above, the electricity that is generated by these private electricity producers is transmitted via the transmission and distribution grid of the Company (a service that is given to the producer against payment, including all of the ancillary services that the Company supplies with respect to the supply of electricity, except billing services). Since most of the private electricity producers use the transmission and/or distribution grid and pay infrastructure services for this, the Company estimates that the Company revenues in the distribution segment are not expected to be significantly harmed due to the entry of the private producers into the electricity sector, and may even increase. However, an increase in the volume of self-

producers that do not use the infrastructure of the Company may, to a certain extent, adversely affect the revenues and profitability in the distribution segment.

### **Historical distributors**

Over the years, the Electricity Authority published decisions within which it determined arrangements and terms for transferring distribution areas of historical distributors<sup>64</sup> to other entities that will be given an electricity distribution and supply license. Following these decisions, in June, 2015, the Electricity Authority published a decision which regulates the calculating mechanism for transferring a distribution infrastructure to a different distributor. This decision replaced the decision published by the Electricity Authority in July 2013 without a hearing proceeding.

The Decision of the Electricity Authority of June 2015 sets a Mechanism that distinguishes between distributors with a license of an essential service supplier that holds 25% or more of the distribution volume in the electricity sector (a dominant distributor) and other distributors and determines various rules and terms for the transfer of the distribution areas. The aforesaid mechanism and the rules set in this decision harm the Company's ability to compete.

*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, inter alia, to factors that are not controlled by the Company, such as, the manner in which the distribution areas will be transferred in practice.*

On January 15, 2015, the Electricity Authority reached a decision which ratified a previous decision of the Electricity Authority of June 25, 2012, for providing electricity distribution and supply licenses to the Shean (Electricity) Development Company Ltd. ("Shean Development Company"), and according to which the Minister signed in the past supply and distribution licenses for the Shean Development Company that were in force until January 1, 2015. The Shean Development Company supplies electricity to plants in the industrial area that is close to Beit Shean. The distribution license was granted for a period of one year that begins on the date that the permit is received. To the best of the Company's knowledge, the supply license was granted until June 30, 2015. The stated licenses entered into force upon receiving the Minister's approval, which was granted on March 1, 2015.

On September 24, 2015, the Company filed a petition with the Court to grant orders nisi against the Electricity Authority, Sha'ar Hanegev Energy Supply and Tapugan Industries Ltd. Within the petition, the Company requested that the Court, inter alia, instruct the Electricity Authority to cease from all activity, instruction, decision, requirement or clarification pertaining to the privatization of the electricity sector and electricity distribution in Israel, including with regard to determining reduced rates for entities engaging in distribution or supply of electricity and/or granting permits and/or licenses for distribution or supply of electricity, before the reform and structural change in the electricity sector is completed. On October 6, 2015, the Court decided that the respondents should submit their responses to the petition by March 6, 2016.

On November 25, 2015, the Electricity Authority reached a decision to provide a license to supply electricity to the Ramat Negev Energy Ltd. Company. The license was granted for a period of 20 years. On December 24, 2015, the Minister's approval for granting the aforesaid license was received.

On December 13, 2015, the decision of the Electricity Authority was received, regarding the granting of distribution and supply licenses to distribution companies in kibbutzim connected to the distribution grid, as

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<sup>64</sup> In accordance with the Electricity Authority's decision no. 272 of August 11, 2009, a "**Historical Distributer**" is: a body such as local councils, villages, Kibbutzim, cooperative Israeli settlements (Moshavim), communal settlements or other settlements, which fulfills the following terms: it owns rights in real estate which serves it as a place of consumption and owns rights in an electricity infrastructure which serves it to distribute electricity to its residents. It executes, without licenses, electricity distribution and supply activity (as these activities are defined in the Electricity Sector Law, 1996) for domestic consumers owning personal meters in its distribution area. It received approval from the head of the Engineering Division of being a historical distributor".

detailed in the decision (hereinafter: the “Kibbutzim”, “Distribution Companies”, and “Decision”, respectively). Within the Decision the Authority decided, for the first time, to grant distribution licenses for a period of 20 years and to grant supply licenses until January 1, 2017 to dedicated distribution companies established by the Kibbutzim, in accordance with an outline to arrange the legal operation of historical electricity distributors, pursuant to that determined in the Authority’s decision of August 11, 2009. The aforesaid licenses will enter into effect upon receipt of the approval of the Minister of National Infrastructures, Energy and Water.

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

## **9.5 Distribution capacity**

On December 31, 2015, the distribution system consisted of approximately 26,961 km of medium-voltage grid lines (compared with approximately 26,707 km on December 31, 2014); approximately 48,825 distribution transformers with a total output of approximately 24,476 megavolt-amperes (compared with approximately 48,366 distribution transformers with a total output of approximately 24,149 megavolt-amperes as of December 31, 2014) and approximately 20,298 km of low-voltage grid lines (compared with approximately 20,026 km of low-voltage grid lines as of December 31, 2014).

## **9.6 Fixed assets, land and facilities**

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

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

The Company has approximately 30 district and regional offices, in the total area of approximately 150,000 m<sup>2</sup>.

In addition, the Company has 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 13 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 –the distribution segment**

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

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

The Development Plan in the distribution segment for 2016-2020 which is adjusted to budget frameworks, 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<sup>65</sup>, 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 connection to homes. The Development Plan is intended to adapt the distribution system to the needs of the Electricity Sector in view of the introduction of new substations and the development of existing substations, adding of consumers, increase in the predicted load of existing consumers and antiquation of the existing grid, in accordance with techno-economic planning criteria. The Development Plan for the distribution system is being carried out by the districts of the Company that are responsible for planning, executing, operating and maintaining the distribution grid.

### **9.7.2 Key assumptions and restrictions underlying the Development Plan**

The distribution grid Development Plan of the Company, which as stated above still requires the approval of the Minister in consultation with the Electricity Authority and with the consent of the Minister of Finance, is based on the following data and assumptions:

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

### **9.7.3 Anticipated development of additional distribution capacity**

The anticipated development of additional distribution capacity is based on long term planning of the Company for 2016 in an alternative adjusted to budget frameworks, which is submitted to the Board of Directors within the financial planning of the Company, each year.

Within the Development Plan, and subject to the approval of the Development Plan as detailed above and its complete execution, in 2016-2020 approximately 3,670 km of overhead and underground medium voltage lines are expected to be added. In addition, approximately 353 km of grid will be replaced.

Additionally, approximately 5,084 km of overhead and underground voltage lines are expected to be added. In addition, approximately 202 km of grids will be replaced and approximately 5,651 new transformers. During these years, approximately 3,040 transformers are scheduled for replacement.

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<sup>65</sup> As detailed above, the Minister's approval, insofar as will be given, will be in consultation with the Electricity Authority and with the consent of the Minister of Finance.



#### 9.7.4 **Development budget of the distribution segment**

In 2015, a sum of NIS 1,227 million (after remeasurements deduction) was invested in the development of the distribution segment. According to the decision of the Board of Directors, the development budget of the distribution segment for 2016 is expected to be approximately NIS 1,207 million (after remeasurements deduction), a cutback of approximately NIS 39 million compared to the development budget of the distribution segment for 2015.

The following is the major current project of the Company in the distribution segment (data in NIS millions):

<b>Project name/identification</b>	<b>Scope of expected comprehensive investment*</b>	<b>Scope of Investment until the Balance Sheet Date**</b>	<b>Budget completion rate</b>	<b>Remainder of Investment</b>	<b>Date of completion of installation of remote control units in the field</b>
DMS	571	505	88%	66	6/2018

\* The total investment in the "Scope of expected comprehensive investment" column is an estimate for 2016 which as of this date has not yet been approved by the Board of Directors of the Company. Additionally, it is clarified that it is only an estimate, which even if approved, may change from time to time, inter alia according to the progress of the project, its continuation, and costs the Company will bear.

\*\* The "Scope of Investment until the Balance Sheet Date" column is composed of cumulative performance until the end of 2013 in December 2013 prices, and performance for 2014-2015 in current prices, pursuant to the IFRS principles.

The Company is committed pursuant to the Electricity Sector Law to execute the projects in the Company's Development Plan, which was approved by the Minister.

*The above mentioned with regard to the Company's development plan for the distribution segment and the expected development budget for 2016 constitutes forward looking information, as per its definition in the Securities Law. This information includes forecasts, subjective estimates and other plans of the Company and is based on future data, whose materialization is uncertain and is not under the exclusive control of the Company. The main factors that may affect the non-materialization of the forward looking information or changes occurring in the estimated schedule of its execution, in accordance with that which has been described above, include, inter alia: non-implementation of special projects, change in the expected growth rate in the number of connections, implementation the structure change in the Electricity Sector and of the Company (see Note 1.e to the Financial Statements), the Development Plan to be determined by the Minister including changes that will be made to it, difficulties in securing licenses and/or changes in legislation in the environmental protection and licensing field; the absence of appropriate charge rate coverage (see Note 3 to the Annual Financial Statements); the inability of the Company to raise the financing required for executing the Development Plan, a change in the expected rate of growth of demand for electricity and an increase in the number of consumers.*

#### 9.7.4.1 **Renewing the distribution grid**

The Company has formulated a plan to renew the distribution grid, and it is expected to spread across ten years, at an amount of NIS 7.5 billion. Its execution has not yet commenced. The plan has been presented to the Board of Directors of the Company, but has not yet been submitted for the Minister's approval under section 19(a) of the Electricity Sector Law.

The Company is partially implementing the renewal of the distribution grid in a security aspect only, in an amount of approximately NIS 100 million in 2015 and 2016.

#### **9.7.4.2 Smart metering project**

The smart metering project includes the installation of “smart meters” that are capable of managing the metering 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 for the sake of energy efficiency and preparation of the electricity bill which is sent to consumers.

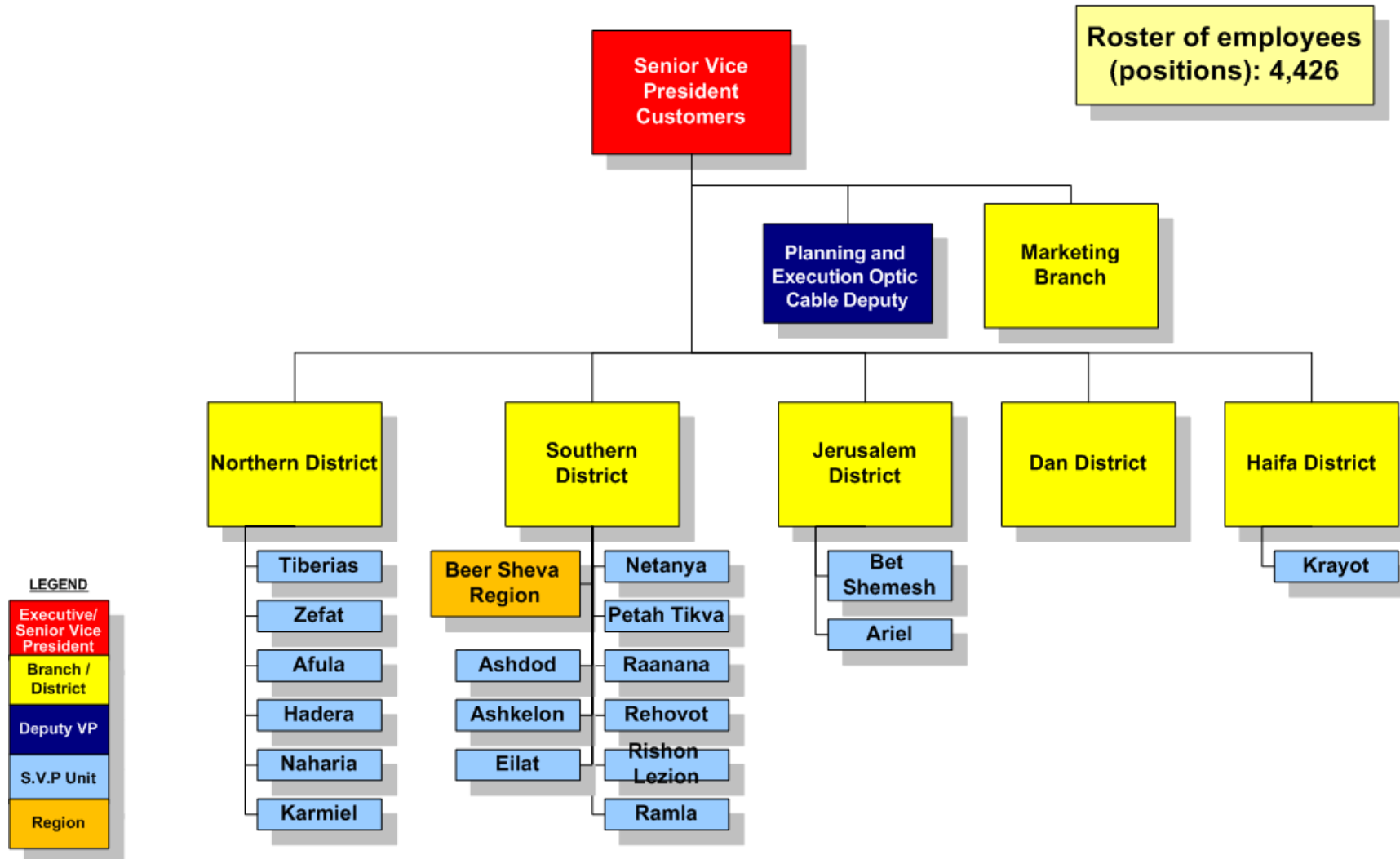
A technological pilot in Binyamina, Givat Ada and the Caesarea Industrial Zone ended in 2014. In the pilot, approximately 4,400 smart meters were installed. The Company is working to issue specifications for executing a rate pilot of approximately 32 thousand meters in order to examine the profitability of transitioning to nationwide smart metering in accordance with the decision of the Electricity Authority (no. 394/2).

In addition, the Company is working to deploy smart metering in new cities and neighborhoods, as of the fourth quarter of 2016.

#### **9.8 Human capital**

The organizational structure of the distribution segment:

## Field of Activity – Distribution Segment



As of December 31, 2015, the distribution segment employs 3,269 permanent employees and 1,157 temporary employees in the marketing segment and in the districts compared with 3,465 permanent employees and 1,065 temporary employees in the marketing segment and in the districts as of December 31, 2014 (the number of employees relates to organizational assignment and does not include employees assigned to other branches and working for the segment and vice versa). In accordance with the above, some of the employees who are organizationally affiliated with the distribution segment work, in addition to working in the construction and maintenance of the distribution system, in the constructing and operation of the transmission grids (see Section 8.7). See Section 13 for details with respect to the employment agreements and additional details.

## **9.9 Raw materials and suppliers**

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

## **9.10 Environmental risks and their manner of management – distribution segment**

### **9.10.1 Environmental risks and environmental regulation – general**

See Section 7.12 for details on this subject.

### **9.10.2 Non-ionizing radiation**

According to the provisions of the Non-Ionizing Radiation Law, 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, which it operates. Operating a radiation source without a legal permit or with deviation from its conditions may constitute a violation of the law and may even cause, inter alia, the issue of an injunction to remove the source.

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

During the past 35 years, many studies have been conducted in the world to examine the connection between prolonged exposure to magnetic fields from electricity installations or from household electrical appliances and the increased incidence of certain diseases. Findings that point to a statistical connection between magnetic fields and childhood leukemia were found in some of the health studies conducted. The findings of these studies were attacked by different researchers using the argument that they are based on estimates alone and that the statistical connection found is very weak and does not establish a causal relation, while findings pointing at the existence of any connection whatsoever were not found in other health studies and in laboratory tests. In November 2010, updated directives were issued by the International Commission for Non-Ionizing Radiation Protection (ICNIRP), for a maximum value of exposure to a magnetic field from the electricity grid for the general population of 2,000 milligauss for short term effects, based on the known health effects that result from the induction of a magnetic field in the body<sup>66</sup>. 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

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<sup>66</sup> Guidelines for Limiting Exposure to Time-Varying Electric and Magnetic Fields (1 Hz - 100 kHz). Health Physics 99(6):818-836; 2010.

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. The Company is working to gradually execute the implementation of the principle of preventive care in existing installations according to the recommendations of the experts' committee report regarding magnetic fields from the electricity grid, which is published on the website of the Ministry of Environmental Protection.

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

In December 2015, the Council for the Prevention of Noise and Air Pollution in Israel (Malraz) filed a petition to the High Court of Justice, against the Minister of Environmental Protection, the Minister of Finance and the Minister of national infrastructures, Energy and Water. Within the petition, the petitioner is requesting to oblige the Minister of Environmental Protection to realize his duty to regulate regulations with respect to threshold values as set in the Radiation Law. In view of the fundamental issue of the petition and the arguments in it, in February 2016, the Company submitted a request to include it as a respondent of the petition.

Within the hearing of the petition, the Company received a regulations draft regarding threshold values as aforesaid, which was formulated by the Ministry of Environmental Protection. If the threshold values included in the regulations draft delivered to the Company will become binding values, it may have material implications for the Company.

The aforesaid, regarding the Company's estimate that insofar as regulations will be regulated and they will include threshold values as detailed in the regulations draft, it may have material implications for the Company, constitutes forward looking information, as its definition in the Securities Law, which is based on future data whose realization is uncertain and not controlled by the Company, but is dependent, *inter alia*, on the final version of the regulations which will be regulated, the manner of their interpretation by the Ministry of Environmental Protection, and the manner in which the Company will be required to implement them. In recent years, a joint initiative of the Ministry of Health and the Ministry of Environmental Protection has been advanced for establishing binding threshold values for magnetic fields from the electricity grid.

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

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

opinion was received from an international expert on the subject, pursuant to which the precautionary principle should be implemented according to means which were detailed in the opinion and determining an arbitrary threshold value should be avoided. The report was discussed by the stated inter-ministerial team, but as of the date of this report a summarizing report has not been published on its behalf.

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 with regard to the maximum magnetic field levels between the electricity infrastructure and sensitive uses (2 to 10 milligauss). This condition may constitute an obstacle to the construction and connection of facilities to the electricity grid and to the population of various structures.

In June 2015, a joint notice on behalf of the Supervisor of Radiation at the Ministry of Environmental Protection and the Manager of the Planning Administration at the Ministry of Finance was sent to the heads of the planning committees in the country, pursuant to which building plans and permits do not have to determine threshold values for non-ionizing radiation.

Later on, the Supervisor of Radiation at the Ministry of Environmental Protection sent a clarification, under which the planning committees are independent in their discussions and decisions in all that relates to the plans including the issue of non-ionizing radiation in any case of plans and permits which may create a conflict between an installation emitting non-ionizing radiation and use of land or sensitive designation. Nonetheless, it is advisable not to set the threshold values of exposure to radiation in the plans, as this is under the authority of the Supervisor under the Non-Ionizing Radiation Law.

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

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

The Ministry of Environmental Protection includes explanatory comments on the issue of non-ionizing radiation in answer to public applications to it on this subject, in non-ionizing radiation measurement reports that are compiled by the Ministry and by private surveyors, and on the website of the Ministry of Environmental Protection. These explanatory comments, in various forms, include information whereby the threshold value for short term exposure to magnetic fields from the electricity grid is 1,000 milligauss, long exposure to levels of more than 4 milligauss is a possible carcinogen and that the recommended average level of 24 hour continuous exposure is to be 4 milligauss. The Ministry of Environmental Protection is even of the opinion that the value of 4 milligauss will relate to a 24 hour day in which the electricity consumption peaks, whereas the annual average will not exceed 2 milligauss. These values were also cited in various correspondences between the Ministry and the Company following which contentions and claims are raised towards the Company. The Company has forwarded its objections to this position to the Ministry of Environmental Protection and to the Ministry of National Infrastructures, Energy and Water and has asserted that these values are being translated by the public and by some of the authorities into a binding standard, which the Company cannot comply with.

### **9.10.3 Material legal or administrative proceedings with respect to environmental protection**

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

9.10.4 **Material events or matters with respect to environmental protection**

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

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

See Section 7.12 for details.

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

In 2015, the expenses of the Company relating to wise avoidance regarding non-ionizing radiation came at approximately NIS 2.9 million (after remeasurement deduction). For additional details, see Section 20.8.

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

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

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

In addition, the Electricity Authority has determined<sup>67</sup> 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 (in this section - "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 measured downtime per consumer for 2015 is 272 minutes, inter alia due to the damage of the storm which befell the country in October 2015. There is a possibility that failure to uphold the objective at the times that shall be set in the plan, once these have been determined by the Electricity Authority, will manifest in the non-recognition of certain expenses for the purpose of setting the charge rate in the distribution segment.

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

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

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

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<sup>67</sup> Resolution No. 6 of meeting 109 dated June 26, 2002 in the matter of "[The] level of reliability in charge rate bases".

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

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

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

**10. Customers - electricity consumers**

**10.1.** On December 31, 2015, the number of customers of the Company stood at approximately 2,675 thousand customers, in comparison with 2,633 thousand customers on December 31, 2014, representing an increase of approximately 42 thousand customers. The electricity consumption in 2015 was approximately 50,601 million kWh, which constitutes an increase of approximately 699 million kWh in comparison with 2014.

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

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

In the twelve-month (12) period that ended on December 31, 2014, and 2015 (in millions of kWh, and in percentages)(for details of Company revenues according to customer types see Note 28 to the Financial Statements):

	<b>Total electricity consumption In percent</b>	<b>2015</b>	<b>Total electricity consumption In percent</b>	<b>2014</b>
Domestic	34.8	17,604	32.1	15,981
Industrial	18.0	9,108	17.9	8,951
Public and commercial	30.3	15,342	32.0	15,953
Water pumping	4.0	2,018	4.8	2,404
Agriculture	2.6	1,332	3.5	1,769
East Jerusalem Electricity Company	4.2	2,128	3.9	1,945
Palestinian Authority	6.1	3,069	5.8	2,899
<b><u>Total</u></b>	<b><u>100</u></b>	<b><u>50,601</u></b>	<b><u>100</u></b>	<b><u>49,902</u></b>

**10.2.1** The domestic sector – as of December 31, 2015, 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, 2014.

In the year that ended on December 31, 2015, the domestic consumption increased by approximately 10.1%, relative to the corresponding period during the preceding year. The total electricity invoices issued in this sector decreased by approximately 1% in 2015 relative to the corresponding period during the year that preceded it, because of a decrease in the rate.



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, 2015 by approximately 3.8% relative to the corresponding period during the preceding year. The total electricity invoices issued in this sector decreased in 2015 by approximately 14% relative to the corresponding period during the year that preceded it because of a decrease in the electricity rate and a decrease in electricity consumption due to the entry of private electricity producers.

10.2.3 The industrial sector - includes electricity consumption by industrial plants and private electricity producers. The electricity consumption of the industrial sector decreased by approximately 1.8% in the year that ended on December 31, 2015 relative to the corresponding period during the preceding year. In 2015, the total electricity invoices issued decreased in this sector by approximately 14.3% relative to the corresponding period during the year that preceded it, because of a decrease in the rate and a change in the consumption mix.

10.2.4 Water pumping<sup>68</sup> 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 16.1% for the year that ended on December 31, 2015, relative to the corresponding period during the preceding year. In 2015, the total electricity invoices issued decreased in this sector increased by approximately 28% relative to the corresponding period during the year that preceded it because of a decrease in in electricity consumption due to the entry of private electricity producers.

10.2.5 The agricultural sector – in the year that ended on December 31, 2015, the consumption of the agricultural sector decreased by approximately 24.7% relative to the corresponding period during the preceding year. In 2015 the total electricity invoices issued decreased by approximately 32% relative to the corresponding period during the preceding year because of a decrease in in electricity consumption due to the entry of private electricity producers.

10.2.6 The East Jerusalem Electricity Company – in the year that ended on December 31, 2015, the consumption of the sector increased by approximately 9.5% relative to the corresponding period during the preceding year. In 2015 the total electricity invoices issued decreased by approximately 5.8% relative to the corresponding period during the preceding year because of a decrease in the electricity rate.

On May 8, 2014, the Company filed an action with the Jerusalem District Court against the East Jerusalem Electricity Company Ltd. in the amount of approximately NIS 531 million. Within this action, the East Jerusalem Electricity Company Ltd. is sued to pay the Company part of the debt it has accumulated towards the Company with respect to electricity that was provided to it in the period until October 2013 and has not yet been paid. The Company is also considering filing an action for the balance of the debt of the East Jerusalem Electricity Company Ltd.

For additional details with respect to the debt of the East Jerusalem Electricity Company Ltd., including the Company's activity to collect the debt, and details regarding the claim submitted by the East Jerusalem Electricity Company against the Company, see Note 6.c. to the Financial Statements.

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<sup>68</sup> Mainly Mekorot, water desalination, local authorities, etc.

10.2.7 The Palestinian Authority – in the year that ended on December 31, 2015, the consumption of the Authority increased by approximately 5.9% relative to the corresponding period during the preceding year. In 2015 the total electricity invoices issued decreased by approximately 10.5% relative to the corresponding period during the preceding year because of a decrease in the electricity rate.

On June 12, 2014, the Company filed a petition to the High Court of Justice against the Minister of Finance, the Government of Israel, the Minister of Defense, the Minister of National Infrastructures, Energy and Water, the Electricity Authority and the Palestinian Authority, requesting a decree nisi. In the petition, the Minister of Finance was requested to use his powers and offset the debt owed by the Palestinian Authority to the Company from the monies transferred to the Palestinian Authority. Alternatively, the Court was requested to provide a solution within the State budget or in any other manner for the deficit created for the Company as a result of non-repayment of the total debt of the Palestinian Authority towards the Company. A hearing of this petition was held on April 20, 2015, within which the Company struck off the petition while preserving all its other rights.

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

Payments by the Palestinian Authority and the East Jerusalem Electricity Company are executed through transfer of payments by the Palestinian Authority and by the East Jerusalem Electricity Company, and by transfers received by the Company from the Ministry of Finance, out of the amounts credited to the Palestinian Authority at the Ministry of Finance.

Since the bills are not paid in full, the management of the Company is acting to collect the debts both by collection acts (such as reducing the electricity supply) and by legal means as stated above. Additionally, the Company approaches the relevant State entities in order to bring about the collection of the stated debts.

### **10.3 Types of electricity charge rates**

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

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

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

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

As of December 31, 2015, the total number of consumers who use the load and time charge rate is approximately 83,355, in comparison with 82,409 consumers as of December 31, 2014. In other words, approximately 3% of the total number of consumers consumes approximately 54% of the total annual electricity consumption.

As of December 31, 2015, the total number of consumers using the “domestic” charge rate is approximately 2.35 million, in comparison with approximately 2.3 million for December 31, 2014. In other words, approximately 88% of the total number of consumers consumes approximately 34.8% of the total annual electricity consumption.

## 11. Seasonality

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

In addition, the revenue of the Company in the various seasons is affected by the change in the charge rates for consumers that pay based on load and time (load and time charge rate), representing approximately 53.5% of the electricity consumption (in accordance with the data for 2015), as the load and time charge rates are higher on average during the summer than the load and time charge rates in the transitional seasons and winter.

### Breakdown of Revenues, net, for 2015 and 2014

	<u>In NIS million</u>				
	<u>Q1</u>	<u>Q2</u>	<u>Q3</u>	<u>Q4</u>	<u>Total</u>
<u>2015</u>	5,678	4,842	7,133	5,191	22,844
<u>2014</u>	6,221	5,317	7,678	5,677	24,893

## **12. Research and development**

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

The research and development budget for 2016 will be approximately NIS 3.9 million.

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

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

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

## **13. Human capital**

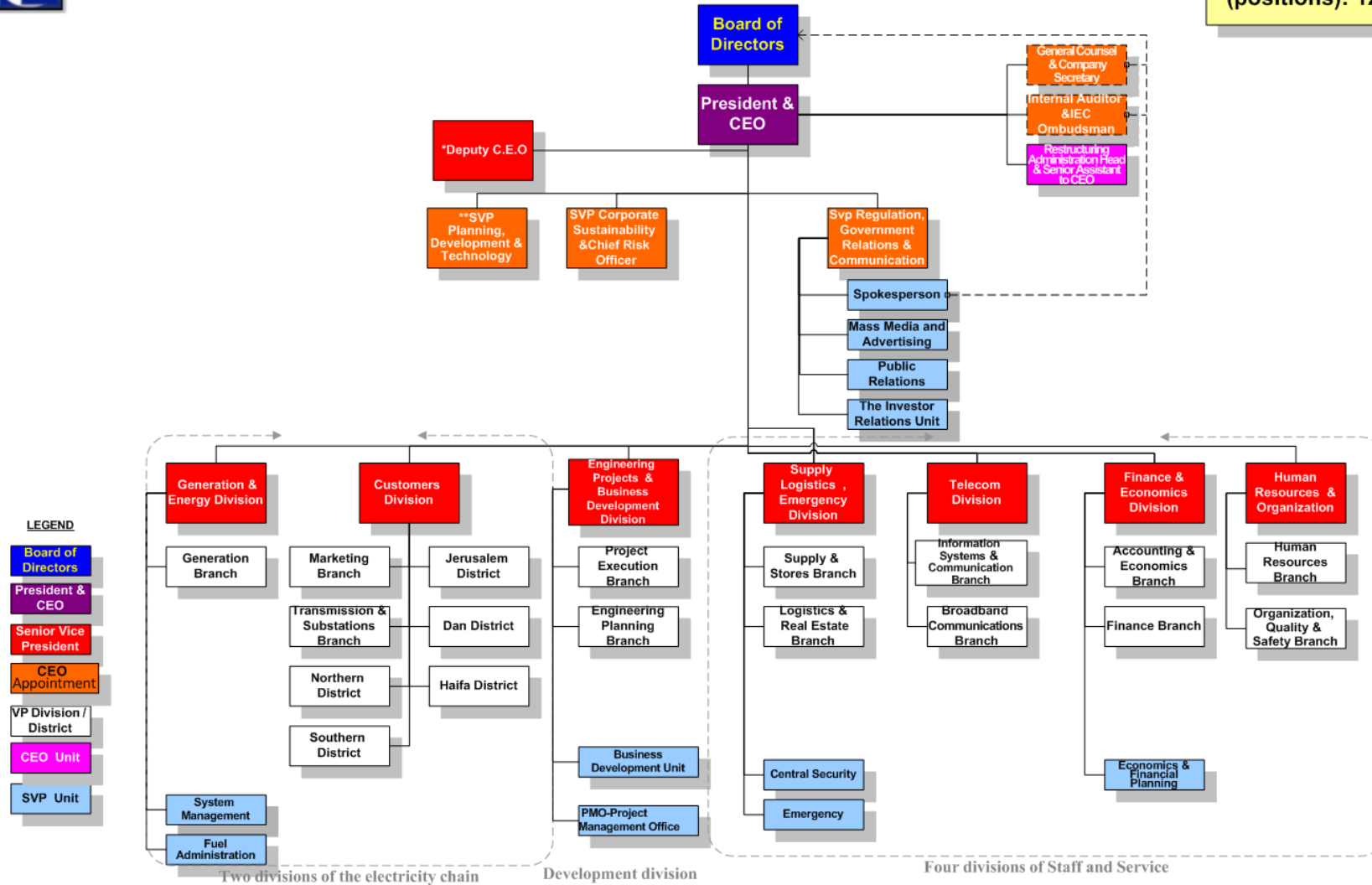
### **13.1 Organizational structure of the Company**

In 2015, the Human Resources and Organization Division was established, to which the Human Resources Branch and the Organization, Quality and Safety Branch were subordinated. The Internal Auditor and the Ombudsman were defined as Deputy CEO. The Business Development Unit was transferred from the Customers Division to the Engineering Projects Division.



# Israel Electric Corporation – Organizational Structure

Roster of employees (positions): 12,077



**LEGEND**

- Board of Directors
- President & CEO
- Senior Vice President
- CEO Appointment
- VP Division / District
- CEO Unit
- SVP Unit

\*S.V.P Customers also serves as Deputy C.E.O  
 \*\*SVP Planning ,Development & Technology also serves as VP Planning, Development & Technology

### 13.2 Employee roster by areas of operation

The personnel roster (number of positions) as of December 31, 2015 is as follows: 12,077 employee positions, in comparison with 12,532 employee positions as of December 31, 2014. As of December 31, 2015, 12,371 employees worked at the Company, compared with 12,754 employees as of December 31, 2014. The segmentation of the job roster by segments reflects the organizational assignment in the Company and not the internal reciprocal activity, which is done between the units of the Company in the different segments. Approximately 40% of the pay of Corporation employees is assigned to the Electricity Sector development activities of the various activity segments.

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

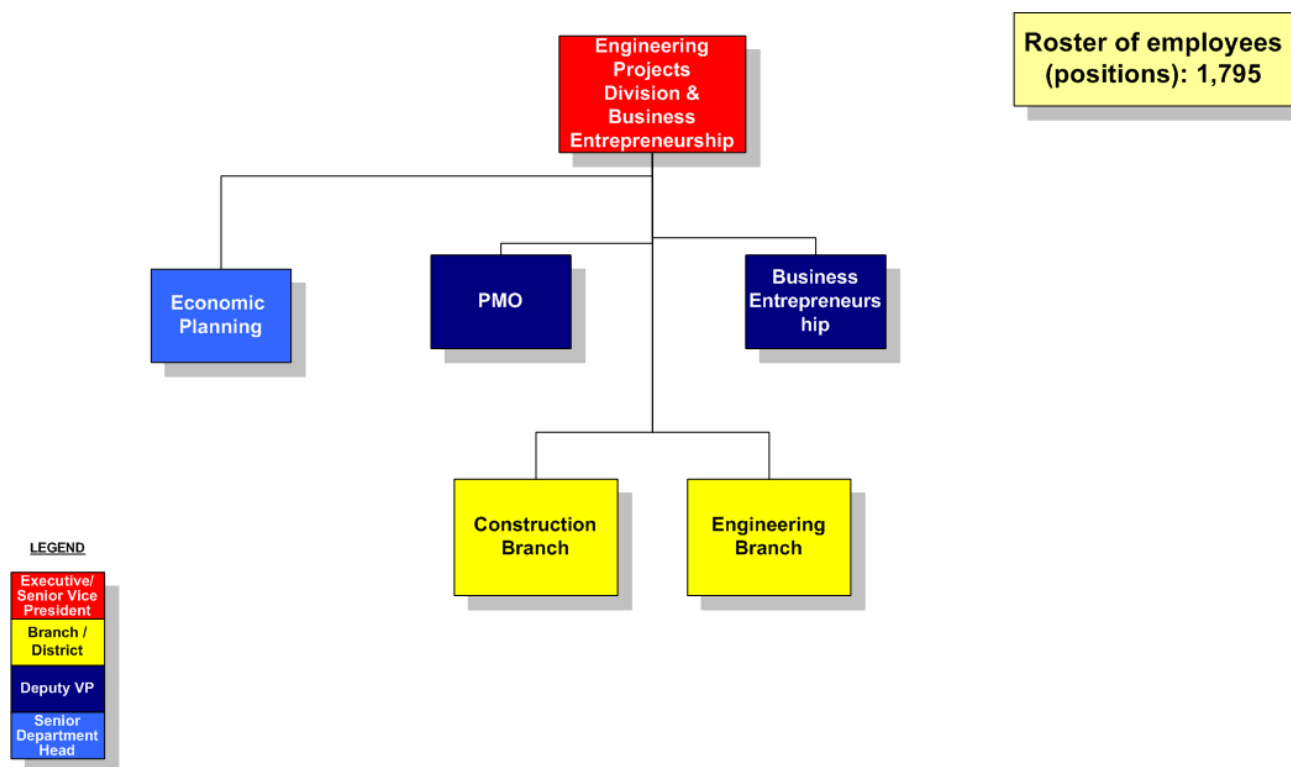
Field	Employee roster (positions)	
	As of December 31, 2015	As of December 31, 2014
1. Generation	2,425	2,547
2. Transmission and transformation	336	348
3. Distribution (marketing and districts)	*4,426	*4,530
4. Headquarters (human resources, sustainability, planning development and technology, finances and economics, general administration)	1,528	1,572
5. Service (organization quality and safety, logistics, security and emergency economy, supply and storage organizations***)	1,567	1,661
6. Engineering projects (planning and execution)	**1,795	**1,874
<b>Total:</b>	<b>12,077</b>	<b>12,532</b>

\* 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.

\*\*\* As of March 2016, the Quality and Safety, Logistics, Security and Emergency Economy Division is named the "Logistics Division", and the Supply and Storage Branch is named the "Acquisition Branch".

## Field of Activity – Engineering Projects Segment



### 13.3 Changes in the personnel roster

The change in personnel roster on December 31, 2015 compared to December 31, 2014 mainly derives from early retirement of 460 permanent employees in 2015. For details of a special collective agreement signed between the Company and the New National Labor Federation and the employees' union (with the approval of the authorized authorities), see section 13.5.1. In addition, the extent of temporary manpower hiring was slightly reduced during 2015, in light of the Company's financial position.

### 13.4 Training and instruction at the Company

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

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

The expenses for training and instruction at the Company for 2015 were approximately NIS 118.9 million in current prices.

### 13.5 Employee compensation plans, benefits and employment agreements

#### 13.5.1 Employment agreements

The labor relations in the Company are regulated by the labor legislation and are subject to various provisions of the law, including the Budget Foundations Law. Additionally, the labor relations are arranged within the



framework of collective agreements (hereafter: the “**Employment Agreements**”); these constitute a binding formula for the Company with respect to the hiring and the termination of employees, terms of employment, labor relations, and the rights and the responsibilities of the parties.

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 9,268 permanent employees of the Company and 6,029 pensioners and surviving relatives to electricity for home consumption and personal 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<sup>69</sup> 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 fact that labor relations in the Company are regulated by labor agreements (as defined above) causes a significant decrease in the flexibility of the labor relations in the Company and creates restrictions for the Company, inter alia as detailed below:

- a. The Company is limited in the employment period of temporary employees without granting them tenure (limited up to 5 employment years in the Company). Additionally, there is sometimes difficulty in retaining temporary employees even if they excel at their job.
- b. There is difficulty in dismissal of employees due to the need to receive the consent of the employees’ union for the dismissal. The difficulty in dismissing employees also affects the ability of the Company to carry out organizational or structural changes, for as far as these changes require dismissal of employees, they require the consent of the employees’ union.
- c. There is difficulty in recruiting and retaining high-quality and skilled manpower, such as: cyber employees and electrical engineers, whose remuneration scope and promotion options in the Company may be limited compared to parallel positions in the private market.

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

On July 18, 2013, a new collective agreement (salary agreement) was signed between the Company and the Employee Union and the New National Labor Federation (the “**July 2013 Agreement**”). This salary agreement is based on the salary agreement signed at the civil service in May 2013 and became valid with the legislation of

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<sup>69</sup> The terms of retirement are governed by the Pension Regulations for Employees of the Israel Electric Corporation, dating from 1958; by the regulations of the Central Pension Fund; and by various Company procedures and provisions.

the “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.

The July 2013 agreement exhausts the claims of the employees on the subject of salary increments for a period until December 31, 2012, and according to the agreement between the parties, there was a commitment for industrial peace on this subject until December 31, 2014.

In December 23, 2015, the Chairman of the New National Labor Federation and the Minister of Finance reached consents regarding a new wage agreement for 2013-2017 which will apply to the employees of the public sector. For additional details see Note 11f.3) to the Financial 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.

For details of an assessment of an expected salary raise and the implications of the consents formulated with regard to a new wage agreement for civil servants, see Note 11.f.3) and Note 11.f.4) to the Financial Statements.

On February 25, 2015, a special collective agreement was signed between the Company and the New National Labor Federation and the employee union (the “**Collective Agreement**”). It was agreed in the Collective Agreement, inter alia, on early retirement of 440 permanent employees in 2015, granting tenure and conditions for eliminating permanent positions, extending employment of temporary employees employed in projects, deducting salary due to participation of employees in sanctions and strikes, industrial peace and exhausting claims in issues arranged in the agreement (“**Special Retirement Plan**”).

On May 27, 2015, the Commissioner of Wages of the Ministry of Finance and the Government Companies Authority approved the stated Collective Agreement. The retirement cost assessment that was included in the report period with respect to the early retirement of 440 retirees is approximately NIS 569 million before tax effect (approximately NIS 418 million after tax effect), of which approximately NIS 227 million before tax effect is with respect to the compensation (approximately NIS 167 million after tax effect).

On September 24, 2015, an addendum to the special collective agreement, which was signed between the Company and the New National Labor Federation and the employees’ union, was signed, according to which the Company will increase the number of retirees by early retirement by 20, and an appropriate update will apply to the tenure quotas and permanent positions’ suspension which were determined in the collective agreement. On October 14, 2015, the authorized authorities approved the addendum to the agreement. The estimate of the additional cost with respect to realizing the addendum to the agreement as stated is approximately NIS 33 million before tax effect (approximately NIS 24 million after tax effect), of which approximately NIS 14 million before tax effect with respect to compensation (approximately NIS 10 million after tax effect).

### 13.5.2 **Employee relations and the conclusion thereof**

The employment relations in the Company are based primarily on the principles that have been prescribed by the Employment Rules. The Employment Rules and the relevant procedures instituted constitute the primary normative source in all matters that pertain to employment at the Company, the conclusion of employment, labor conditions and employment relations. The contractual effect of the Employment Rules ended on December 31, 2015, according to the provisions of the Employment Rules for employees of the Electric Company of March 25, 2002, which is a collective agreement. The Company formulated a proposal for a new labor agreement and is acting to promote it through negotiations with the employees’ union, aimed at reaching consents on the issue.

According to the terms of the Employment Rules, the management of the Company is limited, in practice, in its ability to employ efficiency measures which involve the conclusion of the employment of employees of the Company. In cases of differences of opinion on the layoffs of permanent employees and some of the temporary employees with the labor union, it is possible to negotiate on the matter with the Labor Federation, but to the extent that the negotiations should prove unsuccessful, there is no mechanism in the Employment Rules that

would provide for the implementation of measures of reorganization that involve layoffs, without the consent of the Labor Federation to these measures having been given.

See also Note 35 C to the Financial Statements with respect to the labor relations in the Company and the state of labor disputes as of the date of this report.

#### 13.5.3 Claims of salary irregularities

As a government company, the Company is subject to Section 29 of the Budget Foundations Law which effectively limits its abilities to operate independently on wage issues and benefits to its employees, and imposes upon it a commitment to receive the approval of the Commissioner of Wages on these matters.

For details of the decision of the Commissioner of Wages of October 10, 2013, about various salary irregularities, including the legal proceedings pertaining to this decision, and consents by the parties in this matter, as well as additional details, see Note 11.g and Note 35.c to the Financial Statements.

#### 13.5.4 Central pension provident fund

Commencing from March 8, 2005, the Company has been depositing money for covering the pension liability for employees that are insured by a budgetary pension arrangement (employees hired up to June 10, 1996) in the central pension provident fund ("**the Fund**"). The Fund is managed as of the date of the report by a managing company, Infinity - Management Central Pension Fund Ltd. See Note 11 k 1) to the Financial Statements for additional details, including with regard to the gap between the actuarial calculations of the Company and those of Infinity.

#### 13.5.5 The trust fund for non-budgetary pension components

For liabilities in respect of pension components that are not of allowance types (as described below), amounts were deposited into a trust account that is managed by the United Mizrahi Bank Trust Company Ltd. (hereafter: the "**Trust Account**"), in accordance with a trust agreement that was signed on March 23, 2000. For details of the Trust Account, the Court's rulings in the proceedings conducted in this matter at the Company's request, and details regarding the manner of investment of the funds in the Trust Account see Note 12 to the Financial Statements

#### 13.5.6 Permanent employees

As of December 31, 2015, the Company has 9,277 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 (presently managed by the Infinity Company); and employees (who started their work at the Company on June 11, 1996, and onward) who are insured in accumulating external pension insurance funds.

#### 13.5.7 Special agreement employees

As of December 31, 2015, the Company has 672 special agreement employees – an employee who is hired for a non-permanent position, for performing a defined task that lasts for a set period, such as: the construction of power stations or substations. Such an employee is entitled, in accordance with the collective agreement, to the rights as stated in the Employment Rules with respect to permanent employees, except the right to a budgetary pension and to an energy allowance. The compensation that will be paid to special agreement employees, at the time of their termination shall be enlarged as follows: for the first two years of work, compensation at 200% for each year of employment, and for the third year onward, compensation at 300% for each year.

According to collective agreements on the subject, the maximum employment period of employees by special agreement, who began their employment in the Company since January 1, 2005 and onwards, is five work years.

#### 13.5.8 Temporary employees

As of December 31, 2015, the Company has 1,089 temporary employees - an employee who is hired for a task that is not as specified with respect to a special agreement employee. Such an employee is entitled to the rights as stated in the Employment Rules, with the qualifications appearing there, except the eligibility for a budgetary pension and an energy allowance. The compensation that will be paid to temporary employees will be as required by law.

#### 13.5.9 Special agreement temporary employees

As of December 31, 2015, the Company has 1,174 temporary special agreement employees – a temporary employee who has worked for less than two years at the Company and who was recommended by his superiors to be transferred to temporary status under a special agreement. In accordance with the collective agreement, such an employee is entitled to rights that are specified in the Employment Rules with respect to a permanent employee, except the eligibility for a budgetary pension and an energy allowance. The compensation that will be paid to temporary employees in a special agreement will be as required by law.

#### 13.5.10 Personal agreement employees

As of December 31, 2015, the Company has 56 personal contract employees - an employee with a personal employment agreement is an employee who is hired for any work at the Company and who has signed a personal contract, which prescribes his salary and regulates all of his terms of employment at the Company. In addition – the company employs 91 trainees and apprentices and 12 scholarship recipients who are working within the “Enlightened Future”<sup>70</sup> project (as of the salary data of December 2015).

According to the letter of the Chairman of the Board of Directors of the Company addressed to the Director of the Companies Authority, of February 4, 2015, the Company will act to man the management positions (branch head and higher) with employees employed by personal contracts.

13.5.11 As a government company, the Company is subject to the Government Companies Law and the relevant regulations and the directives of the Companies Authority and the government resolutions, *inter alia* on the issue of personnel.

13.5.12 The procedures for hiring employees for the Company are subject to the Government Companies Regulations (Rules of Employment of Relatives) - 2005, and to the internal instructions of the Company, which are adjusted for the regulations and directions of the Board of Directors of the Company. In view of the above, restrictions have been prescribed in the Company with respect to the employment of relatives in functions in which there are subordination relations or when concern of conflict of interests may arise. Within the internal audit of all of the operations of the Company, the issue of employment of relatives is also audited, and the Company acts in accordance with the recommendations of the Internal Auditor of the Company.

As a government company, the Company is subject to the provisions concerning the proper representation of various sectors among its employees, as appropriate.

### 13.6 Employee compensation

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

13.6.1 The Board of Directors of the Company is allowed to decide to pay a bonus to the employees of the Company with respect to the Company's excellence and success, subject to the provisions of the circular of the Companies Authority<sup>71</sup> (in this section – the “circular”), which state, *inter alia*, that the distribution of a bonus to

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<sup>70</sup> “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.

<sup>71</sup> Circular of the Government Companies Authority 2013-7-2 dated June 2, 2013.

employees will not be permitted unless the following threshold conditions are fulfilled and with the approval of the Government Companies Authority: (1) the adjusted annual net profit return on capital is 5% or more, in the year for which the bonus is being paid; (2) in the year that preceded the year for which the bonus is being paid, the Company had a net profit return of 5% or more; and (3) for the year after the year for which the bonus is being paid, the budget of the Company as approved by the Board of Directors expect a net profit return of 5% or more. Additionally, it was determined within the circular that the cost of the bonus to the Company (including all payments involved that the Company must pay for payment of the bonus) is not to exceed 10% of the net annual profit of the Company according to the approved financial statements of the Company and that no distribution of bonus to employees will be permitted if no dividends have been distributed in the year for which the bonus is requested, except with extraordinary approval of the Director of the Companies Authority. The bonus will be paid to the employees immediately following the dividend transfer to the State. The circular also determines that the bonus will be differential and will be distributed according to criteria decided upon by the Board of Directors and under a procedure based on employee evaluation, provided that it will not exceed two salaries. The bonus level will not be uniform for all the bonus receivers, and at least a quarter of the Company's employees will receive a bonus that will not exceed half a salary. .

- 13.6.2 The permanent employees and pensioners of the Company are entitled to an energy allowance, up to a consumption limit of 18,000 kWh per year per employee or pensioner / next of kin, for their own residential homes only, for their domestic consumption and personal use, subject to the Criteria that have been specified within the framework of the procedures of the Company.

### **13.7 Compensation policy regarding senior officers at the Company**

- 13.7.1 According to the requirements of the Companies Law, the Company's Compensation Committee, Board of Directors and the General Meeting approved the compensation policy of the Company for the senior officers on December 19, 2013, December 26, 2013 and January 9, 2014, respectively ("**Compensation Policy**").

On September 16, 2014 and October 2, 2014, the Compensation Committee and the Board of Directors of the Company (respectively) approved an amendment to the compensation policy of the Company, as required in the circular of the Government Companies Authority with respect to "Principles for a Compensation and Incentive Model for Senior Employees of Government Companies". On February 4, 2015, the general meeting approved the stated amendment.

- 13.7.2 As of December 31, 2015, there are 7 officers in the Company who are employed under the collective agreements that apply to all the employees of the Company and 6 officers (including the CEO and the Chairman of the Board of Directors) who are employed under a personal employment agreement in a form that has been approved by the Companies Authority and according to the instructions of the Authority. For details of the Compensation Policy and the terms of office and employment of the senior officers of the Company see sections c.7 and c.8 of the Report of the Board of Directors and regulation 21 of Chapter D of this periodic report.

### **13.8 Organizational change - economization plan**

On May 14, 2008, the Board of Directors of the Company tentatively approved the outline of action of the program for organizational change (hereafter: the "**Matzpen [Compass] Program**" for restructuring), which was based, *inter alia*, on the early retirement of approximately 2,000 employees according to management lists and the examination of an additional 500 early retirements and of Corporation staff layoffs that was supposed to be spread out over a period of several years, on the reorganization of the units of the Company that will include a change in the span of managerial control, the joining of functions that have economy of scale, the elimination of duplications and the formation of supportive mechanisms whose goal is to improve processes, management flexibility and optimum utilization of resources and personnel. At the same time, the Company estimated that implementation of the program may involve costs in material amounts.

During 2011-2013, the Company carried out several updates to the "Matzpen" efficiency program which were based, *inter alia*, on principles of the aforesaid program and continuation programs.

For details of a special collective agreement which was signed between the Company and the New National Labor Federation and the employee union, within which it was agreed, inter alia, on early retirement of 440 permanent employees in 2015, and regarding the supplement to the special collective agreement under which the Company will increase the number of employees retiring by special early retirement by 20, see section 13.5.1.

The Company estimates that the cost of retirement of employees, whether within the implementation of the Structural Change, if implemented, or within the implementation of the plans to increase efficiency in the Company, may be material.

**13.9 Labor disputes**

For details regarding labor disputes see Note 35.c of the Financial Statements.

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

Regarding the rights of employees employed by contractors in the field of cleaning and security, the Company is acting in accordance with specific legislation provisions and the lateral orders in the field of cleaning and the field of security, which became effective on March 1, 2013 and on November 1, 2014, respectively.

## 14. Fixed assets, land and facilities

### 14.1 General

The Company owns the assets that it uses (subject to the statements in Section 14.3 with respect to the assets arrangement) or possesses either within long term lease agreements (mainly with the Israel Land Administration) or pursuant to purchase or expropriation, or within rights that were extended to the Company by property owners (such as an easement or authorization of use at no cost that is not a lease, or possession rights that have a contractual regulation process) or within rights that the Company has by statute. The Company operates within a work plan for executing an arrangement and register of its rights to its principal assets, which may be registered and regulated, and tracks those that it cannot perform such a proceeding for. In addition, the Company has rights to thousands of small properties (mainly transformation rooms of different types) whose rights regulation and registration has begun, but are subject to restrictions in accordance with what is specified below. For a material part of the real estate assets, the rights of the Company are not registered or regulated. The Company has been leasing some or all of the assets, for a long period, and it is operating to sign contracts or arrange rights when these are not regulated or to evict squatters, if there are any. The status of the real estate assets that have not yet been regulated derives from a number of reasons, such as: planning reasons (absence of parcelization or demands for regulating outline plans, a large number of properties, dependence on outside parties, absence of documents), disputes with various authorities, including tax authorities, which prevent the receipt of approvals for the registration of the rights. In view of the complexity, the Company cannot estimate the length of the period until the conclusion of the registration settlement, but it estimates that the costs involved in this are not expected to be material (see Note 13 c to the Financial Statements).

It is the position of the Israel Land Administration that the land areas that were allocated by the Israel Land Administration to the Company for public purposes, but which are effectively unused or are not being used for the allocated purposes, should return to the possession of the Israel Land Administration. Based on various considerations, the Company believes that this decision does not apply to the land that was leased to it by the Israel Land Administration, based on the recognition of the management of the Administration that the Company has a need to regulate sites for electricity with nationwide coverage in advance. However, even if this decision were not to apply to the land allocated to the Company with a tender exemption, as of the date of the report, the Company is making use of all of the land areas that have been allocated to it by the Israel Land Administration, except a few tracts whose usage date in accordance with the development plan is not yet due, and for which there is future zoning for development and use. In addition, in accordance with this decision, even if the Company is required to return land that has not been used to the Israel Land Administration, the return to the Israel Land Administration will require paying the Company consideration for the return, as prescribed on this matter in this decision, to the extent that the "properties arrangement" does not establish to the contrary; see Section 14.3.

In addition, the Company leases from various parties (such as the Israel Land Administration, local authorities, private entities) approximately 60 more properties that are used for various purposes, including: offices, storerooms, monitoring stations, temporary and portable substations. The agreements are made out for different periods of time, from one year to ten years and are renewed or updated in accordance with the needs of the Company in various places and for different purposes, the rental agreements for the properties, including the option period of the Company for their extension, end in 2016 to 2025. The Company believes that it will be able to renew the lease agreements under terms similar to those existing as of the date of the report.

*The information on the preparations of the Company with respect to the assets registration costs and extension of the rental agreements is forward looking information, as per its definition in the Securities Law. There is no certainty with respect to such an estimate, this being, inter alia, due to it being based on the existing information at the time of the report and its dependence on various factors that do not depend on the Company, such as market conditions, the needs of the Company, agreements with the lessors and more.*

The Company has created floating charges on all of its assets on which it is allowed to create charges for securing some of its liabilities, including on assets and rights as described, and three fixed charges for securing its liabilities

towards various financing entities for the financing of Stage A of the Emergency Plan, financing the emission reduction project and financing Stage B of the Emergency Plan (see Note 20 h to the Financial Statements).

In addition, the main office building of the Company, covering an area of approximately 80,000 m<sup>2</sup>, 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 year lease (until June 2048), with an option for an extension for an additional forty nine years.

The Company has two head offices in Haifa and in Tel Aviv, as follows:

	Name and location of the site	Nature and registration of the right	Land area in m <sup>2</sup>	Comments
1.	Head management offices – Haifa	The rights of the Company to this property are lease rights of the ILA for a lease period that ends in 2048 with an option for the Company to extend this period for 49 years more. A cautionary remark is registered to the benefit of the Company for its rights.	80,000	1. The land has comments registered for expropriations and an antiquities site. 2. An agreement exists with the Haifa Municipal Council whereby no additional parts of the parcel will be expropriated.
2.	Head management offices – HaChashmal St., Tel Aviv	Ownership of the Company is registered at the Land Registration Bureau.	14,540	1. There are two comments of use – structure listed for preservation. 2. The Company is acting to improve the property, which will involve zoning of land for public purposes and additional construction rights and uses.

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

	Name of the site	Location	Type of site	Site area in m <sup>2</sup>	Nature of the rights
1.	Giborei Israel warehouse	Tel Aviv	Logistic	8,508	Lease from Tel Aviv Municipal Council
2.	Kiryat Shemona warehouse	Kiryat Shemona	Logistic	3,000	Lease from ILA
3.	Kiryat Gat compound *	Kiryat Gat	Empty compound	3,600	Lease from ILA
4.	North Akko logistic center **	Akko	Logistic	121,572	Lease from ILA
5.	Area for storing equipment trolleys, Jerusalem	Jerusalem	Logistic	775	Rental / authorization from Jerusalem Municipal Council
6.	Beit Dagan warehouse	Beit Dagan	Logistic	85,108	Ownership / right of possession (without documents)
7.	Leyland logistic center, Ashdod	Ashdod	Logistic	106,000	Ownership
8.	Orot Rabin logistic center	Hadera	Logistic	270,000	Sub-lease from the Caesarea Development Company
<b>Total area</b>				<b>598,563</b>	

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

\*\* Under construction.



## 14.2 Fixed assets

The fixed assets of the Company are divided into two key groups: operated fixed assets and fixed assets under construction. Operated fixed assets consist mainly of power stations (including land, buildings and machines), and substations, distribution grids, switching stations and 400 kV extra high voltage switching stations. The assets of the Company that are under construction consist mainly of power stations and buildings.

The Company has assets (mainly distribution grids) in the territories of the Palestinian Authority. See Section 9.6 for details on assets of the Company that are in the territories of the Palestinian Authority.

## 14.3 Arrangement for the transfer of rights and assets pursuant to Section 62 of the Electricity Sector Law

Section 62 of the Electricity Sector Law states various provisions with respect to rights and assets that were held by the Company prior to the expiration of the Concessions that were given to the Company pursuant to the Electricity Concessions Order with (March 4, 1996), despite the statements in Section 46 in Part A of the Addendum to the Electricity Concessions Ordinance.

For additional details, see Note 1.f to the Financial Statements.

*The information included in this report, and within the framework of the Financial Statements of the Company, with respect to the effect of the assets arrangement on the Company and its financial position, constitutes forward looking information, as per its definition in the Securities Law. Information as stated is based on interpretation of legislation with regard to assets with respect of which the Company will be obliged to pay and on the determination of the method for determining the value of those that are not under the sole control of the Company, but depends, inter alia, on the decisions of the Ministers. The Company cannot estimate which opinion will be accepted – whether the opinion of the Company and its legal advisors or the opinion of the State, or other interpretation, and what method will be used to calculate the value of the stated assets. Additionally, and inter alia by paying attention to the draft of the report, the Yogev Letter with respect to the arrangement of the assets, and the letter sent to the Chairman of Securities Authority on May 18, 2015, by the Comptroller General of the Ministry of Finance and Director General of the Government Companies Authority (the “**Letter of the Comptroller General and the Director General of the Government Companies Authority**”), the Company has no certainty as to the manner and method in which the arrangement of the assets will be implemented, insofar as will be implemented, and it has no certainty that it will not have a material effect on its business, the results of its activity or its financial position. In addition, this data is based on the estimations of the Company as of the date of the report. Such estimates may not be realized or may be realized partially or differently than expected due to, inter alia, the changes in the position of the Ministers and the Government or the applicable law, which are not under the Company's control.*

## 15. Intangible assets

### 15.1 Information and teleprocessing systems

The Company engages in the characterization, development and implementation of information systems and solutions that support business processes in the Company in the following fields: customer service and billing, the electricity chain, planning and construction of engineering projects, programs on security and safety, and programs that deal with managerial, business and logistic issues. In addition, the Company has extensive experience and knowledge that have accrued on the following issues: planning, hosting and operation of computer infrastructures on all types of platforms, telecom and command and control infrastructures and services, protection packages specialization in diverse IT architectures and technologies with emphasis on the protection of the cyber space, smart counting, integration of a SAP package, business information strategy as well as all stages of the lifecycle of large-scale IT and telecom projects.

### 15.2 Concessions

The Company owns a license for the use of VHF frequencies, and a license for the use of UHF frequencies and microwave frequencies.

## 16. Suppliers

The following table shows the material suppliers of the Company, rates of purchase that in 2015 exceeded 10% of the rate of purchases of the Company from suppliers throughout 2015:

<b>Name of the supplier</b>	<b>Raw material</b>	<b>Acquisition rate</b>
The National Coal Supply Corporation Ltd.	Coal	20.37%
The Tamar Partnership	Gas	26.12%

See Sections 7.9.6 and 7.9.9.2 (a), respectively, for details on the Company's contracts with these suppliers.

## 17. Working capital – credit policy

### 17.1 Customer credit

For details of days of credit for customers and average balance of credit to customers see section a.5.b)4) of the Report of the Board of Directors.

### 17.2 Credit from suppliers

For details of average days of credit for suppliers and average balance of credit from suppliers see section a.5.b)4) of the Report of the Board of Directors.

## 18. Financing

### 18.1 General

The electricity charge rate for the consumers is determined by the Electricity Authority in accordance with the provisions of the Electricity Sector Law as stated in Note 3 to the Financial Statements. In view of the principles of determining the charge rate as stated, the revenue of the Company that is based on the electricity rate that the Company collects from the consumers does not constitute a principal source of financing of the development activity of the Electricity Sector, and the Company is therefore required to raise most of the necessary financing for this purpose and for recycling the existing debt of the Company from external financing sources.

In the Electricity Authority's decision regarding the 2014 annual update from January 2015, the Authority gave the Company an additional advance for 2015 for the transmission and distribution segments of approximately NIS 300 million, and determined that a condition for the additional advance and assurance of its channeling into investments is its deposit in a dedicated account. Therefore, the funds deposited in the account were dedicated to financing investments in transmission and distribution.

In the Electricity Authority's decision regarding the 2015 annual update from September 2015, the Authority determined that the annual advance sum will remain unchanged compared to the 2014 annual update and will add up to approximately NIS 700 million. Additionally, it was determined that the Company will deposit the full sum of the annual advances in the dedicated account in 12 equal monthly deposits as of the date of the annual update and until a new rate base is set for the grid's segments.

However, in recent years, the financing of part of the Development Plan of the Company has been carried out, *inter alia*, through a supplement in the rate.

In accordance with the five-year financial plan of the Company, the Board of Directors of the Company resolved in June 2014 to reduce the financial debt in an amount of NIS 0.5 billion a year and to gradually reduce the Company's debt-to-balance ratio (hereafter: the "**Financial Leverage**") to 81%.

On October 15, 2015, the Company's Board of Directors decided to maintain a safety cushion with a monetary value which will not be less than NIS 3 billion, and the cash balance and cash equivalents and short term investments will not be less than NIS 2.2 billion, and the value of surplus liquid fuels inventory and/or unused secure credit lines for a period exceeding a year will constitute part of the safety cushion up to a value of NIS 0.8 billion. As of the date of publication of the report, the Company is meeting the target of the Board of Directors.

In January, 2015, the Company took a bank loan of NIS 1 billion.

In June, 2015, the Company raised a sum of approximately NIS 923 million through issue of Debentures (Series 26) and Debentures (Series 27), which were listed for trade on the Tel Aviv Stock Exchange Ltd. (the "**TASE**").

On November 26, 2015, the Company published a shelf prospectus on the basis of the Company's Financial Statements of December 31, 2014 and on the basis of the Company's Financial Statements for the second quarter of 2015.

On February 17, 2016, the Company executed buyback of the Company's Debentures (Series L) and Debentures (Series M), which were traded on the "Retzef Mosadi'Im" system of the TASE, in a comprehensive amount of approximately NIS 1,556 million.

On February 22, 2016, the Company raised approximately NIS 1,510 million through expansion of series of the Company's Debentures (Series 26) and Debentures (Series 27), under a Shelf Offering Report published under the Company's Shelf Prospectus which was published on November 26, 2015

For additional details of capital raisings by the Company and material repayments see Note 20 d to the Financial Statements.

## 18.2 Average interest rate of loans

The Company finances its actions using bank credit and non-bank credit. A breakdown of the average nominal interest rate for the twelve month period that ended on December 31, 2015, except for the loan for financing the gas transmission project (as detailed in Note 34 b. (1)(a) to the Financial Statements) that are not intended for the exclusive use of the Company, segmented by short-term credit and long-term credit from bank and non-bank sources, is provided below.

Details	Average interest rate (%) for long term credit
Bank credit sources	1.93
Non-bank credit sources	6.10

### Notes:

1. Average interest rate relates to loans and debentures which have not yet been repaid on December 31, 2015, with fixed interest and variable interest for all the currencies.
2. Short term credit is credit whose repayment date is within one year from the raising date.
3. Long term credit is credit whose repayment date exceeds one year from the raising date.

## 18.3 Restrictions applying to the Company at the time of receipt of credit

To finance the Development Plan of the Company, the Company is required to have external financing sources of significant magnitudes.

The ability of the Company to borrow from the Israeli banking system is limited because of the credit restrictions that apply in accordance with the Proper Banking Management Regulations of the Bank of Israel (Regulation No. 313). In accordance with these regulations, the Bank of Israel will not extend loans to a "single borrower" at a rate exceeding 15% of its equity capital, after adjustments, and in addition, the Bank of Israel will not extend loans to a "borrower group" at a rate exceeding 25% of the equity capital of the bank, after adjustments. The term "borrower group" includes, *inter alia*, the borrower, the person controlling it and any person that is controlled by them, except banks and other borrowers such as borrowers with material commercial dependence on the Company. With respect to these restrictions, the State of Israel is not considered a borrower and it is not included in the "borrower group". To the best of the Company's knowledge, government companies that do not control each other do not together constitute a borrower group. In addition, according to the Bank of Israel's Letter dated November 8, 2011 (whose validity was extended until September 30, 2013) the banks are required to provide special disclosure to the Supervisor of banks regarding credit risk in respect of significant exposure to groups of borrowers. To the best of the Company's knowledge, this disclosure is likely to include the group of borrowers to which the Company belongs.

In accordance with the Regulations of Supervision over Financial Services (Provident Funds) (Investment Rules that Apply to institutional Bodies), 2012, in general, a provident fund is allowed to hold securities of a certain corporation, make deposits in that corporation or extend to it loans at a rate of up to 5% of the revalued market value of its assets, or beyond this, subject to the conditions prescribed in the aforementioned regulations.

In addition, in accordance with these regulations, a provident fund or a group of investors are allowed to hold negotiable bonds (that are not bonds of the State of Israel) to a rate of up to 25% of the total par value of the bonds of that series, or beyond this, subject to the conditions prescribed in the aforementioned regulations.

In effect, based on public publications of some to the financial institutions, the provident funds' holdings of the Company securities do not reach the maximum rate that is permitted for them in accordance with the aforementioned regulations.

The theoretical potential for the receipt of loans from the banking system and from the institutional market in Israel stands, in accordance with the Company's estimate, reaches an amount that is significantly lower than the

needs of the Company, which cannot in any case constitute a unique funding source for the Development Plan of the Company (taking into account the fact that, to the best of the Company's knowledge, the ability of institutional investors to provide financing to the Company, is affected by their exposure to the electricity sector in Israel (i.e. – including material suppliers that are dependent on the Electric Company, private electricity producer and gas suppliers, including the Gas Lines Company that is responsible for the gas transmission), and not only by their exposure to the Company). Regulatory restrictions that apply to the banking system and the institutional market in Israel, along with internal investment restrictions that are prescribed by these entities, make it difficult for the Company to raise the debt required for the Company exclusively in Israel and therefore the Company sometimes raises its required credit from the capital markets and the banking system overseas.

#### **18.4 Credit that has been obtained from the date of the statements until the date of signing this Report**

After December 31, 2015 and until the date of publication of the report, the Company raised an amount of approximately NIS 1,637 million, of which NIS 1,510 million through expansion of series of the Company's Debentures (Series 26) and Debentures (Series 27), as detailed in section 18.1.

#### **18.5 Restrictions that apply to the Company pursuant to financing agreements**

For details with respect to conditions that may cause the calling of debt of the Company pursuant to the agreement, for immediate repayment, see Note 20 d to the Financial Statements, and regarding the causes for immediate repayment that are included in the financing agreements the Company has entered, that are defined as "Material Loans" with respect to the implementation of the Securities Authority Directive pertaining to "Reportable Credit Event" see section 18.9.

#### **18.6 Credit facilities for December 31, 2015**

As of December 31, 2015, the Company has bank and non-bank credit facilities in an amount of NIS 1,400 million:

#### **18.7 Variable interest credit**

As of December 31, 2015, the Company has variable credit interest coming to a total of approximately NIS 4,402 million. A breakdown of the variable interest credit that the Company has received follows:

Currency	Interest rate range (in %)		Interest range in 2015 (in %)		Balance for December 31, 2015 (in millions)	
	High	Low	High	Low	Original currency	NIS
U.S. dollars	Libor 6m + 2.5	Libor 6m + 1.65	3.25	1.98	376	1,466
Euro	Euribor 6m + 2.5	Euribor 6m + 0.325	2.68	0.29	386	1,639
CPI linked NIS	Government bond yield + 0.25	Government bond yield + 0.25	0.11	0.11	47	47
Unlinked Shekel	Telbor 6m + 1.15	Telbor 6m + 1.15	1.82	1.25	250	250
Unlinked shekel	Prime + 0.6	Prime + 0.6	2.35	2.20	1,000	1,000

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

## **18.8 Credit rating**

The Company is rated by two local credit rating companies and two international credit rating companies. For details with respect to the credit rating of the Company see Note 20.g to the Financial Statements.

## **18.9 Reportable Credit Event**

In accordance with Legal Position No. 104-15 of the Securities Authority of October 30, 2011 with respect to a reportable credit event (in this section: "Securities Authority Directive"), a disclosure with respect to the material loan agreements to which the Company is a party follows<sup>72</sup>.

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<sup>72</sup> It should be noted that after the Company examined all of its liabilities for December 31, 2015 (coming to a total of approximately NIS 65 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 3.2 billion as of the date of this report.

<u>Loan / bond contract</u>	<u>Characteristics of the lender</u>	<u>Revalued principal balance as of date of Report</u>	<u>Amortization schedule</u>	<u>Contractual interest and effective interest</u>	<u>Linkage mechanisms</u>	<u>Sureties extended to the lender</u>	<u>Restrictions applying to the Company with respect to the loan</u>			
							<u>Cross default or cross acceleration clause</u>	<u>Negative charge undertaking</u>	<u>Comments on material conditions to receipt of credit (*)</u>	<u>Material changes that occurred in the loan agreements / credit extension agreement</u>
Issue in the USA 05/2008 (GMTN)	Non-negotiable overseas bond	Revalued par value balance NIS 3,902 million	Principal will be repaid in one installment on January 15, 2019	Contractual interest 7.25% and effective interest 7.41%	U.S. dollars	Floating charge on all assets of the Company	The bond holders have a right of early repayment in the following cases: (1) debt towards lenders of the Company in the amount exceeding US\$ 25 million or equivalent has not been paid (after the remedy period for non-payment has ended); or (2) another lender of the Company has a right to call the debt to it for immediate repayment in the amount exceeding NIS 25 million or equivalent in NIS	Negative charge undertaking, except: (A) floating charges of equal degree to a floating charge securing the bonds and securing amounts relative to the amounts secured by this floating charge; (B) permitted charges as per its definition in the bond terms.	----	----

**Other material conditions –**

- A. Endorsement of the debt to the transmission company: in the case of another company, which is not the Company, engaging in all or most of the electricity transmission activity in Israel (“**the Transmission Company**”), the debt in accordance with the agreement shall be endorsed to the Transmission Company, and this company will assume

the place of the Company as the issuer of the bonds (hereinafter: the “**Relevant Time**”) and the Company is committed to act (in accordance with certain conditions) for this debt endorsement to take effect.

- B. The Company shall manage, finance and operate its business affairs in an adequate manner, while considering its cash flow, subject to any law, including demands that are in its incorporation documents and environmental permits.
- C. The bond holders have an option (under certain conditions) to demand early repayment of the bonds (a put option), *inter alia*, in accordance with common causes and upon the fulfillment of one of the following conditions.
  - (1) At the Relevant Time (as defined above), the following cumulative conditions are fulfilled: (A) the State of Israel has an investable rating; (B) the bonds are rated below an investable rating; and (C) the Company has not taken the utmost effort to achieve an investable rating for the bonds; or
  - (2) At the Relevant Time (as defined above), the Company was not acting in accordance with its commitments for the endorsement of the debt to the Transmission Company to take effect;
  - (3) The Company does not legally engage in electricity transmission activity in Israel, or, at the Relevant Time (as defined above) or thereafter, the primary occupation of the Company has ceased to be electricity transmission;
  - (4) The State of Israel has ceased to be, directly or indirectly, the controlling shareholder of the Company (on this matter, “controlling” means the ability to direct the operations of the Company or a holding of 50% or more of the voting rights of the Company);
  - (5) In the occurrence of a case or circumstances that may constitute an event that has a material adverse effect over the Company – as such an event is defined in the terms of the bonds.
- D. The bond holders have a right (under certain conditions) to immediate repayment of the loans in accordance with accepted causes, *inter alia*, upon the fulfillment of:
  - (1) Attachment or expropriation of the assets of the Company to the benefit of the creditors to a value in excess of US\$ 25 million, or equivalent to this amount in foreign currency.
  - (2) Impairment of the validity and/or enforceability and/or rating of the floating charge in accordance with the terms of the bonds.
  - (3) The debentures are not rated through two international rating companies



<u>Loan / bond contract</u>	<u>Lender characteristics</u>	<u>Revalued principal balance as of date of report</u>	<u>Amortization schedule</u>	<u>Contractual interest and effective interest</u>	<u>Linkage mechanisms</u>	<u>Sureties extended to the lender</u>	<u>Restrictions applying to the Company with respect to the loan</u>			
							<u>Cross default or cross acceleration clause</u>	<u>Negative charge undertaking</u>	<u>Comments on material conditions to receipt of credit (*)</u>	<u>Material changes that occurred in the loan agreements / credit extension agreement</u>
Linked Electricity 2022	Non-negotiable bond in Israel	Revalued par value balance of NIS 3,870 million	The principal will be repaid in six equal semiannual installments from July 18, 2020 to January 18, 2023	Contractual interest 6% and effective interest 4.57%	Linked shekel loan (principal and interest) linked to the Consumer Price Index	Floating charge over the assets of the Company	The bond holders have a right of immediate repayment in the case of a debt of another financial financier of the Company in the amount exceeding US\$ 100 million or equivalent in NIS being called for immediate repayment	Negative charge undertaking, except: (A) floating charges of equal degree ( <i>pari passu</i> ) or inferior than that of the floating charge given to secure the bonds; (B) permitted charges as per its definition in the terms of the bonds	----	----

**Other material conditions -**

The mechanism for raising the contractual interest for the bonds in the case of decreasing of the rating

The bond holders have a right to immediate repayment of the loan in accordance with common causes, and when:

1. The State of Israel has ceased to be the controlling shareholder of the Company ("controlling" – as per its definition in the Securities Law).
2. A material deterioration has occurred in the business affairs of the Company and there is genuine fear that the Company will not be able to repay the bonds.
3. A termination of rating for a period that exceeds sixty 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 days of its date of imposition.

<u>Loan / bond contract</u>	<u>Characteristics of the lender</u>	<u>Revalued principal balance as of date of Report</u>	<u>Amortization schedule</u>	<u>Contractual interest and effective interest</u>	<u>Linkage mechanisms</u>	<u>Sureties extended to the lender</u>	<u>Restrictions applying to the Company with respect to the loan</u>			
							<u>Cross default or cross acceleration clause</u>	<u>Negative charge undertaking</u>	<u>Comments on material conditions to receipt of credit (*)</u>	<u>Material changes that occurred in the loan agreements / credit extension agreement</u>
Dollar Electric 2024 within the GMTN Plan	Non-negotiable bond offered to institutional purchasers in the U.S.A. and listed in Israel	Revalued par value balance NIS 4,878 million	Principal will be repaid in one installment on November 12, 2024	Contractual interest 5% and effective interest 5.125%	U.S. dollars	Floating charge on all assets of the Company	The bond holders have a right of early repayment in the following cases: (1) debt towards lenders of the Company in the amount exceeding US\$ 25 million or equivalent has not been paid (after the remedy period for non-payment has ended); or (2) another lender of the Company has a right to call the debt to it for immediate repayment in the amount exceeding US\$ 25 million or equivalent in NIS	Negative charge undertaking, except: (A) floating charges of equal degree to a floating charge securing the bonds and securing amounts relative to the amounts secured by this floating charge; (B) permitted charges as per its definition in the bond terms.	----	----

**Other material conditions –**

- A. The Company shall manage and operate its business affairs in an adequate manner and in accordance with the law, including demands that are in its incorporation documents.

- B. The bond holders have an option (under certain conditions) to demand early repayment of the bonds (a put option), in accordance with common causes and upon the fulfillment of one of the following conditions:
- (1) Insofar as the bonds will be rated by S&P or by Moody's, two levels below the international credit rating and the senior debt rating of the Company by S&P or Moody's, respectively, and this rating has not been raised back by S&P or Moody's, respectively, during a period of 3 months.
  - (2) The State of Israel has ceased to be, directly or indirectly, the controlling shareholder of the Company (on this matter, "controlling" - the ability to direct the operations of the Company or a holding of 50% or more of the voting rights of the Company);
  - (3) In the occurrence of a case or circumstances that may constitute an event that has a material adverse effect over the Company (as such an event is defined in the terms of the bonds).
- C. The bond holders have a right (under certain conditions) to immediate repayment of the loans in accordance with accepted causes, *inter alia*, upon the fulfillment of:
- (1) Expropriation of the assets or request to realize asserts to a value in excess of US\$ 25 million, or equivalent to this amount in other currency.
  - (2) Impairment of the validity and/or enforceability and/or rating of the floating charge in accordance with the terms of the bonds.
  - (3) The liabilities of the Company under the bonds become invalid, illegal or unenforceable and this may have a material adverse effect on the bond holders.

#### **18.10 Implications of insolvency proceedings on the Company**

The Company's licenses do not include an explicit instruction pursuant to which in case of initiation of insolvency proceedings against the Company, any of the Company's licenses will automatically expire. Nonetheless, pursuant to the provisions of the Electricity Sector Law, and also pursuant to the provisions of the Company licenses, the Electricity Authority (or, according to some of the Company licenses, the Minister) may cancel or suspend the Company licenses, inter alia, if the conditions of competence required to receive a license pursuant to the Electricity Sector Law cease to exist in the Company, and/or one of the restrictions against receiving the license exists is fulfilled, within which, inter alia, it was determined that a license will not be granted to a corporation if a receiver or liquidator is appointed to it, or it has decided on voluntary liquidation. Additionally, even if the Company license is not cancelled or suspended in light of non-fulfillment of the competence conditions as stated above, it is possible that upon initiation of insolvency proceedings against the Company, it will not be able to fulfill all or part of its obligations pursuant to its various licenses. Violation of the conditions of the license by the Company may also constitute grounds for cancellation or suspension of the relevant Company license by the Electricity Authority or the Minister (as relevant). It is noted that insofar as any Company license will be canceled or suspended, then pursuant to the conditions of the Company licenses, the Company will not be permitted to supply the service which is the subject of the license.

Additionally, and in accordance with the above mentioned, insofar as a receiver or liquidator will be appointed to the Company, or the Company will decide on voluntary liquidation, the Company will fulfill the competence conditions determined in the Electricity Sector Law for receiving new licenses.

In addition to the licenses which were granted to the Company pursuant to the Electricity Sector Law, the Company has from time to time entered into agreements which may be cancelled by the other party as a result of initiation of insolvency proceedings against the Company, including also some of the Company's lease agreements with local authorities.

Beyond this, insofar as in light of the insolvency proceedings against the Company, the Company will not be able to fulfill its obligations pursuant to lease agreements it is party to, or pursuant to other agreements it is party to or permits and other licenses the Company is required to have pursuant to the construction laws, environmental protection laws or other general laws which apply to the Company, this may constitute grounds for cancelling those agreements pursuant to the general contract laws, or pursuant to the conditions of those licenses and permits, and may lead to sanctions being imposed on the Company, despite the fact that in most of the contracts, permits and licenses of the Company, explicit provisions, which enable cancellation of the agreement, license or permit as stated only because of initiation of insolvency proceedings against the Company, are not included.

For details of the grounds for demanding immediate repayment in the financing agreements of the Company, including the existence of cross default grounds and cross acceleration grounds in a material part of the financing agreements of the Company, and the existence of grounds for demanding immediate repayment in some of the financing documents of the Company in cases of issuing a liquidation order, stay of proceedings, or appointment of a receiver over material assets of the Company, see Note 20d to the Financial Statements.

#### **19. Taxation**

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

## **20. Environmental risks and environmental regulation – general**

### **20.1 General**

For details of the aspects of quality of the environment and environmental risks in each of the operational segments of the Company, see sections 7.12, 8.8 and 9.10.

### **20.2 Hazardous materials**

The Logistics and Assets Branch possesses a poison permit for conveying hazardous materials for the national transport segment, which is renewed every two years, a poison permit for a logistic site in Ashdod and a poison permit for the technical center with respect to the Section's operations in the technical center, in cooperation with the Supply Section and the Southern District.

### **20.3 Business licensing**

Various activities of the Company at the logistic and administrative facilities require licensing in accordance with the Business Licensing Law, and environmental issues are also regulated within the terms of the licenses. As of the date of the report, the Company is operating to regulate the licensing of the activities whose licensing proceeding has yet to be completed in accordance with the provisions of the law and the requirements of the authorities. The operation of the sites of the Company without a business license constitutes a violation of the Business Licensing Law and may lead to the termination of the activity of the business. For additional detailing of this subject see section 21.8. For details of the integrative licensing procedure see section 7.12.12.

### **20.4 Material events or matters relating to environmental protection**

As of the date of this report, to the best of the Company's knowledge, it is not exposed to material events or matters with respect to environmental protection in its activities, which have not been set forth in the report.

### **20.5 Energy saving**

The Company's activity is subject, *inter alia*, to the Energy Sources Law and various relevant regulations that deal with energy saving and Government resolutions that are published from time to time with respect to the policy for energy saving and greenhouse gas emissions abatement. The Company is acting to comply with this regulation and is studying its consequences and the consequences of new regulation initiatives in the field. The Company estimates that at this stage the existing regulation does have material implications for the Company. In January 2015 the Company received a draft of reference documents on the topic of energy saving within the framework of the integrative license mechanism.

In May 2015, the Company submitted to the Ministry of Environmental protection its comments to the reference documents, within which it claimed, *inter alia*, that they are not suitable for the activity of the power stations and that another regulation already applies to the stations within an individual reference document for power stations.

The Company estimates that in the event that the reference documents will be assimilated in binding permits or documents it will receive, despite its position that the provisions are not suitable for the activity of the power stations, this may have a material effect on the results of its operation.

*The estimate of the Company, pursuant to which application of the reference documents may have a material effect on the results of its operation, is forward looking information as this term is defined in the Securities Law. This estimate may not materialize or may materialize partially or in another manner, and this, inter alia, according to the manner and extent in which the reference documents will apply to the Company.*

**20.6 Material legal or administrative proceedings with respect to environmental protection**

A number of class actions and other material actions have been filed against the Company. See Note 35 B to the Financial Statements, for details.

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

See Section 7.12 for details on this issue.

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

A breakdown of the investments of the Company in environmental protection in the generation segment, over the three recent years, is as follows. The figures do not include the generation segment for which separate information has been provided in Section 7.12.17, and includes the transmission and transformation segment and the distribution segment and general expenses that may not be attributed to a particular segment.

<b>NIS millions (current prices, after remeasurements deduction)</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>
Total investment in environmental protection facilities, misc. purchases and investments	Approx. 5	Approx. 7	Approx. 6
Current costs (without depreciation) (fuels, research and development and more)	Approx. 4	Approx. 3	Approx. 11

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 and therefore, despite the Company's position, there is no certainty that all the costs required according to the Company's position as aforesaid will eventually be covered within the rate.

*The assessment of the Company with respect to covering the costs required for compliance with the provisions of the legislation pertaining to environmental protection is forward looking information, as this has been defined in the Securities Law, which is based on the past experience of the Company in its connections with the Electricity Authority, which have no certainty of materialization, in part or in full.*

## **21. Restrictions and control over the operations of the Company**

### **21.1 Provisions of the Electricity Sector Law, relevant regulations, licenses issued accordingly and resolutions of the Electricity Authority**

#### **21.1.1 General**

From March 4, 1996, the activity of the Electricity Sector has been regulated under the Electricity Sector Law and its regulations by which the Company operates. The provisions of the Electricity Sector Law state that its purpose is to regulate the activity in the Electricity Sector to the benefit of the public, while securing reliability, availability, quality, efficiency and while creating conditions for competition and minimization of costs.

In accordance with the Electricity Sector Law, no person shall conduct activity in the Electricity Sector other than under a license that has been given to them pursuant to this law. The types of licenses that are given for activities in the Electricity Sector are as follows: (1) a license for generation of electricity; (2) a license for transmission of electricity – transmission of electricity from a high voltage or extra high voltage generation source to a substation; (3) a distribution license – transfer of electricity from a substation to a consumer, through medium and low voltage lines; (4) a supply license – sale of electricity to consumers in general or types; (5) an own-use generation license – generation of electricity for own use without selling it to another party, with certain exceptions; (6) a license for system administration – administration of the electricity system in the generation and transmission segments, including constant balancing out of the supply and demand of electricity, and securing the survivability of the electricity generation and transmission array, management of the transfer of energy from power stations via the electricity grids or substations at the required reliability and quality, scheduling of the execution of maintenance works in the generation units and in the transmission units, management of trade in electricity under competitive, equal and optimal conditions, including execution of agreements for the purchase of available capacity and energy from electricity producers and planning of the development of the transmission and transformation system. In addition, the Electricity Sector Law states that a holder of a license for system administration, transmission or distribution of electricity is an essential service supplier license holder. Additionally, a holder of a generation license or licenses for which the Minister has determined, in accordance with the factual state of the electricity sector, that it concentrates a material part of the generation in the Electricity Sector – will be considered as a holder of an essential service supplier license. The provisions of the Electricity Sector Law regarding a holder of an essential service supplier license will apply to an electricity producer and a license holder having direct or indirect control of an electricity producer, except for a provision requiring the holder of an essential supplier license to purchase electricity from a private electricity producer, and provide infrastructure services and backup services.

In accordance with the Electricity Sector Law, the Minister is the party in charge of execution of the law. In addition, pursuant to the Electricity Sector Law, the Electricity Authority has to act in accordance with the goals of the Electricity Sector Law and the policy of the Minister and the Government according to their powers under the law, in the field of the electricity sector, to implement their policy in accordance with the provisions of the Electricity Sector Law and to supervise compliance with the provisions of this law and the licenses and to fulfill the duties set for it in this law and that will be imposed on it by any other law. In addition, the Electricity Authority is the professional entity in the Ministry in the field of the electricity sector, which assists the Minister in formulating his policy. The Electricity Authority has to fulfill 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 and executing cost control for this purpose according to its sole professional discretion as set in the law, establishing of criteria for the level, standard and quality of the service that an essential service supplier license holder provides to the consumer, supply license owner, electricity producer, private electricity producer or another essential service supplier license holder, and supervision of fulfillment of its duties in accordance with these criteria, granting licenses and supervising the fulfillment of terms set in the licenses as detailed below, determining rules for conducting transactions between an essential service supplier license holder and a license holder and supervising the fulfillment of the provisions under the Electricity Sector Law by a license holder and their enforcement. In addition, in accordance with



Section 37 (2) of the Electricity Sector Law, the Electricity Authority has the authority to check and decide on complaints of consumers.

Should the Minister be of the opinion that a decision reached by the Electricity Authority is not compatible with his policy or the Government's policy in the field of the electricity sector, or with the objectives of the Electricity Sector Law, he is permitted to point out to the Authority aspects in which the decision deviated, in his opinion, from the stated policy or from the objectives of the Electricity Sector Law, and to instruct the Electricity Authority to conduct an additional discussion on the subject. Were he to do so, the decision of the Electricity Authority will be suspended until an additional discussion is held on the on the subject, in order to examine the suitability, if it is required in the opinion of the Electricity Authority. Should the Electricity Authority find that its decision is compatible with the stated policy or the objectives of the Electricity Sector Law, and there is no need to change it, it will detail the reasons of its decision and the suspension of the decision will be cancelled.

Authority as stated will not apply with respect to decisions of the Electricity Authority pertaining to rates, regarding which its sole professional discretion will be maintained.

The Electricity Sector Law empowers the Electricity Authority to give licenses and supervise the fulfillment of terms set in the licenses, and insofar as the Minister has not done so, to determine rules with respect to terms for granting licenses, modes of selection among license applicants, specific activity in a specific place or area, procedures for submitting applications for a license, rules for operating a license and the obligations which will apply to the license owner, including the provision of securities and insurance. 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.

A generation license exceeding 100 megawatts, a supply license exceeding 100 megawatts, a distribution license exceeding 5% of the annual consumption volume, a transmission license or a system management license, will enter into effect after its approval by the Minister. Notwithstanding, if the volume of the distribution licenses in the sector which are not owned by a Government Company exceed, accumulatively, 10% of the annual consumption volume, or another rate decided upon by the Minister within principles of the policy, which will not be less than 10% of the stated consumption volume, an additional distribution license will enter into effect after its approval by the Minister.

Determination of a rate as stated above does not derogate from the Minister's power to decide on a policy in the field of the electricity sector (as stated in section 57a of the Electricity Sector Law), *inter alia* in these matters: long term master plan for the electricity sector, multi-annual development plan for the electricity sector, with the consent of the Minister of Finance, policy for granting licenses, reducing the risk of disruption in the supply of electricity, operation of the electricity sector in a state of emergency and other special situations, promoting competition and reducing the centralization in the electricity sector, in consultation with the Minister of Finance, the mix of energy sources which will serve to generate electricity, the mix of technologies to generate electricity, the reserve required to generate electricity.

The Electricity Sector Law states that the Minister, upon consulting the Electricity Authority or according to its proposal, 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 regulated, to prescribe, *inter alia*, procedures and conditions that a license applicant must comply with, including: conditions on the matter of minimal equity capital, minimal self-financing rate and so on. In addition, the Law states that transactions with a holder of an essential service supplier license will be conducted in accordance with rules set by the Minister, in consultation with the Authority or according to its proposal. Accordingly, the Minister enacted the Electricity Sector Rules (Transactions with an Essential Service Supplier), 2000. The rules determine, *inter alia*, that a transaction for purchase of electricity will be conducted under a contract to be signed by the supplier and the producer. If a

tender is issued, the contract will be signed in accordance with the terms of the tender. If a tender is not issued, a contract adjusted to the method of the transaction will be signed and will require the approval of the Minister.

The Electricity Sector Law has been amended on numerous occasions, *inter alia* with the goal of regulating structural changes in the Electricity Sector, including the future structure of the Company. See Note 1 e to the Financial Statements for details on the provisions of the Electricity Sector Law pertaining to the Structural Change in the Company that is required by the provisions of the Electricity Sector Law.

#### **21.1.2 Licenses that have been granted to the Company pursuant to the Electricity Sector Law**

The first license that was granted to the Company pursuant to the Electricity Sector Law, in 1997, is a license for transmission, distribution, supply, sale and trading of electricity, which is referred to by the Company as “the general license” (hereafter: the “**General License**”). In addition, the Company has been granted generation licenses for the generation units that it operates. In 2007, a new sphere of operations was included in the Electricity Sector Law that was defined as “system administration”. The system administration activity is carried out by the Company within the General License, without it having been given an additional, specialized license for system administration.

As the Company holds a license for the transmission and distribution of electricity, it is considered to be an “essential service supplier” in accordance with the Electricity Sector Law. In addition, as the Minister has stated that the Company concentrates a material part of the generation in the Electricity Sector, the provisions of the Electricity Sector Law relating to an essential service supplier apply to it. Additionally, the Company is deemed an essential service supplier in light of the fact that in accordance with the general license the system management activity is performed by the Company.

For additional details with respect to licenses that have been granted to the Company pursuant to the Electricity Sector Law see sections 1.1 and 7.1.2 above.

In accordance with the licenses of the Company, the Company must act in accordance with the provisions of the law, including any law that takes effect after the giving of the licenses and international treaties to which Israel is a party with respect to the actions pursuant to the License, which as stated is subject to the law. A violation of the law constitutes a violation of the licenses, and the Electricity Authority is allowed to cancel or suspend the licenses if it has found that any of their conditions has been violated (see Section 21.1.4 with respect to the power of the Authority to cancel the licenses). As of the date of the report, except in accordance with that which has been stated in Section 22.1.3.6 with respect to the violation of duties related to activity and reporting as profit centers, the Company materially complies with the terms of the licenses that have been given to it.

#### **21.1.3 Duties and restrictions in accordance with the provisions of the Electricity Sector Law, the relevant regulations and the provisions of the licenses of the Company**

##### **21.1.3.1 Duties of the Company with respect to the type and nature of the services provided by it**

In accordance with the provisions of the Electricity Sector Law, the Company as an essential service license provider holder is committed to –

- (a) Providing service to the entire public without discrimination in accordance with the Criteria that the Electricity Authority has prescribed with respect to reliability and efficiency, and in accordance with the terms of its license and any law; see below for the Criteria that have been established.
- (b) Purchasing electricity from a private electricity producer, and providing infrastructure services and Backup Services, in accordance with the terms of its licenses and in accordance with any law;
- (c) Providing Backup Services to a self-consumption generation license holder, at its request, in accordance with the terms of its licenses and in accordance with any law;
- (d) Acting in order to ensure the provision of all of its services throughout the period of its licenses, including the provision of services in accordance with the Development Plan that has been approved in accordance with the Electricity Sector Law (see Section 7.7.1 on this matter), while performing all of the actions required for the provision of these services.

In accordance with the licenses of the Company, it has been determined that the activities that are being performed by it and the services provided by it pursuant to its licenses will be executed by the Company reliably and efficiently, without discrimination and in a manner that will not infringe on the possibility of fair cooperation.

In addition, the General License of the Company states that the Company shall provide infrastructure and Backup Services to other license holders and that the Company will purchase electricity from private electricity producers in accordance with the terms of their licenses and in accordance with the rules that will be prescribed by the Minister, including quantities of electricity to be sold, dates of purchase and dates of changes. See Section 7.4.1.

The Electricity Sector Law further states that an essential service supplier license holder will charge payments in accordance with the charge rates that the Electricity Authority has prescribed and that an essential service supplier license holder shall pay payments to a license holder or to a consumer in accordance with the charge rates that the Electricity Authority has prescribed (including in case the payments are collected for it by another). The term "charge rates" includes all of the following payment types: (1) that a consumer, private electricity producer or self-consumption generation license holder pays to an essential service supplier, including payments for provisions of infrastructure services and Backup Services; (2) that an essential service supplier license holder pays to another license holder, except payment that is prescribed in a tender that has been published by the State of Israel; and (3) that an essential service supplier pays to a consumer for generation of electricity by the consumer and payments to the consumer for consumption management arrangement.

In addition, in accordance with the provisions of the Electricity Sector Law, the Electricity Authority has to establish criteria by which an essential service supplier license holder will be allowed not to provide the service or not to make the acquisition that it is required to provide or make in accordance with the Electricity Sector Law, terminate, delay or restrict them, if the payments for them have not been paid to the license holder as required by law or if the conditions for the provision of the service or execution of the acquisition have not been fulfilled as required by law. The Electricity Authority has prescribed such criteria in the Book of Criteria that have been set forth below. In addition, the Minister has prescribed the Electricity Sector Regulations (Rules, Conditions and Cases for Termination of Electricity Supply), 2003, which regulate the cases in which an essential service supplier license holder is allowed to terminate the electricity supply.

In January 2016, 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<sup>73</sup>, as they are subject to updates and amendments executed by the Electricity Authority from time to time. The prescribing of the Criteria is intended to regulate the activity in the Electricity Sector, supervise and secure the quality of electricity and the standard of service that the Company provides to consumers. Additionally, the Electricity Authority continuously publishes updates to the Book of Criteria.

The Book of Criteria covers, *inter alia*, the following issues: electricity consumption (including electricity consumption rates), connection to the electricity grid, reliability of supply, infrastructure services, purchase of electricity, maintenance, and operation regime of private generation license holders.

The Electricity Sector Law states that the Electricity Authority will prescribe instructions with respect to payments that an essential service supplier license holder is to pay consumers due to violation of the Criteria which it prescribed. Accordingly, the Electricity Authority has determined in the Book of Criteria that an essential service supplier that violates one or more of the Criteria shall pay the consumer for this violation payment in accordance with that which has been prescribed by each of the Criteria that have been violated, within sixty days of commission of the violation. In 2015, 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

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<sup>73</sup> 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>

prescribed in the Criteria for performing an action) relatively negligible amounts totaling approximately NIS 1.9 million.

#### 21.1.3.2 The duty of the Company to submit Development Plans for the Electricity Sector

The Minister, upon consultation with the Electricity Authority and with the consent of the Minister of Finance, is allowed to demand that the Company, as a holder of an essential service supplier license, submit for his approval, in a manner and on a date as required, a Development Plan, complete or in parts, for the purpose of its activities in accordance with the provisions of the Licenses. The Minister, in consultation with the Electricity Authority and with the consent of the Minister of Finance, approved the plan. The Company, as a holder of an essential service supplier license, has to operate according to the approved plan. If it has not submitted a Development Plan for his approval, the Minister is allowed to prescribe for the Company, upon consultation with the Electricity Authority and with the consent of the Minister of Finance, a Development Plan, in which case it must act in accordance with it. See Sections 7.7, 8.6 and 9.7, for details on the Development Plan of the Company. Accordingly, the licenses of the Company state that a license holder that is an essential service supplier is to submit to the Minister a Development Plan with respect to its activity in accordance with the License.

In addition, in accordance with the Electricity Sector Law, the Minister, upon consulting the Electricity Authority or according to its proposal, 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, and to set regulations regarding the system management license owner's obligation to execute actions set by the Minister, to ensure the required development level in the electricity generation system. As of the date of the report, no such regulations have been prescribed.

#### 21.1.3.3 Restrictions on the types of activities that the Company is allowed to execute

The Electricity Sector Law states that no essential service supplier license will be given except to a company that has undertaken to engage only in activities in accordance with the licenses that have been given to it pursuant to the Electricity Sector Law and ancillary actions. However, an essential service supplier license holder is allowed to engage in other actions, that the ministers have approved for it, upon consultation with the Electricity Authority, engagement in which will not impair its actions or the supervision of fulfillment of its duties in accordance with the Electricity Sector Law.

Accordingly, each of the licenses of the Company states the activity for which the License has been given and in which the Company is allowed to engage. In addition, the licenses of the Company state that the license holder is allowed to perform actions that are ancillary to the activities in accordance with the license, which are determined in the appendix to the License. In some of the licenses, certain ancillary actions require the approval of the Manager of the Electricity Administration.

Therefore, when the Company is going to engage in a related act that requires the approval of the Head of the Electricity Administration or in another activity that is not regulated within its licenses, the Company applies to the head or the ministers, respectively, for approval for this purpose.

#### 21.1.3.4 Restrictions to the transfer, pledging or attachment of a license

In accordance with the Electricity Sector Law, a license or any part thereof may not be transferred, pledged or attached, directly or indirectly, except with the approval of the Electricity Authority. In addition, guarantees that a license holder and money stemming from their realization may not be pledged or attached. In addition, in accordance with the law, the Electricity Authority is allowed to determine in the License that certain properties of the license holder, which are required, in the opinion of the Electricity Authority, 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 Electricity Authority. The Electricity Authority, 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.

It is determined in the licenses of the Company that it is prohibited to pledge, transfer or attach, directly or indirectly, assets as stipulated in the licenses (which include most of the assets of the Company), except with the approval of the Minister. The General License also states that the Minister is allowed to add to or subtract from the list of assets that are in the appendix to the License, during the term of the License. The inclusion of or reference to an asset, in the appendix, does not serve to grant the license holder any right to the asset or detract from its duties with respect to it in accordance with the provisions in the Electricity Sector Law. In addition, the licenses state that if any third party is granted, as of the effective date of the License, rights with respect to any of the properties that are used for the provision of the activity of the license holder, the license holder shall ensure, to the maximum extent possible that no situation will occur in which the exercising of rights to a property as set forth may impair the execution of its undertakings in accordance with the License. See Section 14.3 and Note 1 f to the Financial Statements with respect to the Property Settlement.

In accordance with the provisions of the law (as existed until Amendment 13 to the Electricity Sector Law) and the licenses of the Company as stated, in the past the Company applied from time to time 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 stated. In accordance with the provisions of the Electricity Sector Law in its present version, creating charges on the Company's assets is subject to the approval of the Electricity Authority (instead of the Minister's approval).

In the past, the approvals that the Minister gave for the charges on the assets of the Company did not include special stipulations with respect to charge realization, but charge realization will require approval in accordance with the provisions of the law. With the Minister's approvals for charges provided to the Company, as of 2011, all the approvals for the floating charges over the assets of the Company that were given to the Company by the Minister, include restricting conditions, primarily as follows:

- No sale, transfer or rental of assets that are being used for carrying out activity in accordance with the Electricity Sector Law is to be made except to a party that is allowed pursuant to the law in Israel to engage in activity as stated using those same assets, which will receive its rights to and keep the assets for executing those activities, in accordance with licenses permitting their execution;
- The assets listed shall be kept at all times by a party that has a license to operate them in accordance with the Electricity Sector Law and shall be used at all times for the purposes of the licenses only;
- The appointment of a temporary or permanent receiver (in this section: the "Receiver") shall be contingent to its undertakings to act in a manner that fulfills the duties of the Company, as they may be from time to time;
- The approval for creation of the charge does not constitute an approval to realize the rights conferred under the charge, including appointment of the Receiver;
- The identity of the Receiver requires prior approval of the Minister and his appointment will be contingent to further fulfillment of the duties in accordance with the licenses of the Company, including continuing the regular operation of the activities in accordance with the Electricity Sector Law, using the assets and facilities of the Company;
- The authorities that are granted to the Company by law as the license holder shall apply, *mutatis mutandis*, to another holder of the pledged assets.

The aforementioned approvals state that they do not detract from any other undertaking of the Company, including pursuant to other charge agreements, and do not establish priorities for other charges of the Company.

#### 21.1.3.5 Restrictions over change or reorganization in a license holder

The Electricity Sector Law states that the Electricity Authority 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 Electricity Authority. A similar provision prescribed in most of the licenses of the Company.

Beyond that detailed above, the Electricity Sector Law states that control of a license holder shall not be transferred, directly or indirectly, except with the approval of the Electricity Authority. 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 Electricity Authority. In accordance with the Electricity Sector Law, the Electricity Authority is allowed to approve the transfer such control, as long as of the time of the transfer, the conditions that are required to give the License in accordance with the Electricity Sector Law are fulfilled as well.

The Conditions and Procedures for Granting Licenses Regulations state that the Minister is allowed to stipulate conditions of a license of an essential service supplier, such as a requirement for an organizational and legal structure of the license applicant or to the giving of an undertaking to make a structural change as mentioned and order a change of organizational and legal structure during the period of validity of the License. The Minister shall not order as stated until after having given the license holder notice, a reasonable time in advance, and an opportunity to voice its contentions before the Minister with respect to his instructions as stated. As of the date of the report, the licenses of the Company have not been made contingent upon any particular organizational or legal structure.

#### 21.1.3.6 Execution of activity as profit centers, manner of preparation and submission of Financial Statements

For details regarding the execution of activity as profit centers and the manner of preparation and submission of financial statements of the Company, see note 1.b.2) to the financial statements.

#### 21.1.3.7 The responsibility of the State of Israel within the framework of the licenses and the duties of the Company towards it

In accordance with the provisions of its licenses, the Company is committed to indemnifying the Company for payment that it is charged for an act or default of the Company, with respect to its activity in accordance with the License. In addition, the Company will bear all of the legal and other expenses of the State of Israel, to the extent that there are any for the charge. The duty of indemnification shall not apply unless the Company has been given, at a reasonable time, a notice of the claim that a third party filed against the State of Israel in order to allow it to participate in the defense and the State of Israel has consented to the participation of the Company in the legal proceeding. This duty of indemnification is not limited in time or amount.

In addition, in accordance with the terms of the licenses, any approval, permit or instruction that has been given to the Company for the purpose of or within the License, whether given before the giving of the License or given thereafter, shall not impose on the State of Israel any liability towards the Company or any third party and shall not serve as a cause of claim of the Company or a third party towards the State.

In addition, the authority of approval or supervision that is given in accordance with the License, including the exercising of such authority, does not impose on the State of Israel any liability that is imposed pursuant to the License on the Company, or negate or diminish from that liability.

#### 21.1.4 Cancellation, suspension and change of the terms of the licenses

In accordance with the Electricity Sector Law and the provisions of the licenses of the Company, the Electricity Authority is allowed, at any time, to cancel or suspend a license, and it is allowed to add to 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 the Electricity Sector 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 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. However, the Electricity Authority will not use its powers as stated, pertaining to licenses requiring the Minister's approval as detailed in section 21.1.1, except as regards cancelling or suspending a license if it has found that any of the conditions of the license have been violated, that any of the qualifications for receiving it is fulfilled, or the capacity required for its possession by the Electricity Sector Law has ceased to be fulfilled. A cancellation or 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, according to amendments of the Electricity Sector Law, the instructions in these licenses are to be read as granting the authority to the Minister or to the Electricity Authority in accordance with the Electricity Sector Law after its amendment within the Arrangements Law.

As of the date of the report, the licenses of the Company have not been suspended or cancelled and the Company has not received a notice that it is not fulfilling any of their conditions.

In addition to what has been stated above, the Electricity Authority is granted authority to cancel the validity of an essential service supplier license (after having warned the holder of this license), if it has learned that the essential service supplier license has not made the payments that are due (in accordance with the Electricity Sector Law or the terms of the License) to another license holder. The Company, except in exceptional cases and in circumstances that have not been under its control, (such as a strike), has made sure to pay other holders of licenses for activities in the Electricity Sector the payment that is due to the by law, on time and as required. In effect, the Company has not received any notice of intent to cancel the validity of a license that has been given to it and it estimates, in view of its function as an essential service supplier in the Electricity Sector, that even in the case of violation of the duty to pay another license holder a payment that is due to it by law, the likelihood for such a severe sanction of far-reaching consequences for the Electricity Sector to be enacted is very low.

*The Company's estimates 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, there is no certainty that the Company's estimates will materialize, as their materialization may be affected by external factors that are not under the control of the Company, including decisions of the Electricity Authority and its policy as will be from time to time.*

In accordance with the Conditions and Procedures for Granting Licenses Regulations, the authority has been vested in the Minister<sup>74</sup> 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.

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<sup>74</sup> Although in the Regulations, authority has been conferred upon the Minister, in accordance with Amendments to the Electricity Sector Law, the regulations should be read as granting this authority to the Electricity Authority.

21.1.5 **Sanctions for execution of activity in accordance with the Electricity Sector Law without a license, for violation of the terms of the licenses and for violation of other duties of the Company in accordance with the Electricity Sector Law**

The Electricity Sector Law states, inter alia. that the execution of the activity that is licensable in accordance with the Electricity Sector Law (including in the field of generation of electricity) without a license constitutes a criminal offense punishable by three years' imprisonment or a fine that is four times the fine rate determined in Section 61(A)(3) of the Penal Code 1977 (hereafter: the "Penal Code") and an additional fine for each day that the offense continues, at four times the fine rate determined in Section 61c of the Penal Code.

In addition, the Electricity Sector Law states that a violator of the provisions of Sections 17(B) (dealing with the preparation of Financial Statements in accordance with the principles prescribed by the Ministers), 17(C) (dealing with the duty of collection of payments in accordance with the charge rates determined by the Electricity Authority), 34 (dealing with accounting entry and reporting to the public requirements that will apply to a holder of an essential service supplier license, as determined by the Electricity Authority) or 35 (dealing with requiring the holder of an essential service supplier license to submit to the Electricity Authority reports and any information in accordance with its demands, for fulfilling its duties), or a license holder violating any of the terms of the License, with respect to the activity of the license holder, is liable for one year's imprisonment or a fine of three times the rate of the fine determined in Section 61(A)(2) of the Penal Code, and an additional fine for each day on which the offense has continued, at three times the rate of the fine determined in Section 61(C) of the Penal Code. In addition, in accordance with Section 65 of the Electricity Sector Law, this law is part of the list of laws specified in the first addendum to the Administrative Offenses Laws - 1985.

The Electricity Sector Law further states that the violator of the provisions of Section 17(A) (dealing with provision of service to the entire public without discrimination, according to the criteria set by the Authority, reliably and efficiently, according to the terms of the license and the law, purchase of electricity from a private producer and provision of infrastructure and Backup Services to a private producer, according to the terms of the license and the law, provision of Backup Services to a self-generation license holder according to its request, according to the terms of the license and the law, and ensuring the provision of all of its services throughout its license period, including provision of services in accordance with the development plan that was approved pursuant to Section 19, while performing all actions required for providing these services) is subject to three years' imprisonment or a fine that is four times the fine rate as stated in Section 61(A)(3) of the Penal Code and an additional fine for each day on which the offense continues, at four times the fine rate set forth in Section 61(C) of the Penal Code. In addition, the Electricity Sector Law states that an officer who has violated a duty to supervise and do everything possible to prevent violations of the law by the Company or any of its employees is punishable by one year's imprisonment or a fine (as stated in Section 61(A)(3) of the Penal Code). The Electricity Sector Law states that if a violation of it has been committed by a corporation or any of its employees, it is presumed that the officer in the Company violated the duty of regulation, unless he proves that he acted without *mens rea* and without negligence and did everything he could to fulfill his duty.

21.1.6 **Provisions of the Electricity Sector Law and the Resolutions of the Electricity Authority with respect to the electricity charge rate**

In accordance with the provisions of the Electricity Sector Law, the Electricity Authority prescribes the electricity charge rate. As described above, most of the electricity consumers pay one weighted charge rate for electricity, which includes all segments of activity.

See Sections 7.11.1 and 8.9.1 for details on the principles for setting the charge rate and the manner of setting the electricity charge rate in each of the segments.

**21.2 Contentions of the Company with respect to the electricity charge rate**

In the view of the Company, the resolutions of the Electricity Authority on the matter of the charge rate do not provide full, adequate coverage for its costs. In its view, the non-recognition by the Electricity Authority, within the charge rate, of the costs that the Company has incurred on certain issues, leads to significant erosion of the



revenues of the Company, which is estimated to be to the tune of billions of shekels. It is the position of the Electricity Authority, as delivered to the Company, that the electricity charge rate need not recognize all of the costs of the Company in accordance with its actual costs, if they are not required in the opinion of the Electricity Authority for discharging the duties of the Company as an essential service supplier.

For details of the gap between the revenues of the Company under the rate formula and the expenses of the Company under the Financial Statements, see section a.1.e) of the report of the Board of Directors.

The management of the Company and the Board of Directors are conducting an ongoing dialogue with the Electricity Authority in order to advance the discussions with respect to the issues under dispute pertaining to the electricity rate.

### **21.3 Resolutions of the Government and the Cabinet**

In accordance with that which has been stated above, the operations of the Company are materially affected by the resolutions of the government, including on the issue of the Electricity Sector and because of its identity as a “government company” (see Section 21.5). During the years that have passed since the date the Electricity Sector Law was legislated, the Government of Israel and government entities adopted a number of resolutions and recommendations with respect to the Electricity Sector, some of which were later adopted as amendments to the Electricity Sector Law, and some were not adopted by the law and were not even implemented, because of various considerations, including the continued discussions between the Company and Government entities on the issue of the Structural Change and the sanctions of the employees with respect to these resolutions.

On October 5, 2014, the Ministerial Committee for Social and Economic Affairs (Socio-Economic Cabinet) (hereinafter: the “**Cabinet**”) approved a “Multi-annual Plan to Execute Issue of Minority Stakes in Government Companies” which was approved by the Government Resolution number 2093 of October 7, 2014 (hereinafter; the “**Decision**”). Within the Decision it was decided, inter alia, to approve a multi-annual plan to execute issue of minority stakes in government companies (hereinafter: the “**Plan**”), and to promote the creation of an appropriate legal infrastructure for executing the issue of minority stakes in government companies in order to implement the Plan. The Cabinet classified the Company as a company in which the State has an interest in maintaining long term government control. Accordingly, under the Plan outline, in 2017, subject to a Government decision to perform a structural change in the Company, as far as a decision will be reached, and minding the nature of the structural change that will be formulated, an issue of minority stakes of the Company will be executed at a total amount of up to 25% of the share capital of the Company (fully diluted). Additionally, within the Decision, the Cabinet instructed the Government Companies Authority to act so that the companies included in the Plan (including the Company) will distribute dividends to the State budget in a total amount of approximately NIS 500 million in each of the years 2015-2017, all subject to the progress of the privatization proceedings according to the timetables set and subject to the distribution analysis and permits required under the law, as amended, insofar as will be required.

### **21.4 Restrictions and regulation of the corporation’s operation**

The operation of the Company is subject to governmental regulation and control in a wide range of fields of activity of the Company through diverse regulatory instruments such as laws, regulations, decrees, letters of authorization, licenses and permits.

#### **21.4.1 Regulation by virtue of the Government Companies Law and status of the Company as a government company**

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 (a company of which over half of its voting powers in its general meetings or its right to appoint more than half of its directors are held by a government company, a government subsidiary, or a government company with a government subsidiary), are governed by most of the

provisions of the Government Companies Law, with the modifications stated in Section 57 of the Government Companies Law.

The following is a description of the principal provisions which apply to the Company by virtue of the Government Companies Law.

Pursuant to section 2 of the Government Companies Law, the Companies Ordinance and the Companies law will apply to the Company, all subject to the provisions of the Government Companies Law.

#### **21.4.2 Investments in the Company<sup>75</sup>**

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.

#### **21.4.3 Actions and decisions that require the approval of the Government**

Pursuant to section 11 of the Government Companies Law, various Government company decisions require the approval of the Government, as detailed henceforth: (1) a change in the objectives of the Company; (2) increase of the registered share capital of the Company; (3) a change in the rights attached to the shares of the Company; (4) allocation of Company shares or consent to transfer shares as required by the incorporation documents - if they may cause a material change in the balance of power between the members of the Company or grant a new member with 10% or more of the nominal value of the share capital or voting power of the Company or the right to appoint a director; (5) issue of redeemable preference shares by the Company; (6) issue of debentures convertible into shares, and conversion into shares of debentures issued without conversion right or loan received by the Company; (7) transforming the Company from a company which is not private to a private company, or from a private company to a company which is not private; (8) reorganization of the Company, its voluntary liquidation, compromise, arrangement or merger with another company; (9) establishing a company, alone or with others, and purchase of shares in an existing company, except for purchase of shares on the stock exchange by a company for whom such a purchase is part of its regular business; regarding this - "company" - including another corporation, and an enterprise which satisfies the conditions as determined by the Minister of Finance; (9a) a right granted by the Company or obligation undertaken 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; (9b) offering securities to the public under a prospectus, if the Companies Authority was of the opinion that as a result of publication of the Prospectus the State, being the controlling shareholder of the Company, may be liable for damage which will be caused due to a misleading detail that was in the Prospectus, pursuant to the Securities Law, and so informed the Company; (10) operation as a shareholder of a government subsidiary in one of the issues stated in paragraphs (1) to (9b); (11) commitment to one of the operations stated in paragraphs (1) to (10). Such decisions by a government subsidiary also require government approval, and will be presented to the Ministers by the parent company to obtain such approval<sup>76</sup>.

A decision by a government company to sell shares it holds in its government subsidiary also requires the approval of the Government and the Finance Committee of the Knesset<sup>77</sup>.

#### **21.4.4 Business decisions and designation of profits in government companies**

Pursuant to section 4 of the Government Companies Law, a government company will operate in accordance with business considerations under which a non-government company operates, should operate, except if the Government determined for it, with the approval of the Finance Committee of the Knesset, other operating

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<sup>75</sup> Section 10 of the Government Companies Law. Government approval will be received in accordance with the Ministers' proposal, which was submitted to the Government and accompanied by the opinion of the Government Companies Authority. The Minister of Finance will bring the Government's decision to the attention of the Finance Committee of the Knesset.

<sup>76</sup> Section 57(2) of the Government Companies Law.

<sup>77</sup> Section 15a of the Government Companies Law.

considerations. As of the date of the report, other operating considerations have not been determined for the Company. Pursuant to section 9(e) of the Government Companies Law, the provisions of section 9 of the Government Companies Law will also apply, mutatis mutandis, when the Government has reached a decision pursuant to section 4 of the Government Companies Law as stated above. The provisions of the state section 9 determine, inter alia, that the Government will be obliged to purchase the shares of the rest of the shareholders who so wish, except for redeemable preference shares.

Pursuant to section 33(c) of the Government Companies Law, a decision of the Board of Directors regarding the designation of the profits of the Company or regarding distribution as defined in the Companies Law requires the approval of the Companies Authority. If the Companies Authority disagreed with the decision of the Board of Directors, the Company will act according to the decision of the Companies Authority as was approved by the Government.

Section 63a of the Government Companies Law determines that sections 4(a) and 33(c) of the Government Companies Law will not apply to a company regarding which the Government, with the approval of the Finance Committee of the Knesset, decided that reasons of public offer of shares oblige not to apply them to it.

As of the date of this Prospectus, the Government has not reached a decision as stated, and therefore provisions of sections 4(a) and 33(c) of the Government Companies Law apply to the Company.

#### 21.4.5 Financial Statements in government companies

(a) Section 33(a) of the Government Companies Law determines that the Board of Directors has to take care of the preparation of the balance sheet, profit and loss statements including earnings designation, report of resources and manner of their use, and in companies with subsidiaries – consolidated financial statements. Pursuant to section 33(a1) of the Government Companies Law, the Minister of Finance, in consultation with the Minister of Justice, may determine that certain government companies will also submit annual, periodic and immediate reports in accordance with the provisions of the Securities Law. Additionally, section 33(b) determines that the Minister of Finance may oblige a government company to prepare an additional report and to determine the date of its submission. Accordingly, 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 were promulgated, pursuant to which government companies are required to attach to the Financial Statements an additional report with respect to the actions that have been taken and the representations that have been given to secure the correctness to the Financial Statements and the report of the Board of Directors, including separate signed declarations of any officer who has signed those reports. In addition, pursuant to that section, the Government Companies Regulations (Additional Reports of Effectiveness of Internal Control of Financial Statement), 2007, (in this section: the “**Government Companies Regulations**”) have been promulgated, whereby certain government companies, including the Company, have a duty to attach to the Financial Statements an additional statement with respect to the effectiveness of the internal control over financial reporting based, 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 expert opinion on the effectiveness of the internal control of financial reporting in the Company and material weaknesses that he has identified.

Pursuant to the amendment to the Securities Regulations (Periodical and Immediate Statements) - 1970 (hereafter: the “**Reporting Regulations**”), which was approved on November 24, 2009, 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.

An additional amendment set on October 7, 2010, was designed to enable the Chairman of the Securities Authority to exercise his 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 Regulations, is to report the effectiveness of the internal control in the form prescribed in the Government Companies 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 the Government Companies Regulations, including those specified above, is to report the effectiveness of its internal control in the form prescribed in the Government Companies 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.

For details of the instructions of the Government Companies Authority regarding the effectiveness of the internal control, see the Government Companies Authority circular 2014-4-4 regarding 'Appointment of an internal auditor and examination of the quality of the internal control in government companies', and the Authority's letter no. 2014-74 of May 22, 2014, regarding 'External examination of the effectiveness of the internal control in government companies'.

For details of additional procedures the Company performs to ensure the correctness of the financial statements of the Company, see section c. 6 c) of the Report of the Board of Directors.

- (b) 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 Government Companies Authority, principles for preparing financial statements of a Government company, that was defined by him as a company that provides essential service to the public.

By virtue of this provision, the Government Companies Regulations (Principles for Preparing Financial Statements of the Israel Electric Company Ltd.) (Temporary Order) - 2004 (hereafter: the "Financial Reporting Regulations") were enacted, according to which the Company prepares its Financial Statements in light of its being a government company, in addition to the Securities Regulations (Annual Financial Statements) – 2010, that apply to the Company by virtue of being a public company.

On May 22, 2012, the Minister of Finance signed a document extending the validity of the provisions of the Regulations of Financial Reporting, including their amendments, up to December 31, 2014, and the extension of the regulations was published in the Official Gazette on May 30, 2012. Accordingly, for the reporting periods commencing on January 1, 2015, the Company fully implements the International Financial Reporting Standards "(IFRS)". For details with respect to the transition by the Company to reporting under the IFRS principles, see Notes 2a and 36 to the Financial Statements.

- (c) Section 33B of the Government Companies Law determines that should the Government Companies Authority perceive that the public interest so requires, it is permitted to instruct a Government company as to the manner in which to present details in its financial statements, or in any other report that the Company is required to submit pursuant to any law, provided that the instructions covering this matter are not determined in the rules, laws or generally accepted accounting principles or generally accepted reporting principles; and it is permitted, should it perceive that the public interest so requires, to instruct

the Company to disclose the position of the Companies Authority and describe the dispute in the reports. Section 33C of the Government Companies Law authorizes the District Court of Law, at the request of the Government 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 stated provisions. Additionally, section 33D of the Government Companies Law determines the sanctions that may be imposed 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.

For details regarding the rules for preparation of Financial Statements by Government Companies see Notes 2.a.1, 38 and 39 to the Annual Financial Statements.

#### 21.4.6 The Government Companies Authority

The Government Companies Law states<sup>78</sup> that the Government Companies Authority shall consult the Government, via the Minister of Finance, and shall consult the ministers on matters related to the government companies; shall handle, in accordance with the directives of the Government, matters that are shared by all of the government companies or classes of companies; shall track the fulfillment of the recommendations of the State Comptroller relating to government companies and shall assist in their fulfillment; shall advise and assist government companies in the conduct of their business affairs; shall continuously track the activity of each of the government companies, the fulfillment of their goals, course of business, financial state and wage policy and shall announce its findings to the Ministers; shall inspect reports that are submitted to it from a government company and the material on which the reports are based and shall make its comments on them to the company and to the Ministers; shall deal with and handle the formation and the execution of liquidation, merger, compromise, settlement, renewal, organization and sale of shares of government companies; deal with and assist in the construction and execution of liquidation, merger, compromise, arrangement, renewal, organization and sale of government companies; consult the Ministerial Committee on matters relating to privatization and deal with the execution of privatization resolutions; shall act to promote and achieve appropriate representation; shall discharge towards a government company any duty that the Government or the Ministers impose on it and any other duty that is intended for it in accordance with the Government Companies Law.

The Government Companies Authority may send to any board and board committee meeting of a government company a representative on its behalf. The representative of 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.

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<sup>78</sup> Sections 27(b) and 54 of the Government Companies Law.

#### 21.4.7 Directors on Behalf of the State

##### (A) Appointment of directors on behalf of the State

A director for the State in a government company (in this Subsection: “**Director for the State**” or “**Director**”) is appointed by the Ministers after consultation with the Appointments Scrutiny Committee whose composition and functions are elaborated in the Government Companies Law.

##### (B) Competency to serve as a Director for the State

The Government Companies Law states terms of competency for serving as a director, qualifications to competency for serving as a director, the term of office, terms of service and provisions on the expiry of the office and suspension of directors.

In accordance with Section 16A of the Government Companies Law, a resident of Israel who is at least 25 years old, who has fulfilled one of the following, is to serve as a director in a company: (A) he has an academic degree in one of the subjects enumerated in the said section; (B) he has at least five years of experience in one of the following, or has at least five years cumulative experience at least in two or more of the following: (1) In a senior function in the field of business management of a company that has a significant volume of business; (2) In a senior public office or in a senior function in the public service on economic, commercial, managerial or legal issues; (3) In a senior function in the primary areas of engagement of the company. Notwithstanding that which has been set forth above, in accordance with Section 16A1(A), a person who has a second or third academic degree is also competent to serve as a director in a government company even if he does not fulfill the provisions in Subchapter (1) above.

Notwithstanding Section 16A1(B), in a government company in which the State of Israel appoints more than six (6) directors, the number of directors as set forth in Section 16A1(A) shall not exceed one (1), and in a government company in which the State of Israel appoints seven (7) directors at least – two (2) directors, at least one (1) of whom shall have a third (doctoral) academic degree.

According to Section 16A2 of the Government Companies Law, each government company shall have at least one director appointed whom the Appointments Scrutiny Committee has found to have accounting and financial expertise, as defined in Section 240 of the Companies Law. The ministers shall be allowed to appoint directors for a government company in accordance with the Government Companies Law, even if no director has yet been appointed in accordance with Section 16A2 of the Government Companies Law in that company, as long as this does not prevent his appointment.

In accordance with Section 17(A) of the Government Companies Law, the following are not competent to serve as a director in a company: (A) a Minister, Deputy Minister or a Member of Knesset; (B) an employee or worker of the company, except the Chief Executive Officer and an elected representative of the employees of the Company, the Chairman of the Board of Directors shall not be considered as an employee of the Company for this purpose; (C) a member of the public, whose other occupations may create a conflict of interest with his capacity as a director in that company; (D) the Director and the Employees of the Companies Authority, unless the company is under liquidation or winding up of business; (E) a person who has been convicted of an offense that in the opinion of the Attorney General is flagrant or compels him not to be appointed; (F) a person who is barred from serving as a director in accordance with the Companies Ordinance [New Version] - 1983 or by any other law.

According to Section 17A of the Government Companies Law, no person shall be appointed as a director if he has economic affiliation with the company or a personal relationship with the management of the company or the management of a company that is related to the company, as these terms are defined in the Government Companies Law.

In accordance with Section 18C of the Government Companies Law, if the Appointments Scrutiny Committee has found that a candidate for serving as a Director, Chairman of the Board of Directors or Chief Executive Officer of a government company, has a personal, business or political affiliation with any of the Ministers of the Government, it shall not recommend his candidacy unless if it has found that he has special

skills in the fields of operation of the Company or for whom there are considerations of other special competency in addition to the terms of competency required pursuant to this law for that service.

In addition, the Appointments Scrutiny Committee is allowed, even if a candidate fulfills the terms of competency prescribed in the Government Companies Law, to consult ministers with respect to the aptitude of the candidate for the function, taking into account, *inter alia*, the needs and size of the Corporation and composition of its Board of Directors and the ability of the candidate to devote the proper amount of time to the function.

Directive 6.5000 of the Attorney General, titled "Appointments in government companies and public corporations" addresses appointments in government companies and public corporations and also applies to the appointment of a director for the State and a Chief Executive Officer in government companies. The main points of the directive follow: (1) a director of a government company has a fiduciary duty to it and must act to the benefit of the company and not to his own benefit or that of the shareholders who have appointed him. The principle with respect to the prohibition of being in a state of concern of conflict of interests also applies to the personal conflict of interests of the officers and an institutional conflict of interests, and each case shall be examined individually; (2) there is no room for civil servants of the most senior ranks, who have authorization to make material resolutions with respect to a government company, to serve as directors in that company. the direction establishes further restrictions for other civil servants too, and exceptions to those restrictions; (3) an appointment that is made due to proximity to or affinity with or dependence on the appointing party of a degree that gives reasonable grounds to believe that there is an illicit tendency, is an illicit appointment; (4) Section 18C of the Government Companies Law does not prohibit the appointment of persons with political, business or personal affinity to any of the ministers of the Government, but sets an objective test, whereby a candidate who has such an affinity must have special skills in the field of activity of the company or have considerations of special other competency in addition to the terms of competency required by the Government Companies Law for that office. In addition, Section 18C does not exclude the principles of public law with respect to the illicitness of political appointments; (5) the necessary approach is that the suggestion of candidates with an affinity is not to be done routinely, but in exceptional cases and when these appointments are worthy beyond any doubt due to a unique, highly significant contribution; (6) the directive also states that an external director at companies to which the directive applies that are also public companies is not a director for the State and therefore Chapter C of the Government Companies Law does not apply to his appointment. However, the suggestion of a candidate for an external director function or a proposal for one candidate or another in a meeting is an administrative action that is subject to the rules of administrative law. The demand of competency in the law constitutes a proper set of minimal requirements for an appointment and therefore it is not proper for ministers to suggest a candidate for an external director position, or vote for his appointment, unless he is approved by the Appointments Scrutiny Committee in accordance with the rules employed with respect to the director for the State.

Resolution No. 3849 of the Government dated July 27, 2008, titled "Appointment of Directors in Government Companies, in Government Subsidiaries and in Mixed Companies – Continuation of Discussion" has also established rules with respect to directors and appointments. The resolution stated, *inter alia*, that: (1) a public figure who is a candidate for a director function in a government company, government subsidiary or mixed company, who is being appointed in accordance with the competency requirement with respect to education enumerated in Section 16 A(1) of the Government Companies Law (in accordance with that which has been set forth above), shall be appointed for his function only if in addition he has at least two years of experience in his field of education, in the field of management or in the primary field of occupation of the company; (2) the Director General of the Government Companies Authority may establish, upon consulting the minister in charge of the affairs of the company (as set forth above, the minister in charge for the affairs of the Company is the Minister of National Infrastructure, Energy and Water), with respect to directors who are not civil servants, aptitude conditions dealing with expertise and professional competency, considering, *inter alia*, the fields of occupation of the company, its scope of activity and the composition of its Board of Directors, which will apply to up to a third of the

maximum number of directors in the company. The aptitude conditions set forth shall bind the ministers when they appoint directors; further to the Government resolution, the Director General of the Government Companies Authority stated that the company would have: one director with at least 7 years of experience and expertise in the financial field and a relevant academic degree, one director who has served or is serving in a senior function (VP at least) in a company to a financial volume of NIS 300 million and higher, one director who is an engineer in the field of occupation of the company, with 7 years of experience in his function; (3) If the Appointments Scrutiny Committee has made use of the authority of consultation given to it in accordance with Section 18B(C)(3) of the Government Companies Law (as set forth above in this Section) and has transferred its recommendations in writing to the Ministers, the relevant legal advisors and the Attorney General, the Ministers shall act considering the recommendations of the committee. The Ministers are allowed to transfer argued written objections to the Appointments Scrutiny Committee, if they do not agree to its recommendations.

(C) Instructions with respect to compensation and expenses of directors on behalf of the State

Section 19 of the Government Companies Law empowers the Minister of Finance, upon consulting the Government Companies Authority and with the approval of the Knesset Finance Committee, to promulgate regulations with respect to compensation and expenses to be paid to a director. Accordingly the Government Companies Regulations (Rules of Compensation and Expenses of a Director from the Public in Government Companies) 1994 have been promulgated. These regulations regulate the amount of the compensation that is to be paid to directors on behalf of the State and its manner of calculation, in accordance with the classification of the Company as set forth in the said regulations that as of the time of the report is 10 (1).

Amendment no. 20 of the Companies Law deals with the terms of office and employment of officeholders in public companies and debenture companies (as defined in the Companies Law) ("**Remuneration Policy**"). Accordingly, section 267a of the Companies Law determines that the Board of Directors of a public or private company which is a debenture company will determine a Remuneration Policy of the company which will require the approval of the general meeting. However, the Companies Regulations (Relief Regarding the Duty to Set Remuneration Policy) - 2013 apply to the company. These regulations enable the company, as a government company or a government subsidiary, under certain conditions set in the regulations, not to approve the Remuneration Policy at the general meeting. Additionally, the regulations enable the remuneration committee or the Board of Directors of a government company or a government subsidiary not to provide in the remuneration policy details of issues detailed in Part A of the First Schedule A of the Companies Law and not to determine in its provisions as detailed in Part B of the stated Schedule, regarding components of the remuneration policy which were determined in instructions by virtue of the Government Companies Law or were approved by the Government Companies Authority by virtue of the stated law, or were determined in collective employment terms approved pursuant to section 29 of the Budget Foundations Law, all in a manner which does not leave the company with discretion as to the scope or sum of remuneration in those issues.

21.4.8 **Directors from among employees**

The Government Companies Regulations (Rules for Determining a Selected Representative out of the Employees of the Company as a Director) 1977 state manners of election of a representative out of the employees of the company who is proposed for appointment as a director (hereinafter: "**Elected Representative**") and terms of competency. The Regulations state the manner and process of election of Elected Representatives, and specific terms of competency, which are not identical to the ordinary rules of competency prescribed in Section 16A of the Government Companies Law with respect to a director for the State. An Elected Representative shall be determined as a director only in a government company or government subsidiary employing at least one hundred (100) employees that is not a bank. The number of directors out of the employees of the Company shall be two. As of the date of the report, two directors on behalf of the Employees are serving in the Board: Mr. Yoav Drucker and Mr. Mordechai Ben Ami, who were appointed on February 10, 2016.



#### **21.4.9 Instructions with respect to the composition of the Board**

In accordance with Section 17(D) of the Government Companies Law, the number of directors out of the employees of the Company shall not exceed two thirds (2/3) of all members of the board who have been appointed as representatives of the Government.

In accordance with Section 18A and Section 18A1 of the Government Companies Law, the composition of the Board of the Company as a government company shall give adequate expression to the representation of both sexes and the representation of the Arab population, respectively. As of the time of the Prospectus, one director from "Among the Arab population", one female director and six additional male directors serve on the Board of Directors of the Company.

#### **21.4.10 Duties of disclosure of information to the State**

Section 20 of the Government Companies Law states that a director must, in accordance with any other law, give the Ministers and the Government Companies Authority, upon their demand, information on the affairs of the Company and his actions therein.

#### **21.4.11 Term of office and expiry**

In accordance with Sections 18(B) and 18(C) of the Government Companies Law, the statement of appointment is to be delivered to a director from the Ministers, after receiving the expert opinion of the Appointment Scrutiny Committee, a copy of which will be delivered to the Company via the Government Companies Authority. The appointment will be valid from the day of delivery of the appointment letter to the Company, unless another time is set therein.

Section 21 of the Government Companies Law states that a Director shall be appointed for a period of not more than three years from the beginning of the validity of his appointment. A director who has ceased to serve may be reappointed.

Section 22 of the Government Companies Law states that a director shall cease to serve before the end of the period for which he was appointed, in the occurrence of one of the following: (A) he has resigned by giving a resignation letter to the Ministers; (B) he is absent from four consecutive meetings of the board or six meetings within a year, unless if the Ministers, after consultation with the Companies Authority, have stated, by notifying the Company, that there was a justified reason for the absence; (C) he is unable to do his duty and the Ministers, after consultation with the Government Companies Authority, have informed the Company to that effect; (D) he has been convicted of an offense that in the opinion of the Attorney General is flagrant or requires, in his opinion the termination of his service; (E) he fulfills one of the circumstances that disqualify a person from being a director; (F) the Government Companies Authority, or the Ministers, after consultation with the Government Companies Authority, have seen that he is not doing his duty properly and have transferred him from his office after notifying the Company; (G) the Government Companies Authority has determined that he is not doing his duty in a manner that advances the performance of a privatization resolution or has acted by deed or default in a way that impairs the ability of the Company to fulfill an instruction or demand that has been duly given in accordance with Sections 59D or 59E of the Government Companies Law.

A director who has been appointed while being a civil servant or an employee in another government company and who has ceased to be such a servant or employee shall cease to serve from the day on which the Government Companies Authority has announced this to the Company, but the Ministers are allowed, after consultation with the Government Companies Authority, to reapprove his appointment.

If the Government has sold shares that it has held in a government company, the directors will cease to serve, if this is necessitated by the sale transaction, from the day on which the Authority announces this to the Company.

In accordance with Section 23 of the Government Companies Law, if a director is suspected of an offense that in the opinion of the Attorney General is flagrant, the Ministers are allowed to suspend him by a notice to the Company, and appoint a substitute for the term of his suspension.

#### 21.4.12 Quorum and its completion

In accordance with Section 28 of the Government Companies Law, the quorum for a meeting of the Board of Directors is a majority of its members, among them at least one director on the part of the State; the decisions will be made with a majority of ballot participants; in the case of a tie – the chairman will break the tie; all when there is no provision to the contrary in the foundation documents. In accordance with the Articles of the Company, the quorum for meetings of the Board of Directors is three directors. In accordance with the provisions of section 23A of the Government Companies Law, if the number of members of the Board of Directors who are allowed to participate in its meetings is less than the quorum for its meetings, and this situation continues for more than 30 days, or the number of members is less than the minimal number prescribed in the Articles of Incorporation of the company and this situation lasts for more than 60 days, the Government is allowed, upon consulting the Appointments Scrutiny Committee, to appoint a director or directors to the number required to complete the quorum.

#### 21.4.13 Provisions with respect to the Board of Directors of a Government Company

##### (A) The Chairman of the Board of Directors

Section 24 of the Government Companies Law states that the Board of Directors of a government company shall elect one of its members as the chairman of the Board of Directors, and his election requires the approval of the Ministers after consultation with the Appointments Scrutiny Committee. The Government is allowed to appoint a chairman of a board out of its members, if it has considered this to be necessary and after having consulted the Appointments Scrutiny Committee.

The Government Companies Law states that a person, who fulfills the provisions set forth in Section 16A of the Government Companies Law with respect to the competency of directors on behalf of the State and one of the conditions in Paragraph (2) of that section, is competent to serve as the Chairman of the Board of Directors of the company. In exceptional cases a person who does not fulfill the condition in Paragraph (1) of that section may be elected, if he fulfills the conditions prescribed in the Law on this matter, and the Appointments Scrutiny Committee has confirmed that there are special grounds for his election as set forth. The Chief Executive Officer of the company shall not be the Chairman of the Board of Directors. The Chairman of the Board of Directors is obliged, notwithstanding any other law, to provide the Ministers and the Government Companies Authority, once every six months and at any time upon demand by the Ministers or the Government Companies Authority, with a written report of the operation of the Company and the work of the Board of Directors. He must also present them with the budget proposal, work plans and the draft of the financial statements, before discussing them.

##### (B) Work of the Board of Directors

The meeting of the Board of Directors of the company shall be held in accordance with the needs of the company and at least once every two months, unless the Ministers have determined after consultation with the Government Companies Authority, other times, based on the nature of the business affairs of the company. In addition, the Board of Directors must hold a special meeting if the ministers, the Government Companies Authority or any of the directors have prescribed this. The Chairman of the Board of Directors shall summon the meetings of the Board of Directors and shall set their time, place and agenda subject to that which has been set forth in the Law. An invitation to meetings of the Board of Directors shall also be delivered to the Government Companies Authority, and it is allowed to send to any meeting a representative who shall be allowed to participate in the meeting, and his status shall be that of a director, but he shall not be considered in the quorum and shall not have a voting right.

##### (C) Functions of the Board of Directors

Section 32 of the Government Companies Law prescribes a list of matters that the Board of Directors of a government company must decide upon, which authorities it cannot delegate. Among other things, the Board of Directors must establish the general policy of the company in the field of its goals, its financial actions; establish its budget each year, the action plan and authorization of employees of the company; track continuously the fulfillment of the policy, plans and budgets of the company; approve senior

appointments; discuss the Financial Statements and any other issue that the Ministers or the Government Companies Authority have chosen to put on the agenda. It is noted that the Minister of Finance may, with the recommendation of the Government Companies Authority, establish rules for making out the budgets and the action plans of all of the government companies or government companies of certain classes.

In addition to that stated, pursuant to Section 33(A) of the Government Companies Law, the Board of Directors must have Financial Statements made out as set forth in the Government Companies Law.

In addition, the Board of Directors receives reports on resolutions to employ relatives (in accordance with the Government Companies Regulations (Rules on Employment of Relatives), 2005, and has the duty (pursuant to other legislative and pursuant to the circulars of the Government Companies Authority) to discuss various issues, such as setting of the risk management policy, setting the policy for advancing environmental aspects in the actions of the Company and discussion of the State Comptroller reports with respect to the Company.

#### **21.4.14 The Chief Executive Officer (CEO)**

In accordance with Section 37 of the Government Companies Law, the Chief Executive Officer is appointed by the Board of Directors, and the appointment requires the approval of the Ministers after consultation with the Appointments Scrutiny Committee, but the Government is allowed to appoint the Chief Executive Officer if it considers this to be necessary, in which case the provisions of the Government Companies Law will apply to the matter. The Law states that a person, who fulfills the provisions in Section 16A of the Government Companies Law and one of the conditions in Paragraph (2) in that section, is competent to serve as a Chief Executive Officer in a government company. In exceptional cases, a person who does not fulfill the provisions of section 16A(1) of the Government Companies Law (does not have an academic degree in one of the professions enumerated therein) may be appointed, if he fulfills the conditions prescribed in the Law for this matter, and the Appointments Scrutiny Committee has confirmed that there are special grounds for his election as set forth.

The Chief Executive Officer is responsible for the regular management of the affairs of the Company within the annual budget and the operation plans of the Company that have been prescribed by the Board of Directors and within the resolutions of the Board of Directors. The general meeting is allowed to restrict or qualify the powers of the Chief Executive Officer, as is the Board of Directors.

Section 41 of the Government Companies Law states that the Chief Executive Officer must inform the Board of Directors, without delay, on any material matter in the company that pertains to the function of the Board of Directors.

According to Section 42 of the Government Companies Law, the service of the Chief Executive Officer shall expire in certain cases, including: resignation, the resolution of the Board of Directors or the Government, conviction for an offense that in the opinion of the Attorney General is flagrant or requires in his opinion the termination of the service of the Chief Executive Officer or the liquidation of the company. In addition, under Section 43 of the Government Companies Law, the Board of Directors may suspend the Chief Executive Officer if it has reason to suspect that he has committed a criminal offense that has caused the Company damage, and the Board of Directors must suspend him if an indictment has been filed against him for an offense that in the opinion of the Attorney General justifies his suspension.

In accordance with Sections 42(C) and 43(B) of the Government Companies Law, in cases in which the term of office of the Chief Executive Officer has expired or if he has been suspended from his function, the Board of Directors may appoint an acting Chief Executive Officer until a Chief Executive Officer is appointed in accordance with Section 37 or until the end of the term of suspension of the Chief Executive Officer. In accordance with the directive of the Attorney General, the appointment of an acting Chief Executive Officer requires the approval of the Government Companies Authority and the resolution of the Appointments Scrutiny Committee that it fulfills the terms of competency required under the Government Companies Law.

On January 28, 2015, the Government Companies Authority published a circular headed "Process for locating a CEO in a government company and government subsidiary", which was intended to summarize and present principles, norms and practice pertaining to the process of locating a CEO in a government company and a

government subsidiary, as were determined in judicial decisions, directives of the Attorney General, circulars of the Government Companies Authority and the customary practice of the Authority in this matter. The circular details, *inter alia*, the preliminary terms as set in the Government Companies Law, and related to the preliminary terms and strict criteria, examination of candidates, including the significance awarded to each one of them.

#### 21.4.15 Special functionaries in a government company

##### (A) Accountant

Sections 44-46 of the Government Companies Law regulate the issue of the appointment, fee, the duties of reporting and substitution of an accountant in government companies. The resolution on a general meeting of a government company with respect to the appointment of an accountant requires the approval of the Government Companies Authority. The Rules for Government Companies (Appointment and Pay of External Auditors) 1994 state rules with respect to the manners of appointment and cancellation thereof, the time of service and the fee of an accountant, as relevant. In accordance with the regulations set forth, committees have been appointed to recommend the appointments and the fee to be paid.

The accountant of a government company is required, notwithstanding any other law, to provide the Board of Directors, the Ministers and the Government Companies Authority, upon their demand, information on the affairs of the company, conduct special audits and give a report on their results.

On December 31, 2015, the Government Companies Authority published a circular titled "Procedure for an Accountant upon Receiving an Appointment to a Government Company". The circular regulates a structured process for an accountant's entry as an auditor to a Government Company when he was preceded by another accountant.

##### (B) Internal Auditor

Sections 48-49A of the Government Companies Law regulate the appointment and powers of an Internal Auditor in government companies. The Board of Directors of a government company shall appoint for the Company an Internal Auditor, unless the Companies Authority has confirmed that the scope of operations of the company or the nature thereof does not require the appointment of an Internal Auditor. The Board of Directors shall establish the functions and authorities of the Internal Auditor, and he shall be subject to the Chairman of the Board of Directors and the Chief Executive officer. The reports and proposals of the Internal Auditor shall be submitted to the Board of Directors.

On July 1, 1992, the Government Companies Authority published a circular dealing with the procedure of internal auditing in government companies and government subsidiaries. The circular includes the Internal Audit Law - 1992, and the Encouragement of Integrity in Public Service Law - 1992. Additionally, the circular determines the issues that should be inspected in a government company and the powers of the Internal Auditor.

On May 22, 2014, the Government Companies Authority published a circular titled "appointment of Internal Auditor and assessment of the quality of the internal audit in the Government Companies" ("**the Authority Circular on Appointment and Quality of the Internal Audit**") that includes instructions whose purpose is, *inter alia*, reinforcement of the status of the Internal Auditor by way of reinforcement of his independence from the government company audited by him, improvement of the quality of the internal audit at the company, and manner of execution of the examination of the quality of the internal audit by an external factor.

##### (C) Legal Adviser

Section 47 of the Government Companies Law states that the appointment of a legal adviser for a government company shall require the approval of the Government Companies Authority. A member of the Knesset shall not be a legal adviser to the company and a no legal adviser shall be a partner of a partnership or a shareholder in a corporation that he is the legal adviser of The Government Companies Rules (Appointment and Pay of Legal Advisers), 1992 prescribe rules with respect to the manners of appointment

and its cancellation, the term of office and fee of the legal adviser, who is not an employee of the company, as relevant. In accordance with the regulations set forth, a committee operates whose function is to recommend to the Director General of the Government Companies Authority appointments and the fee to be paid.

In addition, the Government Companies Authority included in its circular no. 2013-4-1 of March 7, 2013, relating to "The legal advisor in a government company", the need to appoint an internal legal advisor for a company, who will be one of its senior employees, and the importance of appointing him as a permanent appointment. An internal legal advisor is serving in the Company.

On September 2, 2015, the Government Companies Authority published circular no. 2015-4-1, headed "Circular for approval of appointment of external legal advisors for government companies and government subsidiaries and their fees. The circular is designated to regulate the rules for granting approval by the Government Companies Authority for appointing an external legal advisor and setting his fees. The circular details as to the application to receive the approval of the Authority for appointing an external legal advisor, the considerations of the committee, the term of the appointment, employing a legal advisor for an urgent act, appointment of an external legal advisor which will be deemed as approved by the Authority, fees and other issues.

(D) Attorney of the State in the general meeting

In accordance with Section 50 of the Government Companies Law, the Ministers shall appoint the Attorney of the State to participate and to vote in the general meeting of the company pursuant to the shares that the state holds therein. A notice of the date of a general meeting shall be given to the Government Companies Authority at least two weeks in advance, unless the Government Companies Authority has consented to a shorter period. The Ministers are allowed, after consultation with the Government Companies Authority, to give the said attorney instructions with respect to the manner of his voting in the general meeting.

**21.4.16 Instructions with respect to the election of senior officers**

The appointment of senior officers as per its definition in Section 32(A)(4)<sup>79</sup> of the Government Companies Law, shall be done in accordance with the provisions of the Government Companies Regulations (Rules for the Election of Senior Officers) 2005. In accordance with the Regulations, the Board of Directors of a government company must adopt a procedure with respect to the conditions of competency and the manner of election of senior officers in the company, which will be made out in accordance with the provisions of the Regulations and submit it for the approval of the Companies Authority.

On March 7, 2013, the Government Companies Authority published a circular headed "Receiving information regarding convictions and criminal proceedings when appointing senior officers", which is intended to bring the amendment of the Criminal Register and Rehabilitation Law (Changes in the First and Third Schedule of the Law) - 2012 to the attention of the government companies, which enables, inter alia, the CEO of a government company to receive information from the criminal register regarding the appointment of a senior officer. On June 8, 2014, the Government Companies Authority published an updated circular regarding the appointment of the most senior officer in the field of finance in government companies, which determines the manner of appointment of the most senior officer in the field of finance in government companies. The process of appointment of the most senior officer in the field of finance will be executed similarly to the process of appointment of the company CEO. However, locating him will be through a locating committee, which will not be a committee of the Board of Directors of the Company. The locating committee will be guided by the Board

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<sup>79</sup> The CEO, Vice President and Deputy CEO's, Heads of Divisions, Manager of the financing issues, Internal Auditor, Company Secretary and other officeholders who will be determined by the Ministers, after consulting with the Government Companies Authority. It is noted that, inter alia, in light of the ruling in Labor (T.A.) case 11184/07 Adv Ruth Glat v. Israel Ports Development and Assets Company Ltd. (15.6.2009), although a "Legal Advisor" is not specifically noted in the definition of "senior officers" in the law, the procedures applying to senior officers in the company apply to him.

of Directors of the Company with respect to the job requirements and the examination of their fulfillment. Additionally, preliminary conditions were determined for the level of competence of an officeholder in the field of finance, his experience in the field of finance and his managerial experience as its meaning in sections 16a(2)(a)-16a(2)(a)(c) of the Government Companies Law. Additionally, pursuant to the circular, the most senior officeholder in the field of finance in a government company will only be appointed according to a procedure which was approved in writing by the Government Companies Authority.

On June 9, 2014, the Government Companies Authority published an updated circular regarding the appointment of senior employees, salary and employment terms of CEOs and senior employees, which is replacing the 2010-01 circular regarding salary of CEOs and senior employees. The circular applies to an active chairman, CEO and/or senior officers in a government company or government subsidiary as they are defined in the Companies Government Law ("Senior"). The procedure aims to regulate additional pursuit of a senior, in accordance with the intent which is at the basis of the restrictions regarding additional pursuit by seniors in the public service. The permit granted to a senior limits the lists of permitted pursuits and the employment permit is conditional on written approval by the legal advisor of the company and approval of the Board of Directors of the company. The circular restricts the permitted remuneration, and allows only one additional pursuit with payment.

#### 21.4.17 Provisions with respect to the employment of relatives

The Government Companies Regulations (Rules on Employment of Relatives) 2005 (in this section: "**the Regulations**") prescribe rules and procedures with respect to the employment of relatives (as defined in the Regulations) of workers employed in government companies.

In accordance with the Regulations, a government company shall not hire a person if a relative thereof works in the same company

- (1) and is employed in a senior position as its meaning in the law or in a position ranked as one of the six highest salary ranks of the company in each salary scale customary in the company;
- (2) when the position offered him is a senior position as its meaning in the law or a position ranked as one of the six highest salary ranks of the company in each salary scale customary in the company;
- (3) and the rate of relatives employed in the company exceeds 5% of the total company employees.

Notwithstanding, it is prescribed in the Regulations that the company may employ a person who is the most suitable candidate for the position and the conditions as set forth in the Regulations are fulfilled, including the selection of the candidate in a public, equal and competitive process and the Chief Executive Officer and legal adviser of the Company have confirmed the propriety of the public proceeding and the grounds for selection and reporting thereof have been given to the Board of Directors.

As a rule, despite that which has been set forth above, no employee shall be employed at a government company if the employment may lead to subordination relations or employment relations between him and the relative of that employee in the company which employment may cause concern of conflict of interests. In a large government company, such as the Company, an exceptions committee in the company (as defined in the Regulations) may give an argued permit for the employment of relatives who fulfill that which has been set forth above, considering the factors set forth in the Regulations, as long as it is satisfied that this employment does not infringe the ethics and propriety of the activity of the company and it is allowed to set forth conditions for their employment or the employment of one of the employees to avoid subordination relations, work relations and conflict of interests, without voiding the positions of the employees.

It has further been stated that the company must indicate in its financial statement to the Government Companies Authority the number of relatives hired in the previous year and their functions, their relation to employees and their function. In addition it must state the total number of relatives employed in the company.

The Government Companies Regulations (Rules on Employment of Relatives) (Amendment) - 2008 determine that family ties will be, working together for the purpose of making decisions, providing a recommendation,

setting procedures and executing an assignment or a project, as well as family relations with officeholders in the manpower division, comptroller's unit, internal audit, discipline unit or employees' union.

The Government Companies Regulations (Rules on Employment of Relatives) (Amendment) - 2014 determine that a cousin (the son of an aunt or uncle, and the daughter of an aunt or uncle) will be defined as a relative in all that concerns the duty to report. It is also determined that in a company where, according to the determination of the Authority, the information on employing relatives pursuant to the regulations is not complete, the Audit Committee of the Board of Directors will approve the integrity of the public process and the reasons for the selection, and will report this to the Board of Directors of the Company. It is also determined that in a company where the number of employed relatives exceeds 5% of all the company employees, the Audit Committee of the Board of Directors will confirm that the nominee selected has special qualifications compared to the other nominees in the selection process for filling his position in the company, and will also confirm the integrity of the public process and submit a report on this to the Board of Directors of the Company. In a company where the number of relatives exceeds 10%, the Board of Directors will also approve the above mentioned.

#### **Adequate representation for sectors**

As a government company, the Company is subject to instructions with respect to adequate representation for various sectors among its employees, in accordance with the circumstances of the matter, such as, for example, the representation of persons with handicaps in accordance with the Equal Rights for Persons with Handicaps Law - 1998, the representation of women in accordance with the Equal Rights for Women Law 1951 and the representation of a persons who were born, or who had at least one parent born, in Ethiopia, or is a member of the Druze community in accordance with the Government Companies Law.

Furthermore, directive 1.1503 of the Attorney General, headed "Adequate representation for certain sectors", reviews the relevant provisions of the law regarding adequate representation of certain sectors, inter alia, in government companies. The directive deals with issues as follows: (1) representation of women - including the extent of the duty to actively locate nominees; (2) representation of the Arab population (including Druze and Circassians); (3) representation of persons with handicaps, and (4) representation of the Druze population and members of the Ethiopian community among employees of government companies, public corporations and local authorities. As of the date of the report, the Company is fulfilling the aforesaid provisions of the law and conducts a proactive policy in the issue of diversified employment and providing affirmative action to groups specified in sections (1) and (4) above, while setting qualitative and quantitative objectives within the five year plan which was approved by the Board of Directors.

Additionally, a circular dealing with the issue of salary and terms of employment of June 17, 2014, instructs the Board of Directors of the Company to conduct a discussion on the issue of the Company's policy for employing persons with handicaps. As part of the discussion, the management of the company will present objectives in the issue for approval by the Board of Directors, and the Board of Directors will instruct the management to act to fulfill the objectives which were determined. The decisions of the Board of Directors regarding this issue will be delivered to the Government Companies Authority together with data regarding the current situation in the company pertaining to employment of persons with handicaps: the number of company employees who are persons with handicaps in the company (namelessly) and their rank in the company. Once a year, the issue of adequate representation of persons with handicaps will be on the agenda of the meeting of the Board of Directors of the Company and the issues appearing in this circular will be discussed in that meeting, regarding what has been done in the company in the passing year and what is planned for the coming year. Every company is requested to hold a discussion with the Commission for Equal Opportunities in order to determine a recommended employment goal which is suitable for that company.

On October 5, 2014, an extension order to the provisions of a general collective agreement issued by the Minister of Economics was published in the Official Gazette, signed between the Presidency of the Business Organizations and the New National Labor Federation on June 25, 2014, regarding "Encouraging and Increasing Employment of Persons with Disabilities". According to the provisions of the Extension Order (which applies to every employer who employs 100 employees or more), "adequate representation for persons with disabilities"

will be - at the end of the first year of validity of the Extension Order - a rate of 2% from among the employees, and at the end of the second year - an employer of which 3% or more of his employees are persons with disabilities will be considered an entity with adequate representation.

On October 1, 2015, the monitoring committee appointed for implementation of the collective agreement, published operational provisions regarding its implementation. The provisions include details as to the definition of "person with a disability" regarding the implementation of the collective agreement, as well as details of steps that an employer who takes them, regarding available or new positions, will be regarded as acting in good faith to promote adequate representation, even if he does not meet the quota set in the collective agreement. In addition to the continued intake of employees with disabilities into the Electric Company, the steps set in the decision of the monitoring committee with respect to the manning procedures of new or available positions have also been assimilated in the Company.

#### 21.4.18 Receipt of information from a government company

##### (A) Information to the Companies Authority

In accordance with Section 55 of the Government Companies Law, the Government Companies Authority is allowed, for the purpose of the discharge of its duty, to demand of a government company or involved company<sup>80</sup>, 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.

In accordance with the Government Company Regulations (Rules of Authorization of an Inspector by the Authority), 2005, if the Government 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 has used these powers with respect to the Company in 2008 and 2009. For additional details see Note 39e to the Financial Statements. Additionally, as was reported to the Company, in June, 2014, an accountant firm was appointed to execute a factual examination pertaining to negotiations to grant remuneration to employees relating to the Company's entry into operation in the field of communications. The final report of this examination has not yet been submitted.

##### (B) Information to the general public

The Freedom of Information Law 1998 ("the Freedom of Information Law") applies to a public authority, including a government company and a government subsidiary, except companies that have been excluded from the effect of the Freedom of Information Law in full or in part, as determined by the Minister of Justice with the approval of the Knesset Constitution, Law and Justice Committee.

The Freedom of Information Law states that any Israeli citizen or resident is granted a right to receive information from a public authority, in accordance with the Freedom of Information Law.

In accordance with the provisions of the Freedom of Information Law, the Company is allowed to reject a request to receive information in certain circumstances, and not provide information when there is concern that such information would harm the security of the state, its foreign relations or public security, or the security or safety of a person, with respect to any information on a subject that the Minister of Defense has prescribed in an order or whose disclosure invades privacy (as per its definition in the Privacy Protection Law 1981) and any information that must not be disclosed by law.

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<sup>80</sup> As long as more than one quarter of the voting power in the general meeting or the right to appoint more than a quarter (1/4) of its number of directors lies with the State.



In addition, in accordance with the Freedom of Information Law, the Company is allowed not to disclose information in certain cases, *inter alia* information that may disrupt its normative functioning, information about policy in stages of formation or about details of negotiations with an entity or person outside the Company, information about the internal management of the Company that has no bearing on the public, information that is a commercial secret or a professional secret or that has economic value whose publication may cause genuine damage to its value, and is allowed not to disclose information in additional circumstances as prescribed in the Freedom of Information Law.

In September 2010 the Freedom of Information Regulations (Disclosure of Information on Environmental Protection for Public Inspection) 2009 took effect, whereby it was prescribed that a public authority must disclose for public inspection information that originates from a report or gathering of information with respect to a substance, odor or radiation that has been measured or emitted into the air, into the soil, into the sea or into water and that is of a type that may cause an environmental hazard, in ways and at times that have been prescribed in these regulations. From time to time, the Company updates information as stated on the Company's website.

## **21.5 Laws, regulations and other orders applying to the Company as a government company**

### **21.5.1 The Budget Foundations Law - 1985**

A government company is considered to be a "budgeted body" as this term is defined in the Budget Foundations Law, and therefore a number of instructions apply to the Company, the main ones being as follows:

- (1) In accordance with the provisions of Section 29 of the Budget Foundations Law, the Company cannot consent to changes in wages, retirement or pension conditions, or other financial benefits that are related to work, or enact such changes or benefits, other than in accordance with the agreement or custom with respect to all civil servants or with the approval of the Minister of Finance.
- (2) Notwithstanding that which has been set forth above in any law, any agreement or arrangement is void if it contravenes the provisions of Section 29 of the Budget Foundations Law. If the Minister of Finance deems a budgeted body to have failed to fulfill the provisions of Section 29 of the Budget Foundations Law, he is allowed to deduct an amount that is equal to the amount that has been paid due to this from the amounts that must be transferred to that body from the state budget by law, and he is allowed to terminate or reduce any bonus or participation that the body would have received from the Government were it not for the deviation, as long as the body is making payments in contravention of the provisions of this section.
- (3) The Company as a budgeted body must provide the Director General of the Ministry of Finance, upon his demand, any information that is needed for the purposes of tracking the execution of the Budget Foundations Law or annual budget law.
- (4) The Company as a budgeted body must deliver to the Commissioner of Wages and Employment Agreements at the Ministry of Finance, once a year, information, at a time and in the manner prescribed in the Regulations.

In 2011, a disciplinary tribunal started to operate for the first time to try civil servants and employees of budgeted and supported bodies. This tribunal was founded pursuant to the Budget Foundations Law. Among other persons, an employee of a budgeted body who has committed disciplinary offenses in accordance with this law and whoever at the time of the execution of the offenses was a Chief Executive Officer, Accountant, Treasurer, Bookkeeper or officer of the budgeted body responsible for that field, may be tried before the tribunal, if he has not proved one of the following: (1) the offense was committed without his knowledge; (2) he took reasonable measures to ensure the prevention of the offense.

### **21.5.2 The Equal Rights for Women Law - 1951**

In accordance with this law, adequate representation is to be given, in the circumstances of the matter, in a public body that includes a government company, to the representation of women (including in the tender and appointment committees of a public body). The Company has appointed a commissioner for promotion of the

status of women and the representative of the commissioner for promotion of the status of women participates as a member in all the tender committees for positions from the level of department head upwards. In tenders for positions at lower levels, the representative of the commissioner as stated participates if there are female nominees for the position. Additionally, provisions have been determined for adequate representation for women in company procedures dealing with employee hiring, screening and promotion.

#### 21.5.3 **Resolution of conflicts between the Company and the State**

In accordance with Directive 6.1201 of the Attorney General, no civil action shall be filed by the State of Israel against a government company until after receipt of the approval of the following: the Attorney General, the State of Israel Attorney, the Assistant State Attorney or the Director of the Civil Department in the State of Israel Attorney's Office. Initially an attempt at conflict resolution shall be conducted by way of negotiation, mediation, giving of an expert legal opinion or otherwise, and if the conflict is not resolved within a reasonable time, the Attorney General will decide as to the next steps.

Directive 6.1202 of the Attorney General indicates a course of action whereby litigation in Court must be avoided to the extent possible for legal conflict resolution on civil affairs between a government company and the State or a corporation founded by law or another government company, and a government company should make every effort to resolve such a conflict other than by filing an action to the Court. In accordance with the directive, a government company that has not succeeded in resolving the conflict in another way, and which requests to file a suit, shall announce this to the Director General of the Government Companies Authority, who will act to settle the conflict out of court in the ways set forth in the directive. To the extent that the conflict is not settled in a reasonable time, the Director General of the Government Companies Authority shall refer the conflict for handling by the Attorney General or the party determined by him for that purpose. If the conflict is not resolved within a reasonable time, the Attorney General shall express his opinion before the parties on how to act subsequently. If the circumstances oblige an urgent application to the court so as not to miss a date set in law or to prevent a change of situation or other serious damage, an effort will be made to extend the date or prevent the damage, as the case may be. And if it appears that it is not possible, it will be possible to apply to the court as required under the circumstances, and to immediately afterwards take steps to settle the dispute as detailed above.

#### 21.5.4 **Resolution of conflicts between government companies on infrastructure matters**

Chapter H3 of the Government Companies Law, which applies to the Company as an infrastructure company that is listed in the First Addendum, addresses the resolution of conflicts between government companies on matters of infrastructure. The provisions of Chapter H3 state that in conflicts between government companies on matters of infrastructure, including conflicts on coordination with respect to infrastructure works, delivering the information required for planning infrastructure or executing infrastructure works, the scope of infrastructure works, the schedules for the execution of infrastructure works, the payment required for the execution of infrastructure works, coordination with respect to passing through land held by an infrastructure company and other conflicts that delay or could delay infrastructure works, a conflict resolution committee (hereinafter: "**Conflict Resolution Committee**") that will be established for this purpose will hand down a ruling. Subject to the provisions of Chapter H 3 of the Government Companies Law, the Conflict Resolution Committee will have the exclusive authority to hear and rule on such a conflict, unless it has decided not to rule on the conflict.

The Conflict Resolution Committee is allowed to present a compromise to which all parties to a conflict have agreed the effect of a final decree. A final decree of the Conflict Resolution Committee is like a ruling by the court and may be appealed by a question of law only to the Court for Administrative Affairs, if approval was granted for this by a judge of the Court for Administrative Affairs. A final decree of the Conflict Resolution Committee for which no leave to appeal has been filed within the time set for that purpose or for which no leave to appeal has been received shall be considered as a final verdict of a court.

As of the date of the report and to the best of the Company's knowledge, no such Conflict Resolution Committee has been founded.

#### 21.5.5 **The State Comptroller Law**

The State Comptroller Law - 1958 [Consolidated Version] (hereafter: the “**State Comptroller Law**”) subjects any “audited entity” (as per its definition in the State Comptroller Law), and states, *inter alia*, that: any government company is an audited body that will be subject to the scrutiny of the State Comptroller; an audited body is subject to various instructions to serve documents and information and assumes a duty to appoint a team to rectify the deficiencies and make resolutions found in an audit; by law, a person may file a complaint to the Public Ombudsman against an audited body and the Ombudsman may, in the case of finding the complaint to be justified, indicate the need to correct the deficiency and the way and time to do so.

##### **Reports of the State Comptroller:**

On September 9, 2015, the State Comptroller’s Report on the issue of preparation and readiness for state of emergency was published, including a chapter regarding “Preparing the electricity grid for state of emergency”. The Company established a team headed by the CEO to prepare a plan to rectify deficiencies that were raised in the report. The plan was approved by the Board of Directors of the Company and sent to the Government Companies Authority and the Office of the State Comptroller.

On October 28, 2015, the Annual State Comptroller’s Report no. 66a was published, in the matter of “Aspects in the activity of the electricity sector”. The report audits the operation of several entities and authorities in the electricity sector, including the Electric Company. Regarding the Electric Company, the report mainly relates to the following aspects and deficiencies: failure to implement streamlining plans in the Company; increase in the number of senior officials; lack of adequate supervision and control of the process of granting tenure by the Board of Directors; lack of reports according to profit centers and improving efficiency at work, and controlling it. The Company established a team headed by the CEO which is working to prepare a plan to rectify deficiencies, as required by the legislative arrangement. As appears from the audit report itself, realizing some of the components of the plan being formulated is contingent on the cooperation of the regulating entities and formulating consent with the employees’ representatives. The plan was approved by the Board of Directors and sent to the Government Companies Authority and the Office of the State Comptroller.

#### 21.5.6 **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 is in contact with the State Comptroller on this matter.

#### 21.5.7 **Tender Law**

The Obligation for Tenders Law – 1992 (“**the Obligation for Tenders Law**”) states that the State, any government corporation, religious council, health fund and institute of higher education 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. Regarding this issue, “Government Corporation” was defined as “Government Company, Government Subsidiary, or Corporation established by law”.

The Obligation for Tenders Regulations - 1993 (“**Obligation for Tenders Regulations**”) determine provisions regarding tender proceedings and circumstances under which a contractual engagement can be exempted from holding a tender.

Alongside the general provisions of the Obligation for Tenders Regulations, which apply to all the entities on whom the Obligation for Tenders Law applies, Chapter E of the Obligation for Tenders Regulations was enacted, which is a special chapter dealing with contractual engagements of a government company and a government subsidiary. This chapter applies special obligations and provisions on the government companies and government subsidiaries (alongside the general provisions).

In addition to the aforesaid, the Obligation for Tenders Regulations (Preference for Israeli Produce) - 1995, and the Obligation for Tenders Regulations (Obligation for Industrial Cooperation) - 2007, apply to the Company.

In addition to the Tenders Law and the Regulations promulgated under it, the provisions of the Government Procurement Agreement apply to the Company. The Obligation for Tenders Law and the Regulations promulgated under it determine that the provisions determined pursuant to the law will apply insofar as they are not contradictory to an obligation by the State in an international treaty<sup>81</sup>.

#### **21.5.8 Internal Audit Law**

The Internal Audit Law - 1992 ("**Internal Audit Law**") applies, inter alia, on an audited body as its meaning in section 5(9) of the State Comptroller Law. Pursuant to the Internal Audit Law, an internal audit will be executed in every public body by an internal auditor. For details of the appointment of an internal auditor pursuant to the Government Companies Law see section 21.5.15(b).

#### **21.6 Quality control and quality assurance**

21.6.1 Quality control - Within the organization, quality and safety branch of the Company, there is a quality control sector, whose functions are as follows: conducting quality control of products that are purchased by the Company including: preparation of quality requirements in the product specifications that are attached to the purchase requirements; examining the suitability of the product to the requirements at the manufacturing stages of the product until its receipt at the Company; participation in the processing of products in which a failure has occurred during the warranty period.

21.6.2 Quality assurance - the units of the Company are certified under management system standards (quality, environment, occupational safety and health, safety and quality of land transportation and traffic array, and information security). The certification for the aforesaid standards is voluntary and is not required by law. In addition, some of the laboratories of the Company are authorized and some of the laboratories of the Company are required to be authorized by law or for the legal recognition of the correctness of the results arrived at by measurements carried out at premises of customers of the Company. Some of the laboratories of the Company are required to be authorized to be certified to a certain ISO standard by law or for legal recognition of the correctness of the results arrived by measurements carried out at premises of customers of the Company.

#### **21.7 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 in the past as required by law, the Company acts before the relevant authorities to receive permits for working by law. Working without a permit exposes the Company to criminal proceedings against it and against its executives,

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<sup>81</sup> The Government Procurement Agreement (GPA) regulates the access to the government purchase tenders among the countries that signed it. The agreement entered into effect in January 1996. It is unique in that in spite of it constituting part of the agreements of the World Trade Organization (WTO), it is only binding for the countries that signed it (a plurilateral agreement).

as well as a demand for demolition of the illegal construction, in accordance with the Planning and Construction Law and its proceedings.

In accordance with the provisions of the National Planning and Construction Council, for the purpose of construction of 400 kV lines, national outline plans are required. The preparation of the outline plans, as well as the procedural processes for their approval, are carried out in accordance with the provisions of the Planning and Construction Law.

In accordance with the Planning and Construction Law, a land rights holder is allowed to submit against the local committee to whose jurisdiction an outline plan applies a claim for compensation for decrease in value of the land, not by way of expropriation, as a result of the approval of the plan. For certain outline plans, the Company has undertaken to indemnify the local committees in whose jurisdiction these plans apply to the full amounts that the committees would have to pay to the affected landowners, subject to and in accordance with the provisions in the text of the indemnification statement (except one plan in which the burden of compensation will be shared among the institutional bodies involved in the plan). Appeals have been submitted against the local committees to the relevant appellate committees that deal with decrease in value. In accordance with the provisions of the indemnification statements, the Company was enrolled in the appeals as a party that might be harmed by their acceptance (see also Note 35B 8 to the Annual Financial Statements). In the statements of indemnification themselves, or in the indemnification clauses in the plan, no amounts are indicated, but rather the indemnification is 100% or another rate out of the amount of the appeal that has been filed against the local committee. The total claims are stipulated in the Financial Statements and are updated from time to time. For additional details with respect to planning and construction see sections 7.12.8 and Note 35.b.8 to the Financial Statements.

## **21.8 Business licensing**

- 21.8.1 In accordance with the Business Licensing Law, the Company is required to receive a business license for about 210 licensable items out of those stipulated in the Business Licensing Order, including, *inter alia*, power stations, fuel stations, dining rooms and other sites. The operation of the sites of the Company without a business license constitutes a violation of the Business Licensing Law and may lead to the termination of the activity of the business. As of the date of the report, most generation units in the generation segment themselves have business licenses, which are updated or renewed from time to time.
- 21.8.2 As of the date of the report, the Company has a license for about 48% of these items only and applications have been prepared or submitted for about 51% of the total items, and handling has not yet begun for approximately 1%. The Company is acting to regulate a business license for items that require a business license at the sites and facilities of the Company, in accordance with the Business Licensing Law and pursuant to an internal procedure of the Company on the issue. Regulation of the issue of licensing requires compliance with the requirements of the fire brigade, in accordance with the most current standards, whose cost for regulation in 2016 may reach approximately NIS 24 million for each of the sites (most of the works with respect to firefighting). From time to time the Company receives warnings for activity without business licensing and in the past indictments have even been filed against the Company and its employees. As of the date of the report, there are no indictments against the Company. A few warnings that were received by the Company are being dealt with at present in order to remove them.
- 21.8.3 The Company has received conditions from the Ministry of Environmental Protection for granting a business license for the generation units of the Company, and the Company is acting to fulfill the conditions of the Ministry as part of fulfilling the conditions of the business licenses.

See Sections 7.12, 8.8 and 9.10 with respect to environmental conditions within business licenses.

For additional details with respect to business licensing see sections 7.12.11, 7.12.12 and 20.3.

## **21.9 Antitrust**

Pursuant to his authority under the Antitrust Law 1988 (“**the Antitrust Law**”), on January 5, 1999, the Antitrust Commissioner (“**the Commissioner**”) declared the Company to have a monopoly in the fields of electricity supply

(generation and sale of electricity), electricity transmission and distribution and provision of Backup Services for electricity consumers and producers. The status of the Company as a monopoly derives from the definition of "monopoly" under the Antitrust law and it is therefore valid as long as the Company holds more than half of the electricity supply and service provision in the stated fields.

- 21.9.1 The statutory tools prescribed in the Antitrust Law grant the Commissioner, *inter alia*, the power to apply to the antitrust tribunal and request to instruct a monopoly to sell an asset it holds in order to prevent damage or concern of significant damage to business competition or to the public, the authority to intervene in the operations of the Company that may harm the public or impair competition, by giving instructions to the Company on the steps that it must take to prevent such harm and, starting in May 2012, the authority to impose financial penalties in a maximum amount of NIS 24 million with respect to competition inhibiting activities, such as abuse of a monopoly status. With respect to activities such as this, there already exists at present a criminal offense in the Antitrust Law. In addition, the law grants the Commissioner the authority to apply to the Antitrust Tribunal ("**the Tribunal**") with a request to separate the monopoly into two or more separate business corporations, upon the existence of the circumstances set in the law.
- 21.9.2 On May 4, 1999, the Company filed an appeal with the Tribunal against the decision of the Commissioner with respect to the declaration, following which the Company reached (on March 19, 2001) an agreement with the Commissioner, which received the validity of a verdict, as follows:
- (A) The Company has a monopoly in the Electricity Sector, which includes, *inter alia*, the following components: supply of electricity – generation and sale of electricity, transmission and distribution of electricity, provision of Backup Services to electricity consumers and producers.
  - (B) The provisions of Chapter D to the Antitrust Law (on monopoly issues) apply to the Company as a monopoly holder, both in the Electricity Sector altogether and with respect to each of its segments, in accordance with that which has been set forth in Section A above.

Taking into account the declaration for the Company as a monopoly, the clauses preventing private electricity producers from selling electricity to others were not included in agreements of the Company with electricity producers.

On December 8, 2015, the Company applied to the General Director of the Antitrust Authority, requesting to cancel the declaration of the Company as a monopoly and alternatively that the declaration of the Company as a monopoly will be changed and minimized, such that it will be clarified that it does not apply on sale of electricity to big electricity consumers (of high and ultra high voltage). Following the Company's application, and further correspondence, a meeting was held between the Company and the General Director of the Antitrust Authority regarding this issue. As of the date of publication of the report, the decision of the Antitrust Authority in this matter has not yet been received.

Through the date of publication of this report, the declaration of the Company as a monopoly had no material effect over the activity, profitability or financial state of the Company. Notwithstanding, the Company cannot estimate the future implications of the aforesaid declaration on the Company's activity, its profitability and financial position, although it is possible that there will be material implications, taking into account, *inter alia*, the existing level of control over the Company, on the part of the Electricity Authority and other authorities, and in view of the Structural Changes that are required pursuant to the provisions of the Electricity Sector Law insofar as will be implemented as it is (see Note 1 e to the Financial Statements), including the incorporation of generation units within separate subsidiaries, and in light of the hearing held by the Commissioner regarding the letter of the Antitrust Authority (see section 7.1.3).

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.

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. After the Company submitted its position to the General Director of the Antitrust Authority, within which the Company presented legal and economic arguments against granting an instruction as aforesaid, on October 12, 2015, the Company was notified in a letter received from the Antitrust Authority that after weighing all the data and relevant circumstances, the General Director decided not to impose the detailed restrictions on the Company.

In March 2015, the Antitrust Authority began an examination of the Company's conduct with business customers of private suppliers, due to complaints received with respect to discrimination of these customers. On February 2, 2016, the Company received a letter from the Antitrust Authority, headed "Hearing prior to determination regarding abuse of monopoly status and notice of intention to fine". According to the claims in the letter, the Company abused its status as a monopoly and harmed the service received by big business customers who transferred to purchase electricity from private electricity producers, by halting the service of customer portfolio managers which was provided to these customers before the transition to private electricity producers.

In the aforesaid letter, the General Director announced he is considering using the authority vested in him by the Antitrust Law, and to determine that the Electric Company abused its status as a monopoly in transmission of electricity and its distribution, and to impose a fine on the Company in the amount of NIS 13 million, with respect to the alleged violations of the Antitrust Law.

It was further written that the General Director is considering imposing a fine on several present and past senior officials of the Company.

The Company is studying the details of the letter, and intends to use the right to be heard granted to it, and respond to the claims arising from this letter in accordance with the provisions of the law.

For details regarding the notice received by the Company from the Antitrust Authority, concerning the gas nomination beyond the quantities required by the Company to generate electricity in practice in its facilities, see section 7.9.9.2(f).

#### **21.10 Law for Promoting Competition and Reducing Centralization**

On December 11, 2013, the Law of Centralization was published. Chapter B of the law deals with weighing pan-economy centralization considerations and sectorial competition considerations when allocating rights. Within the law, a "committee for reducing centralization" was appointed, and its members are the General Director of the Antitrust Authority (as Chairman of the Committee), the Director General of the Ministry of Finance or head of division of the Ministry of Finance who fills a position of Head of the Economic Division (if the Minister of Finance appointed him as member of the committee) and the head of the National Council of Economics which operates pursuant to the Government's decision or one of his deputies (if the Prime Minister appointed him as a member of the committee).

The Law of Centralization may have a principal significance for the Company in light of the fact that the Committee determined in light of the law that the Company is a centralistic factor, as defined in the Law of Centralization, due to it being a significant real corporation under the definition in section 4 of the law, and

because the scope of its accumulated activity in an area of essential infrastructure (as this term is defined by law), exceeds half of the total activity in that field.

The definition of the Company as a centralistic power may affect the Company as detailed below:

- 21.10.1 Allocation of rights, as well as renewal or extension of rights granted to the Company - according to the provisions of the Law of Centralization, every factor authorized to allocate, renew or extend a right (right meaning license, contract or holding of a significant rate as defined by law) in a field of essential infrastructure should consider pan-economy centralization considerations when allocating the right. The allocating regulator is permitted not to allocate it to a centralistic factor. If it wishes to allocate it to a centralistic factor or to enable a centralistic factor to participate in the process of allocation, it must first consult with the committee for reducing centralization. Additionally, Part C of Chapter B of the Law of Centralization requires the regulator to consider considerations of promoting sectorial competition when allocating certain rights. In addition, if the allocated right will be included in a list published by the Commissioner of the Antitrust Authority, he will have to consult with him prior to the allocation. Regarding Part C the definition of "right" includes in addition to the aforesaid a license in a field of activity that is not an essential infrastructure if the number of operators in that field is inherently limited.
- 21.10.2 Extending the Company's operation to an additional essential infrastructure field by process under the Government Companies law - the Law of Centralization requires to weigh pan-economy centralization considerations when reaching a Government resolution that enables a Government Company that is a centralistic factor to operate in an additional essential infrastructure field. Under the law, the Government Companies Authority has to consult with the committee for reducing centralization prior to formulating its opinion for the Government in this manner.

Furthermore, since the Company is a Government Company, the Law of Centralization affects the Company as detailed below:

- 21.10.3 Allocation of an essential infrastructure right by the Company - according to the Law of Centralization, insofar as a Government Company wishes to enter an agreement with a third party for executing an activity that is one of the essential infrastructure fields, this is a process of allocating a right by the Company. In this situation, the tender committee of the Government Company, as an allocating factor, must weigh pan-economy centralization considerations in the process of allocation. Accordingly, the Government Company is permitted not to allocate the right to a centralistic factor. If the Government Company wishes to allocate the right to a centralistic factor, it must first consult with the committee for reducing centralization. Additionally, under Part C of Chapter B of the Law of Centralization, in addition to any other consideration the tender committee has to consider by law pertaining to the allocation, it will be required to consider considerations of promoting sectorial competition when allocating those rights. In addition, if the allocated right will be included in a list published by the Commissioner of the Antitrust Authority, it will have to consult with him prior to the allocation.
- 21.10.4 Extending the validity of a right - pursuant to Part D of Chapter B of the Centralization Law, the same law which applies to the extension of validity of a right applies to the allocation of a right and the provisions of Part B or Part C of Chapter b of the Centralization Law will apply to it, as the case may be, upon fulfillment of the following: (a) the holder of the right regarding which an extension of validity is requested is holding it for a period exceeding ten years, whether set by a single allocation or accumulated in several allocations; and (b) the allocation of the right or a previous extension of its validity were not examined pursuant to the provisions of Chapter B of the Centralization Law during the ten years preceding the requested extension of validity. During a hearing of the extension of validity of the right, the Tender Committee of the Company will be required to consider, among the gamut of considerations, the characteristics of the proceeding to extend the validity of the stated right and its circumstances.
- 21.10.5 Privatization of a Government Company - when formulating a decision to privatize a Government Company (as defined in section 1 of the Government Companies Law), the Government Companies Authority will consult with the committee for reducing centralization before formulating its opinion or a memorandum on its behalf, under section 59B of the Government Companies Law, regarding the possibility of allocating rights in a Government Company to a centralistic factor and regarding the terms for this, and regarding the definition of the centralization considerations as an essential interest. In addition, under Part C of Chapter B of the Law of



Centralization, as part of the stated opinion, the Government Companies Authority will consider considerations of promoting the sectorial competition. In addition, if the allocated right will be included in a list published by the Commissioner of the Antitrust Authority, it will have to consult with him prior to the allocation.

## **22. Material agreements**

The agreements that have been described below are material agreements that are outside of the ordinary course of business of the Company that are not elaborated in other sections in this chapter.

### **22.1 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 34 b (1)c) to the Financial Statements.

### **22.2 State guarantee for debentures (Series 25) and for loan agreements of the Company**

Between 2011 and 2012, significant disruptions occurred in the supply of natural gas to the Company, which led to a significant surcharge to the costs of fuels required in the production of electricity, and a very material cash flow burden on the Company. In light of the above mentioned, in 2012-2013 the Company entered a contractual engagement with the State of Israel in a number of agreements to provide guarantee, according to which the State of Israel provided the Company with guarantees for debentures raised by the Company and for loans taken by the Company from banking corporations, whose total principal amount that has not yet been repaid is NIS 5.5 billion. The engagement of the Company with the State in agreements to provide guarantee were approved by the audit committee and the Board of Directors of the Company in accordance with the provisions of Section 275 of the Companies Law and Regulation 1(6) of the Companies Regulations (Exemptions in Transactions with Interested Parties), 2000.

The stated guarantee agreements include provisions with respect to the State's entitlement to receive information from the Company, the approvals that need to be obtained from the State for making changes to the terms of the debentures (or of the loan agreements – as appropriate) and the guarantee provision fees that are payable to the State by the Company for the provision of the guarantee.

Furthermore, the Guarantee Agreements stipulate that, if the guarantee is forfeited, in whole or in part, or a payment is made by the State in lieu of the Company to the holders of the debentures (or, as appropriate, to the lenders), the amount of the guarantee forfeited as above and/or the amount paid by the State shall be deemed as a loan that has been extended to the Company by the State on the date of forfeiture of the guarantee or of the payment of such amount. Such loan shall be repaid by the Company to the State with the addition of interest, as set out in each of the Guarantee Agreements.

To secure the repayment of the Company's liabilities to the State in the event of the forfeiture of a guarantee or payment by the State in lieu of the forfeiture of a guarantee, under any of the Guarantee Agreements, the Company has registered, in respect of each of the Guarantee Agreements, a floating charge in favor of the State on all of the Company's assets, ranking *pari passu* to the registered pledges that existed on the date of registration of the aforesaid charge, in accordance with the debenture that was issued by the Company.

### 23. Legal proceedings – pending actions

A breakdown of material legal proceedings<sup>82</sup> that the Company is a party to, as of the time of the report:

#### 23.1 Class actions

See Note 35 B to the Financial Statements for information on class actions.

#### 23.2 Derived actions

See Note 35 B to the Financial Statements for information on derived actions.

#### 23.3 Pending proceedings

Pending proceedings that are not stated in Note 35 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

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<sup>82</sup> This section includes legal proceedings that are class actions and pecuniary actions in an amount in excess of NIS 100 million.

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).

In order to exhaust the negotiations held between the parties as stated, the parties submitted requests to postpone the pretrial hearing date of the case (that was set, as stated, to November 10, 2013). These requests were accepted and the pretrial hearing is scheduled for May 4, 2014. This hearing did not take place and it was postponed by agreement between the parties. A new date has not been scheduled.

It should be noted that within a united claim submitted against the Municipal Council for the same cause of action, some lessees filed with the District Court an application for stay of proceedings of the eviction claims that were filed against them by the Municipal Council with the Magistrate's Court of Tel Aviv - Jaffa.

On October 15, 2013, the Court's decision was given, denying the application for stay of proceedings because, inter alia, the Court was of the opinion that a situation in which lessees use land without paying lease fees to the Municipal Council should not be enabled, and since the interim arrangement proposed by the Municipal Council is a correct and just arrangement for clarifying the issue. An application for leave to appeal the decision that was filed with the Supreme Court was also denied. As of today a new date for a hearing in court has not been set and the Court has referred the parties to formulate an arrangement between them. During this period and until formulation of an arrangement or other decision, the Company is promoting the signing of the interim arrangement documents with respect to each asset of the four assets.

- (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.

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.

Regarding the financial disputes between the parties, an agreement in principle (compromise agreement version) was reached and signed between the Company and IGL, which still requires the State's approval.

For further details, including with regard to the advanced negotiations between the parties in order to solve the disagreement between them and the sums that are meant to be paid to the Company, insofar as these negotiations will come to fruition, see Note 34(B) to the Financial Statements.

- (C) On December 14, 2000, District Outline Plan/3/6/A, dealing with route regulation was published for validation, covering the route through which electricity lines, a railway and Highway 431 will jointly pass. The infrastructure route is south of Rishon le Zion near an existing road. Within its instructions the plan established a mechanism for dividing the burden of compensation that will be set (if set) for it. The mechanism stated that out of the total compensation that is set, the local committee would bear 30% while the rest of the compensation amounts (70%) would be borne by the three utility bodies (Israel Roads, Israel Railways and the Company) in a division that will be determined by the compensation committee headed by the Chief Government Appraiser or a person appointed thereby.

With respect to the approval of the plan, many claims were filed with respect to it pursuant to Section 197 of the Planning and Construction Law, and once these were rejected by the local committee, appeals were filed to the Central District Appellate Committee. In accordance with the decision of the Appellate

Committee, the appeals were transferred for hearing before a deliberating appraiser, setting guiding principles for her appraisal in the process. In May 2011 the final appraisals were received. The total compensation that the decreeing appraiser awarded stands at approximately sixty two (62) million new Israeli shekels as of the effective date. This amount also includes compensation for ground that was expropriated by Israel Roads and Israel Railways, and therefore the expropriation compensation is to be deducted for it (so that no double compensation is given).

Until an agreement is reached between all entrepreneurs of the plan with respect to the allocation of the payments among the parties, Israel Roads, Israel Railways and the Company negotiated a temporary outline for dividing the compensation amount, which has been formalized in an agreement that was signed on May 5, 2012 in accordance with which: out of the total compensation, the amounts due to be paid by the local committee (30%) are to be subtracted. From the balance, the expropriation compensation money that was paid to the appellants, is to be subtracted. The balance 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, the proceeding held in the Court for Administrative Affairs have ended, summaries have been submitted, and the parties are awaiting the ruling of the Court.

- (D) On December 29, 2013, the Company submitted a claim to the District Court of the Center District against the following foreign companies: Alstom grid AG, Alstom Societe Anonyme, ABB Ltd., Siemens AG and Alstom Grid SAS (together: the “**Cartel Companies**”), who supplied GIS arrays to the Company (gas insulated voltage arrays).

The claim is based on the determination of the General Director of the Antitrust Authority of September 16, 2013, which exposed that the global cartel that was occurring in the GIS array market during 1988-2004 was also implemented by the cartel companies in Israel towards the Electric Company, and that the acquisition proceedings conducted by the Company for purchasing GIS arrays during the operation years of the cartel were coordinated in advance by the cartel companies, who presented to the Electric Company a false representation of competition between them.

Within the claim, the Company is claiming damages which were caused by the cartel companies, as well as return of invalid profit the cartel companies gained at its expense, within approximately 20 acquisition proceedings the Company conducted during the years that the cartel was operating. The Company estimates that its damages from the actions of the cartel, as of the date of submission of the claim, amount to NIS 3,777,994,817.

On April 13, 2015, the hearing of the Company’s claim was partially consolidated with an application to approve a class action, which was submitted on September 30, 2013, to the District Court in the Central Region against the Cartel Companies and the Company, for the purpose of deciding the question of liability of the Cartel Companies (for additional details regarding the request for approval see Note 35.b.1)g) to the Financial Statements).

- (E) For details of the legal proceedings between the Company and the Egyptian Gas Companies EGAS and EGPC and the EMG Company see section 7.9.9.2(c).

For further information regarding ongoing procedures against the Company see note 35 to the Financial Statements.

## **24. Insurance**

### **24.1 General**

Based, *inter alia*, on the risk management policy, and the risks that have been identified in the risk review that the Company carried out, the Company determines what the risks worth insuring against are. The Company is a company rich in assets that conducts extensive activity throughout the State. Thus, the Company is purchasing insurance policies such as insurance for property, liabilities, construction, liability of officer holders, vehicle insurance and maritime insurance, which are supposed to provide an appropriate solution to damages that may be sustained by the Company's property, its employees and for actions of third parties. It must be noted that the insurance policies usually make an exclusion for damages that originate from acts of terrorism and war, that are covered by way of a special fund that the State of Israel makes available for the purpose of compensation for damages that result from acts of terrorism and war, by virtue of the Property Tax and Compensation Fund Law.

### **24.2 The principal insured risks**

The principal risks insured are as follows: physical damage to property, loss of revenue and increased fuel expenses, natural damages and liabilities towards third parties and towards employees.

The Company purchases insurance policies as prescribed in the electricity license. In addition, the Company purchases additional insurance policies with the goal of providing adequate, broader coverage for the risks to which it is exposed, in accordance with the decision of the competent organs in the Company, after consultation with professional parties in the Company and insurance consultants outside it. The insurance policies that are purchased by the Company are as follows:

- (A) An "all risks insurance policy for the coverage of damages to the property of the Company (except the electricity grid), the coverage limit of this policy is \$ 1 billion. The coverage includes loss of revenue and increased fuel expenses.
- (B) A liability insurance policy that includes coverage of general third party liability, product liability, professional liability, liability for accidental pollution damages, liability for electromagnetic radiation and employers' liability. The limit of coverage within the framework of this policy is \$ 100 million. In addition, the policy includes coverage of third party liability for cyber damages with a coverage limit of \$ 10 million.
- (C) A construction policy for the coverage of damage during the course of the construction of power stations and other major projects. The limit of coverage within the framework of these policies is the value of the projects.
- (D) An officers' liability insurance policy that covers the liability of the office holders of the Company. The limit of coverage is \$300 million.
- (E) Third party maritime liability and lessees liability insurance that covers the maritime operations of the Company (such as: the loading / discharging of fuel, operation of the gasifying vessel, towing of ships carrying coal and more). The limit of liability within the framework of this policy is \$300 million.
- (F) Mandatory and third party insurance for the fleet of vehicles of the Company.
- (G) Cargo insurance for sea, air and ground transport.
- (H) Insurance for the watercraft of the Company.
- (I) Additional insurance in accordance with the needs of the Company.

The Company estimates that the purchased insurance policies as stated provide adequate insurance coverage.

## **25. Objectives and business strategy**

### **25.1 Vision**

#### **25.1.1 General:**

The Company strives to continue to be the leading business company in Israel in the energy sector. The Company is aiming to operate efficiently and fairly, in a developing competitive environment, in order to ensure financial strength and adequate profitability for the Company, which is required to supply available and high quality electricity to all the economy and to the continued development of the electricity sector. All of this, while adapting the Company to the changing market conditions and the economic, social and technological changes in Israel and worldwide, including the fields of renewable energies, increasing energy efficiency, energy storage, "smart grid", and in order to also operate in new and international markets.

For this purpose:

- (A) The Company will develop and supply products and services that optimally meet the needs of its customers;
- (B) The Company will provide excellent service;
- (C) The Company will ensure quality and safety at the highest level;
- (D) The Company strives for managerial excellence, technological innovation and maximum efficiency;

The Company will execute all these while optimally safeguarding the environment and promoting ideas of "sustainability".

#### **25.1.2 The main values of the Company**

The Company puts the customer at the center of its affairs, but its employees are its most important asset, and it operates based on a business view, emphasizing quality and reliability in its actions, sensitivity to the community and environmental protection, and compliance with the provisions of the law.

#### **25.1.3 Key goals:**

- (A) To provide an optimal response to the needs of its customers at an efficiency level that is adjusted to the market conditions.
- (B) To lead the market and stay ahead of the competitors in quality and nature of the services and products it provides.
- (C) The Company will operate with dignity, decency and reliability towards customers, employees, competitors, suppliers, lenders, shareholders and government entities.
- (D) The Company will recognize its employees as the Company's central asset, conduct open communication with them, support their promotion, create a sense of pride and belonging and encourage them to act out of commitment and creativity.
- (E) The Company will serve as an example of excellence in management, operating, technological innovation, good governance and appropriate transparency.
- (F) The Company will resolutely act to safeguard the environment while producing cleaner energy and striving for sustainable development.
- (G) The Company will be attentive to the human environment in which it operates, in collaboration with the community and while being involved, caring and socially responsible.

#### **25.1.4 The goals will be achieved through:**

##### **25.1.4.1 Development**

- (A) Maintaining the generation capacity of the Company is subject to the implementation of an optimal reliability criterion, to the effect of a balance occurring between the cost of unsupplied energy and the cost of an addition in generation measures.
- (B) Optimal integration of natural gas and coal production assets for reducing the use of expensive fuels and reduction of pollutant emissions into the environment.
- (C) Design and development of the transmission and transformation systems and adapting them to the increase in the sector's needs and entry of new private producers at standards that ensure the transmission of the energy generated using the production assets to consumption centers at the required level of reliability and quality, while maintaining the survivability of the system.
- (D) Development of the distribution system as an answer to the increase in the number of consumers, for the increase of demand from existing consumers, for achieving the level of reliability and quality of electricity that is required, and an answer to safety problems, while minimizing costs.
- (E) Planning and execution of emission reduction projects at power stations and making other investments in the environmental protection field.
- (F) Development of additional areas of engagement.

##### **25.1.4.2 Operation**

- (A) Adoption of an environmental operation and development policy.
- (B) Optimal operation of generation assets, while maintaining economic balance in the allocation resources, at a high level of availability and reliability.
- (C) Implementation of an optimal operation and maintenance policy, which ensures the reliability of systems during peak demands, and conducting renovations at the minimum possible cost, based on economic viability considerations.
- (D) Operation of the generation array using an optimal fuel mix.

##### **25.1.4.3 Customers**

- (A) Development of new products and services for the customers.
- (B) Provision of service with respect to the needs of the different market segments with emphasis on strategic customers.
- (C) Development of relations with the customers of the Company while implementing a customer relations management approach.

##### **25.1.4.4 Resource management**

- (A) Preservation, enhancement and development of the human resources through development of professional and managerial promotion and training tracks.
- (B) Conducting intelligent acquisitions of fuel in accordance with the operation requirements, with attention to the quality and cost of fuels, environmental protection, reliability of electricity supply, and diversification of fuel sources.
- (C) Finding of an overall, systemic solution for the charge rate outline, including improvement in the interface with the Electricity Authority.
- (D) Responsible financial management that will provide for achievement of adequate profitability, maintaining of a stable cash flow, capital raising for financing the needs of the Company, maintaining the Company's credit rating and acts to improve the rating.

- (E) Consent, startup and implementation of all of the changes required, including structural changes in the Electricity Sector, organizational changes and economization in the Company.

## **25.2 Company objectives for 2016**

- (A) Structural change - executing a structural change which will lead to a significant increase in efficiency.
- (B) Financial strength – maintaining the Company’s financial position, while reducing the debt and adapting the activity to the budget.
- (C) Adjusting the budget to the output - the work plan will include defined output which will match the allocated resources to the activity in the budget.
- (D) Measurement - a measurement process will be assimilated according to business parameters which match the position of the Company, its goals and nature of activity in the Company’s departments and divisions.
- (E) Human resources and organization - starting the “Tsamrot Or” program whose goals are: creating a flatter organization and as a result more efficient and effective, creating a more functional organization and decreasing the bureaucracy, and empowering the Company’s management ranks.
- (F) Safety - emphasizing the safety issue and assimilating the proactive safety issue in the Company.
- (G) Electricity supply - improving customer service.
- (H) Promoting strategic projects - advancing the study and accelerated preparation of the smart grid, significant expansion of the smart meters deployment and working with regulators and studying the branch of renewable energies with the intention to significantly enter the field.
- (I) Broadband communications - continuing access network deployment and examining the business model of IBC.
- (J) Regulation and Company image - creating a more sympathetic atmosphere for the Electric Company and its needs and restoring the Company image following the events of the storm of October 2015.
- (K) Sustainability and quality of the environment - continuous communication with entities of the Ministry of Environmental Protection in order to minimize the possible economic damage to the Company while strictly maintaining the provisions of the law and the various orders. Ongoing communication with environmental organizations. Taking the initiative to make the Company a leading entity and partner for the Ministry in developing the renewable energy field in Israel.
- (L) Business development – expanding business development in Israel and abroad, establishing a subsidiary for business development, selling engineering services and preparing to expand areas of operation.
- (M) Increasing efficiency and examining activities - setting clear goals to decrease equipment and spare parts inventory, in-depth examination of the strategy of the information systems of the Company, examining the removal of activities which are not the distinctive core areas of business to outsourcing and setting goals for 2016-2017 to sell assets and real estate. In this context, it should be noted that in response to the Company’s application to the Comptroller General, within which the Company notified the Comptroller General that the Company’s Board of Directors decided to continue to promote the feasibility of selling 2 Company assets whose details were included in the notice delivered to the Comptroller General, on March 20, 2016, the Comptroller Generals Division at the Ministry of Finance notified the Company that it opposes the sale of the assets by the Company in light of the State’s position over the years on the issue of the assets of the Electric Company, inter alia regarding the meaning of section 62 of the Electricity Sector Law. A meeting is expected to be held between the Company management and the relevant State entities to discuss ways to clarify the issue.
- (N) Preparing for extreme events in the Company -implementing conclusions drawn from the events of the storm of October 2015 and continued preparations for the winter and the coming summer.



### 25.3 Information on business enterprising

The business development and enterprise unit was set up in 1995. The unit operates in fields that are contiguous with the fields of activity of the Company that are not an inherent part of the activity of the Company as an essential service supplier, in Israel and abroad. The goals of the unit are the expansion of the areas of engagement of the Company and making the best and most optimal use of the professional knowhow, the skilled human resources, the byproducts, the infrastructures and the other resources that are in its possession. The activity of the unit, the principles of its activity and its goals have been approved as necessary in discussions that have been held by the Board of Directors or the committees of the Company. The business development activity overseas is mainly in the countries of the former Soviet Union, Russia, Eastern Europe and the Balkan States, African States, Mexico, India and others. The business development activity in Israel is focused on selling services and intelligent utilization of the Company's infrastructures and resources.

The Company is operating in the sphere of business enterprise, this being within the framework of the licenses of the Company, while some of these operations, which require the approval of the Manager of the Electricity Administration, are forwarded for approval on an ongoing basis. Other operations, requiring the approval of the Ministers, are forwarded for their approval. As of the date of the report, the unit is operating in a number of main fields:

- (A) Activity for the construction and the operation of power stations and other electricity facilities overseas that is conducted by the Company as a provider of professional services. The Company is interested in acting in this field as an enterprise company and in becoming the owner and in holding shares of companies abroad that own electricity facilities. Toward this end, the Company is required to receive approval from the Government;
- (B) Activity involving the sales of knowhow, consulting services and engineering services in Israel and abroad;
- (C) The commercialization of the byproducts that are created as a result of the generation of electricity – such as ash, coal, steam, various gases and so on;
- (D) Effective utilization and renting of the infrastructures, means and equipment of the Company;
- (E) Other services that are offered by the Company, including in the field of cyber defense.

In May 2015, the Company received a new position on behalf of the staff of the Deputy Attorney General, under which any activity selling services of consultancy, planning and construction abroad will require the approval of the Ministers of Finance and National Infrastructures, Energy and Water, in consultation with the Public Services Authority Electricity. This position may lead to damage to the activity of selling services abroad, as the Company's position is that the required approval process according to the letter may result in delays in executing the activity and may harm the profitability of the transactions and/or feasibility of their realization. The Company submitted a legal opinion under which the position of the Ministry of Justice is not in line with the licenses of the Company.

The Company has faced the various authorities, operating for the continued approval of the operation as was granted until now by the Manager of the Electricity Administration in the Ministry of National Infrastructures, Energy and Water. On August 23, 2015, the clarification of the Government Companies Authority was received, under which the existing state will continue until a discussion is held regarding the issue, namely approval for related activities will be given by the Manager of the Electricity Administration in the Ministry of National Infrastructures, Energy and Water, as in the past.

(F) The communications field

For details regarding the establishment of a communications company see Note 10 b. to the Financial Statements.

(G) Technological incubator

For details, see section 12.

(H) The establishment of a subsidiary for business operations outside of the borders of the State of Israel - in October 2011, the Board of Directors of the Company approved the establishment of a subsidiary, the

purpose of which was to carry out business activities outside of Israel (in other words, projects that involve the construction and operation of power stations and other electricity facilities overseas, as well as other business enterprises that are to be carried out overseas). The Company is interested in the establishment of this company in Cyprus, on the basis of various business considerations. In addition, within the framework of that resolution, the Board of Directors approved a financial framework for that activity in the scope of 100 million euro. The establishment of this subsidiary requires the receipt of approval in accordance with Section 11(A)(9) of the Government Companies Law. In view of the above mentioned, on October 10, 2012, the Company applied to the Government Companies Authority to receive the approval of the Government and the Companies Authority for the establishment of a subsidiary in Cyprus, subject to the limitation of the volume of operations to € 20 million only. On December 24, 2012, the Company reapplied, requesting to approve the application with an additional reduction of the volume of operations to € 10 million only, while the Electricity Company will hold all of the shares in the subsidiary. On October 26, 2014, the CEO of the Company applied to the Government Companies Authority, requesting to conduct a discussion in order to advance the issue as soon as possible. The Companies Authority and the Company are conducting discussions regarding this matter. The discussions with the Companies Authority continued during 2015, aimed at reaching an agreed outline for establishing the aforesaid subsidiary. These discussions have not yet ended and will continue during 2016.

(l) 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 35.a.3) to the Financial Statements.

**26. Forecast of the investments that will be required for execution of the development plan of the Company**

Pursuant to the five year financial plan for 2014-2018, which was approved by the Board of Directors on June 26, 2014, the average annual investment for 2016-2018 for the entire Company is approximately NIS 4 billion. On the basis of the long-term financial plan, which has not yet been approved by the Board of Directors, the investment for the years 2017-2020 is estimated at approximately NIS 3.7 billion each year.

In 2015, a sum of approximately NIS 3,648 million (after remeasurements deduction) was invested in the development plan of the Company.

According to the decision of the Board of Directors, the development budget of the Company for 2016 is approximately NIS 3.7 billion (after remeasurements deduction).

In 2015, a sum of approximately NIS 485 million (after remeasurements deduction) was invested in the development of various acquisitions and investments (that do not belong to a specific segment).

According to the decision of the Board of Directors, the development budget of the Company in the development of various acquisitions and investments (that do not belong to a specific segment) for 2016 is NIS approximately 404 million (after remeasurements deduction), a cutback of approximately NIS 111 million compared to the Company's development budget, of various purchases and investments, for 2015.

*The estimates that have been described above with respect to the forecast of investments that will be required for executing the Development Plan of the Company constitute forward looking information, as per its definition in the Securities Law, which are based on the forecasts and assumptions described above, which the Company has as of the date of the report, and at the end of the formulation of an updated investment forecast or due to instructions that will be given to the Company by the Minister as an essential service supplier with respect to the Development Plans that it must implement, the Company may be required to make investments that differ from those described above. This information includes forecasts, subjective assessments, estimates and other plans of the Company as of the date of the report with respect to the working assumptions that it used in the development of the forecast and the dates of materialization of those assumptions. Such information is based on future figures whose materialization is not certain and that are not under the exclusive control of the Company. The main factors that might affect the forward looking information such that it will not materialize or that changes will occur in the estimated timetable for the execution of the development plan and the investments thereof, according to the aforesaid, are, inter alia: a change in the expected growth rate of the demand for electricity; implementation of the structural change of the electricity sector and the Company (see Note 1.e to the Financial Statements); availability of natural gas for use in the generation system; difficulties in obtaining a license and/or change in regulation in the field of quality of the environment and licensing; changes with respect to the development plan, lack of suitable rate cover (see Note 3 c to the Financial Statements), and the ability of the Company to raise the financing required for executing the development plan.*

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

27.1 For details of the position of the staff of the Securities Authority on the subject of the existence of a high quality corporate debentures deep market in Israel, and its impact on the Company, see Note 2 u 1) to the Financial Statements.

27.2 On December 28, 2014, a number of present and past employees of the Company were arrested, among them two senior officers of the Company (on that date), by the Securities Authority, on suspicion of taking a bribe from the Siemens Company in order to bias tenders entered into by the Company. The Company has not received any official notice in the matter. It is noted that to the best of the Company's knowledge, this investigation is related to a previous investigation of the Securities Authority in this matter within which in its framework Mister Dan Cohen, a former director of the Company, was prosecuted and convicted for offenses of bribery and breach of trust.

## 28. Discussion of risk factors

Risks constitute an integral part of the business environment and the work and business management processes in the Company and are affected by external and internal factors, such as strategic risks, operational risks, financial risks, and compliance and regulation risks. In accordance with the directives cited in the Companies Authority Circular 2009/2 on the issue of risk management, the Company executes a risk management process at the company level.

Pursuant to a risk survey at Company level that was conducted in the year 2013 with the assistance of a risk management consultant, presented below are the main actions that were taken and are taken by the Company based on the findings and recommendations raised in the survey:

- Regular reporting to the Board of Directors' committee in charge of risk management in the Company: "Budget, Financial Management and Risk Management Committee".
- Coordinating a management committee for risk management, headed by the Company's VP Corporate Sustainability, who has been appointed risk manager, and which is in charge of overseeing all matters pertaining to the management of risks in the Company.
- Formulation of work plans based on gap surveys performed.
- Updating of the Company's risk management procedure.
- Integration of a risk management information system and conducting follow-up of realized and nearly-realized events.
- Preparation of individual policy portfolios for all the mapped risks of the Company, including definition of the risk appetite (the amount of risk an entity is willing to accept), risk indices and minimizing plans.

Additionally - the Company has begun execution of a risk survey for the years 2016-2019 at the level of the entire company, in accordance with the instructions of the above mentioned circular of the Companies Authority.

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 current evaluation of risk, including mechanisms for reporting realization and use of these reports as a tool for monitoring risk level.

The table that appears below shows the risk factors of the Company, which have been rated, in accordance with the estimate of the Company, by the degree of effect that they may have over the operations of the Company:

The risk factors of the Company are listed below:

	Effect			Classification of the risk factor in accordance with the Government Companies Authority circular of June 11, 2009
	High	Medium	Low	
	Significant effect on the Company	Moderate effect on the Company	Slight effect on the Company	
<b>Macro risks</b>				
(1) Regulation, corporate governance and compliance	X			Compliance and regulation risks
(2) Security, geopolitical and economic situation in Israel and its surroundings	X			Strategic risks
(3) Natural disasters		X		Strategic risks
(4) Explosion and fire	X			Strategic risks
(5) Market risks	X			Financial risks
(6) Teleprocessing and Cyber Systems and information security	X			Operational risks
<b>Industry risks</b>				
(1) Setting of the electricity charge rate	X			Compliance and regulation risks
(2) Debt raising and management	X			Financial risks
(3) Fuels	X			Strategic risks
(4) The Electricity Sector Law and licenses of the Corporation		X		Compliance and regulation risks
(5) Environmental protection	X			Operational risks
(6) Human capital	X			Operational risks
(7) Suppliers and contractual engagements (without fuels)		X		Operational risks
(8) Safety		X		Operational risks
(9) Project risks		X		Operational risks
<b>Risks unique to the Company</b>				
(1) Liquidity risks			X	Financial risks
(2) Causes for calling for immediate repayment and cross violation clauses in existing financing contracts of the Company	X			Financial risks
(3) Submission of audited Financial Statements to profit centers		X		Financial risks
(4) Competition	X			Strategic risks
(5) Planning of Development and advancing the development program in the generation and transmission segments	X			Strategic risks
(6) Structural change	X			Strategic risks
(7) Asset arrangement	X			Strategic risks
(8) Legal	X			Financial risks
(9) Customers		X		Financial risks
(10) Labor relations	X			Operational risks
(11) Liabilities for pension fund		X		Financial risks
(12) Generation array management and technical failures in generation	X			Operational risks
(13) Planning in the life cycle of the transmission, transformation and distribution array		X		Operational risks
(14) Embezzlements and fraud	X			Strategic risks

## **28.1 Macroeconomic risks**

### **28.1.1 Regulation and Compliance with Laws and Regulations**

The activity of the Company depends to a great extent on regulation that applies to its activity, including the provisions of the Electricity Sector Law and its regulations, pursuant to which licenses are issued for its activity, the policy and resolutions of the Government (including resolutions of the Ministry of National Infrastructures, Energy and Water, the Ministry of Environmental Protection 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 Companies law and its regulations, 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 preparing the financial statement, appointment of directors and special functionaries and more), provisions of the Antitrust Law (*inter alia* pursuant to it being a monopoly), the provisions of the Centralization Law, the provisions of the Securities Law and its relevant regulations and the circulars of the Securities Authority (pursuant to the Company being a reporting entity and a public company, as these terms are defined in the Companies law), and regulations related to business licensing, planning and construction and environmental protection (see Sections 7.12, 8.8, 9.10 and 20). See Section 21 for restrictions and control over the activity of the Company.

Failure to comply with laws and regulations that apply to the Company may lead to the cancellation or suspension of its licenses, imposition of heavy fines, the issue of personal orders against senior executives of the Company, the filing of criminal indictments against some of them and even cause 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 which have not yet been expressed in the electricity rate.

Regarding the internal enforcement plan executed by the Company on the subject of antitrust see section 21.10.2(b).

Regarding the internal enforcement plan executed by the Company on the subject of securities laws see section C.5 of the report of the Board of Directors.

Regarding the criteria document published by the Companies Authority to examine requests to grant an advance commitment to indemnify office holders in government companies, within which are detailed, *inter alia*, criteria which include adoption and assimilation of an internal enforcement plan in a government company, see Note 34.f.1) to the Financial Statements.

In addition, the Company is nearing completion of a process to adopt an internal enforcement plan in the field of prohibition to give a bribe to a foreign public official, and has assimilated the subject of prohibition of trading with enemy countries and money laundering prohibition.

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 even predict the costs that may be involved in the future in the compliance with the existing regulatory provisions that apply to it or compliance with laws, regulations and new rules that will be enacted and that may apply to it. The costs stated may have an adverse effect over its business activity and the financial outcomes, mainly if the costs of compliance or noncompliance with the broad regulation are not recognized in full in the charge rate or if recognized, will not be recognized on time.

### **28.1.2 Security, geopolitical and economic situation in Israel and its surrounding area**

The security, geopolitical and economic situation in the State of Israel and its surrounding area directly affects the Company, whose assets and activity are located in the State of Israel in their entirety or nearly so.

The emergence of major hostilities in the Middle East against Israel, lack of stability in the political situation in Israel or neighboring countries, or deterioration in Israel's international trade relations may materially impair the operations of the Company.

In view of the geopolitical situation in the State of Israel and its relations with its neighbors, in the case of a disaster or other disruptions, the State of Israel has no backup to the electrical grid of the Company, and in effect the electricity grid in the State of Israel is isolated in all matters relating to the generation of electricity and its supply to residents, without an ability to purchase electricity or to secure a backup from other suppliers within and outside of Israel. In addition, security events may impair the activity of the Company in each of its segments, including in the electricity generating, transmission, switching, transformation and distribution facilities and the fuel transport and storage arrays. Harm to the facilities of the Company would impair its generation capacity and might impair its ability to provide electricity continuously, reliably and to a high level of quality to all of its customers. Emergency officials and the Company estimate that some of the facilities may be an objective for terrorist attacks or other security events.

The 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. In addition, 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 piped natural gas supplied by a local supplier as stated in Section 7.9.5). A material part of the fuel and the equipment are acquired in contracts whose validity is limited. Due to the great dependence on foreign sources, the Company is exposed to many risks, such as a delay in the supply of equipment or fuels that may result from political or security instability, including in the case of a long war or closure of seaports or airports in its wake, boycott of goods against Israel, strikes in ports and so on.

The disruptions in the supply of the various fuels that are used for the generation of electricity have adverse consequences for the Company financially and image-wise.

Due to the essential services that the Company provides to the State of Israel and its residents, the Company may be at risk and constitute a target for hostile actions that are directed against its facilities, including cyber actions. The Company makes sure to maintain extensive guarding of its facilities and receives directions from authorized parties on various security issues, including the National Emergency Authority, the Ministry of Defense, the police, the Home Front Command and others. With respect to the generation of electricity, the Company has assessed this threat and takes preventive steps relating to staff at its facilities. The Company cannot anticipate with certainty whether or not attacks of this kind against its facilities will occur in the future or if its facilities will be damaged in wartime and what the effect of such damage, if any, will be.

The insurance policies that are purchased by the Company usually exclude damages that originate from terrorism and war, that are covered by a special fund that the State of Israel extends for compensation due to terrorist and wartime damages pursuant to the Property Tax and Compensation Fund Law. If it is determined in the future that the Company is not entitled to payment from property tax with regard to the payment of direct

war damages, or if the amounts of the compensation that are set for the Company are lower than those to which the Company is currently entitled in accordance with the provisions of the law, this may have an adverse effect over the outcomes of the Company.

### **28.1.3 Natural disasters**

The Company and its facilities are exposed to natural hazards such as particularly extreme or exceptional weather, floods and flooding, tsunamis, severe earthquake in the region (that may cause the materialization of other disasters such as explosion, fire and additional safety and security risks), and damage to the electricity system from electromagnetic waves, that may affect the Company's facilities and its business affairs.

The Company has a steering committee, headed by the Deputy CEO for Operation and Logistics, on the subject of earthquakes and tsunamis (in this section: "**Steering Team**"), under which four subcommittees operate, which deal in the planning and execution of the preparations of the Company for these events in order to reduce and minimize the damage as a result of an earthquake event. The steering committee has established a multiannual work plan for coping with earthquakes, including execution of seismic studies at some of the sites of the Company, analyzing various scenarios which aid in identifying weak points that may be harmed. Based on the analysis of these scenarios, recommendations for executing reinforcements and anchoring of various components are delivered, and the implementation of these recommendations exists at various stages in the Company installations.

Within the preparations of the Company for winter (exceptional weather, snowstorms, strong winds etc.), preparations executed by the Generation and Energy Division and the Customer Division, including: preparations for a higher peak demand than expected according to the forecast, maintenance of substation units, transmission and distribution lines according to the work plan, refreshing division procedures about activating headquarters in a stress crisis situation, and examinations were carried out for their operational preparedness. Additionally, a Company-wide exercise of preparedness for winter including the examination of supporting information systems was performed, headed by the CEO and the rest of the divisions that support the electricity chain units.

During 2015, there were 4 weather events which were declared by the Company as exceptional events.

It is noted that "all risks" insurance of the Company covers the risk that is involved in natural disasters, except with respect to the electricity grid and subject to the deductible specified in the insurance policy of the Company.

### **28.1.4 Explosion and fire**

The facilities of the Company are exposed to various types of explosion and fire risks. In view of the presence of inflammable and combustible fuels, hazardous materials, fire explosives (concentration of flammable materials), work with naked flame, high temperatures and pressures, many electricity and control installations and revolving machines which cause friction, 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. In addition, fires may constitute a safety threat to the employees at the Company's installations and to those engaging in extinguishing them.

With the entry of the Company into the era of natural gas, the risks of explosion and fire which may lead to a mass event and great damage increased. As an answer to the risk, the Company meticulously constructs natural gas installations in accordance with the requirements of the most stringent standards and executes maintenance work or other work near gas installations according to legislative requirements of the State of Israel, and is supervised by the Gas Authority.

The Company's "all risks" insurance policy covers direct and indirect fire damages with obligatory deductible and the Company may be charged for it 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, 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, and conducts considerable training for its employees, in order to increase their awareness to fire risks and provide them with tools to cope with fires. In addition, the Company acts to prevent fires of individual trees, forests and woods near strategic power lines through pruning and visual inspection for the proximity to power lines, while making sure that the required pruning distances are maintained, and also acts to receive the required approvals for a multi-annual plan for pruning and felling trees situated near power lines. 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 or elimination.

The Company has constructed a plan to close the gaps between the requirements of the Fire Authority and the status of the fire detection and extinguishing systems and carries out numerous projects in the field of fire detection and extinguishing that will spread up to the end of 2017.

#### **28.1.5 Market risks**

For details with respect to the market risks of the Company see section B.2) of the Report of the Board of Directors.

#### **28.1.6 Teleprocessing and cyber systems and information security**

The Company, which is a strategic national infrastructure, and also relies on operating and managerial teleprocessing systems, may be a target of cyber attacks. 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. It should be noted that in recent years, there is a gradual increase in the volume of threat, the number of events in practice and their severity, in Israel and overseas.

The Company is operating to prevent failures in the operating, teleprocessing and information systems, *inter alia* through prevention, defense, backup and security mechanisms for preventing failures in its computer systems, including protection from the cyber space. The Company is acting to improve and increase the level of information security and protection in several aspects: operating a national cyber center to monitor and handle a cyber event in the Company's networks, increasing the level of information security of the critical networks, advanced technological solutions and tools, information activities and constantly increasing awareness to the subject among the Company employees.

The teleprocessing and computerized systems 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 damages. The Company operates with the guidance of regulation and supervision in the field of cyber and information security for the systems in the Company.

## **28.2 Industry level risks**

### **28.2.1 Setting of the electricity charge rate**

The revenues of the Company are based on the electricity charge rate that the Company collects from consumers. In accordance with the Electricity Sector Law, the electricity charge rates and manners of update are determined exclusively by the Electricity Authority. The financial status, revenues, profits and cash flow of the Company are affected materially by the level of the electricity charge rates. As a rule, the charge rate is determined in accordance with a mechanism of recognition of the costs that are required for fulfilling the duties of the Company as an essential service supplier, such as: fuels, operation and maintenance costs and capital costs (depreciation, financing and return on capital). See Section 7.11.1 for further information on the manner of setting and updating the electricity charge.

In some cases, the Electricity Authority does not recognize within the charge rate all of the costs and the expenses that the Company actually spends; in addition, although the charge rate includes an update mechanism that is intended to compensate the Company for the gap between the dates on which it incurs the costs and the time at which the charge rate is updated, this mechanism does not compensate in full, in the opinion of the Company, for the cash flow gaps that it sustains when its actual costs are materially higher than expected.

At present, the Company has no ability to unequivocally determine the time of setting the new charge rate bases for the transmission, distribution and generation segments, or the volumes of the property and costs that will be recognized for it, once set.

See Section 7.11.1 for details on the applications of the Company to the Electricity Authority with respect to various issues that were related to the electricity charge rate.

As of January 1, 2015, the Company is implementing the IFRS in full. In view of the fact that the rate, which constitutes the principle revenue of the Company, is calculated according to index adjusted data, while the presentation in the financial statement is executed according to nominal data, this may affect the erosion of the Company's equity in its financial statements, and thus affect the Company's results and business position. However, it is not expected to have a direct impact on the current cash flow of the Company which is derived from the electricity rate. For additional details in this matter, including in relation to the decision of the Electricity Authority which constitutes a partial solution to the erosion of the Company's equity as described above, see Note 3 to the Financial Statements.

### **28.2.2 Debt raising and management**

The Company has needs of financing and debt raising to significant magnitudes, that inter alia serve for financing the development plans of the Company and recycling existing financial liabilities, and for other current needs.

Debt raising by the Company is carried out through loans from Israeli and foreign financial institutions, as well as by public offerings and private placements of debt in Israel and issues to classified investors abroad.

The ability of the Company to raise the debt that it requires under beneficial terms 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 economic, security, legal and political terms, and the geopolitical situation in Israel. Additionally, the raising ability depends on the form and terms of the Structural Change in the Electricity Sector as far as will be applied, the financial performance of the Company (including its leverage level) and the privatization policy of the Government.

Therefore, there is no certainty as to the Company's ability to raise the complete debt it requires or that the debt raised by the Company will be under terms favorable to the Company.

According to the Company's forecasts, in 2017-2018, the Company foresees that it will be required to raise debt in significant amounts compared to previous years, inter alia for financing the Company's development plans, recycling the existing financial liabilities and for other current needs.

In addition, insofar as the credit rating of the Company will be damaged, it may have a material negative impact on the availability of the financing sources of the Company in Israel and overseas. For details on changes in the credit rating of the Company see Note 20.g. to the Financial Statements.

### **28.2.3 Fuels**

The increasing dependence of the Company on the generation of electricity using natural gas causes it risks both as a result of the limited number of the natural gas suppliers and due to restrictions that are related to the natural gas transmission system.

As of the date of the report, the sources of natural gas supply are the "Tamar" field and the liquid gas (LNG) supplied through the gasification ship (in this section: the "**Gas Suppliers**"). In the present reality, shortage in the supply of natural gas can be created as a result of one of the two gas suppliers not supplying the contractual quantities, from failure in the piping transmitting the natural gas from the "Tamar" field to the coastal system entry point at Ashdod and/or from the incapability of the national transmission system to supply the Company with the contractual gas quantities that are at its disposal.

Disruptions in the gas supply that stem from violations of the purchase contracts by the gas suppliers may cause the Company to power its generation system using more expensive and more pollutant alternative fuels, in order to satisfy its consumers' demand for electricity. Disruptions in the transmission of the gas from the field to the coast and/or in the national gas conduction system whose repair may take a long time, are estimated to be of low probability by the Company, but the expected financial damage from the materialization of these events may be high, particularly if following the disruptions in the gas supply, the Company will not have sufficient generation ability using alternative fuels in order to satisfy the demands for electricity.

In order to examine the contractual obligations of the Company to buy fuels, the Company regularly executes an examination of the short and long term forecasted fuels consumption. The estimate is based on analytical tools and a wide range of data (demand forecasts for electricity), performance of the generation system, fuels price forecast, etc.) regarding which there is a high level of uncertainty. A plan was formulated to reduce the risk of over / under estimating the expected fuels quantities. It is a detailed plan to execute the calculation process, including sources for the various data and approval factors for the premises and calculation results. This plan constitutes a risk mitigation plan.

For details regarding the risk that results from the fact that part of the fuel purchased by the Company is imported from abroad and purchased by agreements whose effect is limited, mainly in times of war or other disruptions, see section 7.9.5. For details regarding the Company's exposure to bringing forward payments with respect to gas in accordance with the Take or Pay mechanism set in the agreement with the Tamar partnerships, see Note 35.a.1) to the Financial Statements.

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 Note 35.a.1) to the Financial Statements.

In the absence of available supply of natural gas, the costs of fuels of the Company may be significantly higher than the recognized costs of fuels for the Company in the charge rate basis, although the Company believes that the high costs of fuels will be covered in the end in the charge rate, the time gap between the date on which the Company sustains the expenses for the purchase of the expensive fuels as stated and the time at which the charge rate is updated and the Company is compensated for these expenses, causes material impairment to the cash flow of the Company.

#### **28.2.4 The Electricity Sector Law and the licenses of the Company**

The Company is subject, in accordance with the above, to the provisions of the Electricity Sector Law, pursuant to which it has been granted licenses for its activity. In addition, the Company is also considered as an “essential service supplier” in accordance with the provisions of the Electricity Sector Law.

Pursuant to the provisions of the Electricity Sector Law and the licenses that have been given to it, the Company assumes various restrictions, which are extensively stipulated in Section 21.1.2. The costs of compliance with the provisions of the Electricity Sector Law and the licenses that have been given to the Company pursuant to it are material and have a material effect over the Company and its outcomes. Failure to comply with the provisions of the licenses and the provisions of the law applying to the Company, may lead to various sanctions against the Company and officers therein (including criminal sanctions), to the point of cancellation or suspension of the licenses, and may also constitute a material violation of stipulations in some of the financing agreements to which the Company is a party. As of the date of the report, besides that which has been stated in Section 21.1.3.6, the Company is materially complying with the conditions of the licenses that have been given to it.

In the past, pursuant to the provisions of the Electricity Sector Law and the orders issued pursuant to it, the licenses of the Company have been extended from time to time, for periods of up to one year each time. As elaborated in Section 21.1.2, the licenses of the Company will remain in effect through to January 1, 2017 and pursuant to the Electricity Sector Law in its present version, the extension of the validity of the licenses of the Company beyond this date will require an order by the Ministers, with the approval of the Economic Affairs Committee of the Knesset, for a period not exceeding one year.

The Company estimates that after the implementation of the structural change, the Company will receive new licenses in accordance with the outline of the structural change as will be determined.

The abstention from extension of the licenses of the Company or changes in the terms of the licenses or other provisions that are prescribed in the Electricity Sector Law may have a material adverse effect over its business activity and financial results.

For details of the provisions of the Electricity Sector Law and the Company licenses regarding the submission of financial statements by the Electric Company for profit centers, see section 28.3.3.

#### **28.2.5 Environmental protection**

The activities of the Company are subject to laws and regulations on environmental protection issues, which relate to various issues, such as air pollution, soil and water pollution, prevention of noise, non-ionizing radiation (electrical and magnetic fields), dealing with hazardous materials and more. In recent years, the standards applying to the activity of the Company, the supervision of environmental protection and the enforcement of environmental standards have intensified. This trend, in the assessment of the Company, is expected to continue and even intensify in the upcoming years. Failure to comply with the provisions of the law and regulations in the field of environmental protection may expose the Company and its directors to various sanctions, including financial sanctions and criminal proceedings.

The Company is studying the consequences of the proposed laws and regulations in the environmental protection field, is acting to prevent or minimize the environmental risks that may occur during its activity, is preparing for economic, legal and operational consequences that stem from the laws and regulations, and is allocating money in its budgets for the purpose of compliance with the laws and regulations in the field of environmental protection that apply to it and that are expected to apply to it. However, there is no certainty that the costs that will be demanded of the Company with respect to the laws and regulations existing and expected in the field of environmental protection will not exceed the amounts that have been allocated by the Company for these purposes; however, the Company estimates, as of the time of this report, and based on the provisions of the Electricity Sector Law, that the material costs that will be imposed on it as a result of new regulatory requirements shall be covered within the electricity charge rate.

See Sections 7.12, 8.8, 9.10 and 20 for details on environmental protection instructions that apply to the Company and their consequences for it.

#### **28.2.6 Human capital**

Human capital risks affect the Company's managing, planning and operating abilities. Difficulties in the ability to hire and preserve capable and suitable human resources and lack of adequate managerial flexibility may make it difficult for the operational and managerial capability of the Company. The Company handles this risk through medium and long term planning of human resources, ongoing human resources replacement, mobilization and rotation, plans and arrangements for preserving human resources for permanent and temporary employees (in professions that are in demand), implementing pooling plans and technological engineering and designated training, and preparing a managerial reserve.

#### **28.2.7 Suppliers and Contractual Engagements (without fuels)**

An event of a collapse of a supplier of equipment or of a critical raw material could result in shortages and adversely affect the generation capacity and the current operation. Additionally, a low stock level due to budget restrictions, delays in supply and the supply of defective equipment could adversely affect the current operation and the meeting of project timetables. A service supplier who fails to meet requirements in the field of quality of the environment may lead to breach of laws, regulations and regulation in the field of quality of the environment and to negative media coverage that may cause severe damage to the image of the Company.

In addition, the manner of transport and storage of the equipment and raw materials that may be impaired as a result of various factors, including faults in transport, limited access to ports, natural hazards and so on. The Company stores the equipment in accordance with the instructions of suppliers and in conformity with procedures in order to avoid the storage of equipment and/or hazardous materials in an uncontrolled manner.

#### **28.2.8 Safety**

The occupation and activities of the Company at its various sites expose its employees to various safety hazards for which the Company may be exposed to claims due to physical injury or other damages. The Company takes all of the measures for reduction and elimination of these risks, in accordance with legislative and regulatory acts applying to it, and it is forming and acting according to safety instructions and procedures that reflect and are stricter than the requirements of the legislation and regulations on safety that apply to it, for the purpose of safeguarding the wellbeing and health of its employees. Despite the abovementioned, the Company cannot prevent completely this risk. It should be noted that the Company has insurance coverage for employees and for third parties, subject to the deductible fees that the Company may be obliged to bear, in accordance with its insurance policies.

In order to reduce the risks, detailed work plans were formulated, and they are implemented in the entire Company while being monitored by the national safety unit.

#### **28.2.9 Project risks**

The Company deals in the management of various projects. This activity involves exposure to risks such as:

Failure to comply with schedules, failure to meet quality requirements, failure to meet the budget, missing or excess preparations of inventory, shortage of resources (manpower, equipment, budget), non-optimal use of resources, human errors in decision making, failures in projects in new fields in which the Company has no previous experience, technical failure in equipment and machines that may have implications on project schedules and budget, safety events, effect of extreme weather conditions, an unstable security situation which may result in non-arrival of suppliers and resources from overseas, delays in project execution, delays in receiving statutory approvals and building permits for a project, unexpected faults or findings in soil examinations, erroneous decisions in determining the work plan and the required work stages, dependency on subcontractors for execution of the project, erroneous pricing of the project or parts of it, and more.

The realization of project risks for the Company may cause:

Damage to the reputation of the Company, constitute a cause to file actions against the Company, failure to meet schedule, budget, and quality of the projects, disruptions in the electricity supply chain, bodily injury or property damage due to safety events, and harm to the financial position of the Company.

A policy for managing project risks has been formulated recently, and it is in stages of implementation on all the strategic projects of the Company

### **28.3 Risks that are unique to the Company**

#### **28.3.1 Liquidity risks**

Liquidity risk is a risk that is related to a situation in which the Company will not have enough available monetary resources in order to meet the current business requirements including its financial liabilities and maintaining a financial reserve. 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 extreme conditions, without incurring significant losses or damage to its image.

The Company may be exposed to liquidity risks due to various factors that are not necessarily under its control and, inter alia, as a result of disruptions in the supply of natural gas which may cause the Company to operate the generation system with alternative, more expensive fuels (although the Company believes that the high fuels costs will eventually be covered in the rate, the time gap between the date on which the expenses with respect to purchase of the expensive fuels as stated will be caused to the Company and the date on which the rate will be updated and the Company will be compensated with respect to these expenses, causes material damage to the cash flow of the Company) and/or as a result of employee sanctions that will affect the collection.

As of the date of the report, the Company had surplus cash and credit lines which will enable it to meet the expected liabilities of 2016.

The Company manages the liquidity risk through cash raising of various time ranges in the capital markets in Israel and/or abroad in accordance to its needs, well ahead of the date required under the Company forecasts as well as by creating and maintaining new credit lines in banks in Israel and abroad, while maintaining a reserve (safety cushion) in accordance with the decision of the Board of Directors of October 15, 2015 (for details regarding the Company cash balance see section a.1 c)2)d) to the Report of the Board of Directors.

#### **28.3.2 Grounds for immediate repayment and cross violation clauses in existing financing contracts of the Company**

Some of the financing agreements that the Company has executed include a clause for calling for immediate repayment in the case of a "material adverse change" (hereafter: "**MAC Stipulation**") as this event is defined in any such agreement. The enactment of the stipulation is subject to a test of reasonableness in some cases, and is down to the discretion of the lender in some of them, and this discretion is also subject to reasonableness in some of the agreements.

In some of the financing agreements, the existence of the right of a certain lender to demand immediate repayment of the debt (*that is*, even if it has not called the debt for immediate repayment) grants a right to another lender, whose agreement has not been violated, to demand immediate repayment (cross default).

In addition, some of the financing agreements that the Company has executed include clauses whereby if the Company violates its undertakings towards a certain lender and that lender demands immediate payment as a result of that violation, this will also grant another lender, whose contract has not been violated, the right to demand immediate repayment (cross acceleration).

In case one of the stated events occurs, it may have material negative effects on the business of the Company, its business results and its financial position.

See Note 20d) to the Financial Statements for details regarding the principal terms in the financing contracts of the Company that may cause immediate repayment.

### **28.3.3 Submission of audited Financial Statements to profit centers**

The Company as an essential service supplier is required, in accordance with the Electricity Sector Law to submit Financial Statements in a form as prescribed by the Ministers in consultation with the Minister of Justice regarding the extent of their details, the accounting principles for their preparation, the declarations and the notes to be attached to them. Accordingly, under the Electricity Sector Regulations (Terms and Procedures for Granting Licenses and Obligations of the License Holder), 1997 (“**Electricity Sector Regulations**”), as well as under the licenses of the Company, the Company, as an essential service supplier, is obliged to submit Financial Statements separately for each area, for each activity and for each profit center, and submit consolidated statements with respect to its activities according to all of the licenses that are in its possession. A “profit center” is defined in these regulations as a unit with a closed income and expenses structure, without cross-subsidization with operations of another unit.

The Company manages its activities as separate profit centers but does not submit audited Financial Statements to profit centers as required in the Electricity Sector Regulations and in most of its licenses (including the new generation licenses received by the Company) and does not submit audited annual Financial Statements separately for each area, for each activity, but submits audited financial statements for the Company’s operation in general.

The Company estimates that this issue is supposed to be regulated as part of the Structural Change that will be agreed upon. Notwithstanding, and despite sanctions not being imposed on the Company in this matter as of the date of the report, in the opinion of the management and the Board of Directors of the Company, as long as the issue of reporting by profit centers is not resolved, and in light of the provisions of the Electricity Sector Regulations (Terms and Procedures for Granting Licenses and Obligations of the License Holder) - 1997 and the Company licenses that determine that the Company, as an essential service provider, is required to submit separate Financial Statements for each region, each activity and each profit center, there is exposure for the Company in the form of steps or proceedings that may be taken against the Company for failure to fulfill the provisions stipulated in its licenses.

According to the decision of the Electricity Authority of January 15, 2015<sup>83</sup>, the Company was required to submit to the Electricity Authority by the middle of March, 2015 a timetable on its behalf for completing the preparation of a profit centers report under the requirements of section 9.b of its licenses.

On April 19, 2015, the Company applied to the Electricity Authority in a letter, stating that this issue constitutes a component of the discussions between the parties with respect to the structural change of the electricity sector, and also constituted part of the discussions of the Steering Team and the draft of its recommendations. The Company further noted that in light of this, and since as yet there has been no determination of and no agreement regarding a structure with respect to which a report concerning profit centers as stated can be prepared, the Company cannot provide a logical estimate of schedules for completion of the process, and in lieu it is requesting to conduct a discussion as soon as possible with all the parties concerned, in order to formulate an outline which will enable the Company to complete the process of preparation of the report according to profit centers as required. For additional details see note 1.b.2) to the Financial Statements.

### **28.3.4 Competition**

As of the date of the report, the Company generates, transmits and distributes most of the electricity consumed in the State of Israel. However, as described in Section 6.5, the Government of Israel and the Electricity Authority take steps to encourage the entry of private electricity producers into the Electricity Sector, and in recent years have adopted a list of resolutions that have increased the share of private electricity producers in the Electricity Sector in Israel, while providing a safety net and certain arrangements that are designed to benefit the private electricity producers. The Company estimates that these resolutions are expected to

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<sup>83</sup> Decision no. 5 of meeting no. 451 of January 15, 2015, regarding “Decision of implementing reporting obligations on the Israel Electric Corporation Ltd. - generation, transmission, distribution, supply segments and general reports”



continue to cause a significant increase in the energy generation volume of private producers, including generation using renewable energy.

The expansion of the private production sector and the profusion of various regulatory arrangements for private producers create uncertainty as to the volume of electricity the Company is required to generate and supply to consumers and as to the Company's ability to compete with the private electricity producers in the generation sector.

Nonetheless, and despite the increase in the scope of private production, since most of the private electricity producers use the Company's transmission and/or distribution grid, the Company does not foresee a significant decrease in sales in the grid's segments. However, it should be taken into account that an increase in the amount of independent producers who are not expected to use the Company's transmission and distribution grids is expected in the coming years.

In addition, the decisions of the Electricity Authority regarding historical distributors and granting licenses for 20 years harm the competitiveness of the Company in the distribution segment. For additional details, including with regard to a petition submitted by the Company against the Electricity Authority, within which the Court was requested to instruct the Electricity Authority to cease from all activity pertaining to privatization of the electricity sector and electricity distribution in Israel, see section 9.4.

In the field of the Company's electricity supply and sale operation, the fact that private producers hold a supply license in addition to the production license, which enables them to also serve as suppliers to end consumers, accordingly causes a decrease in the Company's activity in this segment.

For additional details regarding the implications of increase in the private production on the operation of the Company in each of its activity segments, including impact on revenues and profitability of the Company, see section 7.4.4. For details of the Company's application to the General Director of the Antitrust Authority, requesting to cancel the declaration of the Company as a monopoly and alternatively to change and minimize the declaration of the Company as a monopoly, see section 21.9.

### **28.3.5 Development and Advancement of the Development Plan in the Generation and Transmission Segments.**

In accordance with the provisions of the Electricity Sector Law and its regulations and the licenses of the Company, and its classification as an "essential service supplier", the Company is required to submit for the approval of the Minister a Development Plan for the purpose of its activity and to fulfill them and their conditions<sup>84</sup>. The failure of the Company to comply with the Development Plan may expose the Company and its managers to criminal sanctions and lead to the cancellation of some or all of the licenses that have been issued to it.

The future needs of the Electricity Sector in Israel may change in accordance with a great number of parameters, including future demand for electricity, climatic changes, developments of technologies and generation measures, different fuels that will be supplied to the Company, the geopolitical situation, 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.

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<sup>84</sup> As detailed above, in accordance with the provisions of the Electricity Sector Law, the Minister's approval, insofar as will be given, will be given in consultation with the Electricity Authority and the consent of the Minister of Finance.

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 Section 7.7.8. In the past, and the Company expects this to be the case in the future too, the Development Plans were financed, partly or fully, by taking loans from domestic and foreign financial institutions and from raising of debt in public or private issues, in Israel or overseas. As of the date of publication of the report, there is no certainty with respect to the ability of the Company to execute the Development Plan, and this, inter alia, to the extent that the Company will not be able to raise debt from external sources and/or due to other budgetary considerations.

Obsolescence of the distribution grids makes it harder for the Company to meet the electricity supply reliability goals it has set. Additional delays in the renewal of the stated distribution grids may increase the damage to the reliability of supplying electricity to the Company customers. Additionally, it should be noted that the parameters detailed above regarding the generation and transmission segments may also affect the development of the distribution segment.

For details of the decision of the Company's Board of Directors to suspend the advancement of Project D, see section 7.7.7.

#### **28.3.6 Structural change**

The purpose of the Electricity Sector Law is to regulate the activity in the Electricity Sector to the benefit of the public, while ensuring reliability, availability, quality, efficiency, all while forming conditions for competition and minimization of costs.

As of the date of the report, the Company generates, transmits, distributes and supplies most of the electricity that is consumer in the Israeli economy, and therefore a structural change in the electricity sector in accordance with the Electricity Sector Law may weaken the status of the Company in the electricity sector in one or more of these activities, and decrease the monopolistic position of the Company in that activity.

The structure of the electricity sector, as set in the Electricity Sector Law, obliges execution of a structural change in the Company. As of the date of the report there is material uncertainty as to the manner in which the Electricity Sector Law will be implemented and the manner in which the Company and its activities, assets and liabilities will be reorganized in order to comply with the provisions of the Electricity Sector law.

For details regarding the structural change outlined under the Electricity Sector Law, the draft of recommendations of the steering team and the Yogev committee, the Court of Labor's decision regarding promotion of the outline of reform in the Company, and meetings held by the relevant parties in this matter, see Note 1. e to the Financial Statements.

If the provisions of the Electricity Sector Law are not changed (including the need to implement the recommendations draft of the steering team or the Yogev Letter) and/or the agreements required for the implementation of the recommendations draft of the steering team or the Yogev letter are not received, then it is possible that the Company will have to implement the Structural Change as it is laid down in the Electricity Sector Law, whether in the way in which the Company understands that the Electricity Sector Law can be implemented, as stated in Note 1.e. to the Financial Statements, or in another outline.

As of the date of the report, there is yet no certainty with respect to the final format of the Structural Change, its time of implementation or its consequences for the Company, its business affairs or outcomes, but the implementation of the Structural Change, including in accordance with the details of the Yogev Letter is expected to have a material effect on the Company, its business affairs, activity and financial outcomes.

### **28.3.7 Asset arrangement**

As described in Section 14.3, Section 62 of the Electricity Sector Law sets forth various provisions with respect to certain rights and assets which were held by the Company upon the expiry of the franchises which were granted to it by virtue of the Electricity Franchises Ordinance, with respect to part of which an arrangement is to be made between the State and the Company which shall govern the purchase thereof from the State according to the value of the assets on the date of conferral of the rights and the assets. As of the date of the report, no provisions have been established in the matter.

In February 2000, the Company received a letter from the Deputy Commissioner of Budgets in the Ministry of Finance, in which he states that within the framework of the Government team which has been appointed to handle the subject, the State has formulated an opinion, which includes an economic and accounting opinion and a legal opinion on behalf of the State with respect to the asset arrangement (the "**Opinion by the State**"). It was further noted in the Opinion by the State that some of the assets were held by the State on the date the Electricity Sector Law entered into force, with all the implications deriving from that. The letter stated that according to the content of the opinion by the State, it appears that the implementation of the asset arrangement pursuant to the Electricity Sector Law may have a material effect on the Company.

As detailed in Notes 1 e and Note 1 f to the Financial Statements, on March 23, 2014, a draft of recommendations by the Steering Team was published, and included, inter alia, recommendations regarding the issue of asset arrangement. The Company delivered its reaction and initial position regarding this draft of recommendations, and its reservations regarding some of them, to the Steering Team. Additionally and as detailed in Note 1 f to the Financial Statements, the issue of asset arrangement was also expressed in the Yogev letter which was received by the Company on September 8, 2014, and in the letter of the Comptroller General and the Director General of the Government Companies Authority.

It should be noted that the draft of recommendations of the steering team, the Yogev letter and the letter of the Comptroller General and the Director General of the Government Companies Authority have not yet been examined by all the authorized government entities and have not yet been approved by them, and in general are not in line with the provisions of the Electricity Sector Law. The Electric Company and the State entities are continuing to hold meetings in order to advance the assets arrangements outline, but the parties have not yet reached consents and decisions have not been made in the matter. As of the date of publication of the report, the contacts between the Company and the State entities regarding the assets arrangement are continuing.

In the estimation of the Company, as of the date of this report, the assets arrangement does not have a material effect on the Company or on its monetary results or on its financial situation. At the same time, the Company has no possibility of estimating what the actual bottom line will be with respect to the asset arrangement, what its implications will be (if any) for the Company, and it is not in any way certain that future implementation of the asset arrangement will not materially affect its financial situation.

For additional details regarding the asset arrangement, including with regard to the recommendations draft of the Steering Team, the Yogev Letter, and the letter of the Comptroller General and the Director General of the Government Companies Authority, see Note 1 e and Note 1 f to the Financial Statements.

### **28.3.8 Legal**

As of the time of this report, 12 petitions (one of which combines two separate petitions which were consolidated and one of which was submitted as an expansion of an existing claim, as well as 3 additional ones dealing with the same issue) are pending against the Company for recognition of actions as class actions. The sum of 9 of the actions mentioned above amounts to a sum of approximately NIS 17.8 billion and three actions are not specified in amounts and have been estimated by the plaintiffs in the amount of several tens of millions of NIS in total. Additional claims are pending against the Company. For details of the actions see Section 23 and Note 35(B) of the Financial Statements.

Based on the expert opinion of its legal counsel, the Company has not made for these class actions any provision in the Financial Statements, except for two actions in respect of which a negligible provision was recorded, but

to the extent that these petitions are accepted in part or in full, this may have a material adverse effect over the Company.

### **28.3.9 Customers**

The Company provides its customers credit and as a result of this, the Company is exposed to a risk of monetary loss as a result of insolvency or a decrease in the credit quality of debtors or parties to contracts or by unique characteristics of some of the customers of the Company (for details of the debt balance of the Palestinian Authority see Note 6 c to the Financial Statements). The Company is acting on the issue of collection enforcement using “red light” information<sup>85</sup> with respect to deterioration in the business status of its strategic customers, which is received on a regular basis from the business information companies and is transferred to the districts of the Company.

### **28.3.10 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. As detailed in section 13.5.2, the management intends to conduct discussions with the employee union in order to reach consents regarding a new and updated labor agreement which will replace the labor rules.

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.

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 Histadrut and with the authorities of the State in order that changes in the labor relations in the Company, including within the Structural Change, organizational changes and cost saving plans will be conducted with the consent and approval of the relevant entities. To the extent that these changes are implemented without the consent of the labor union, this may lead to a labor dispute, which may affect the Company and its activity.

The Company estimates that the costs of employee retirement as part of the implementation of the Structural Change or as a result of organizational change and internal efficiency processes, insofar as will be implemented, may be material.

For details regarding labor disputes see Note 35 c to the Financial Statements.

### **28.3.11 Liabilities for pension fund**

The deposits into the central pension fund, for first generation and second generation employees who are insured by budgetary pension (the “Fund”), are determined according to the actuarial balance calculated by the actuary of the Fund at the end of the year which is based on a future flow capitalization and includes a number of actuarial assumptions (the pension of third generation employees is an accumulating pension). There is a risk that the actuarial liability of the Company will be higher than that forecasted by it, to the extent that the Fund’s assets, including the deposits and their proceeds, do not cover this liability, and the Company may be required to make additional deposits for the Fund, in amounts that may be material for the Company. In addition, the actuarial model for the calculation of the deposits into the Fund may change in the future, *inter alia* in

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<sup>85</sup> 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).

accordance with changes in the life expectancy, in regulatory provisions 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 Fund.

In addition, the policy of the investments of the Fund's assets is targeted at adjusting assets to liabilities, inter alia, due to the differences between the lifetime and return of Government bonds in which most of the assets of the Fund are invested and the lifetime and return of linked Government bonds by which the pension liabilities of the Company are calculated. These differences may lead to the total assets of the fund being lower than the liabilities of the fund to the pensioners of the Company, in which case the Company will be required to make good the gap between the assets and the liabilities of the fund, to amounts that may be significant.

#### **28.3.12 Generation Array Management and Technical Failures in Generation**

The reliability of the equipment existing in the power stations may have an impact on the reliability of the entire station and the reliability of the electricity system. In case of equipment failure, the station may be restricted in the generation capacity, and even worse, may leave the generation cycle. Repair of extensive failures involves very high direct and indirect costs for equipment, spare parts, experts, contractors and Company employee labor, and alternative fuel costs due to disabled stations working on cheap fuel and activation of other stations working on more expensive and more polluting fuel.

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 addition, there is risk of technical failures in the generation installations, due to various technical and physical reasons which may cause cessation of generation or its restriction for a long time. 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 cases in which this risk materializes and leads to non compliance with the full demand for electricity , it may be interpreted as the Company not meeting its liabilities under its licenses or the provisions of the law, and may therefore adversely affect the Company, in its outcomes and its image in the public eye.

In recent years, many combined cycle stations have integrated into the generation array of the Company. The combined cycle stations are characterized by higher and faster erosion in comparison with other generation units, and they therefore need frequent maintenance activities. The number of severe failures in these units is higher in comparison with other units and their planned lifespan is shorter. Although the Company's "all risk" insurance usually covers severe equipment failures, the deductible of this insurance is high, and handling the insurance claims, which often reach legal proceedings, takes a long time.

The Company estimates that correct operation, continuous monitoring of data, strict forecasted maintenance and planned maintenance in the recommended gaps and acquisition of reliable equipment, based on known technologies, are the efficient means to reduce the number of technical failures and to increase the reliability of the equipment.

The Company is reducing the extent of the planned renovations on the basis of a rational consideration. This policy may have an adverse effect on the reliability of the equipment and the availability of the station.

#### **28.3.13 Managing the life cycle of the transmission transformation and distribution array**

Lack of optimal management throughout the lifecycle of the transmission, transformation and distribution array may cause harm to the reliability of the supply to the customers of the Company, lack of compliance with legislation and regulation requirements, increased exposure to risks of electrocution and fires, loss of income due to numerous technical failures, damage to the image of the Company, and possible damage to the environment.

In the long term, there is likelihood of increase in the risk level due to lack of development or partial development of the transmission, transformation and distribution array, deriving from a partial recognition of the electricity rate of the required development costs, including the costs required to replace old equipment which has reached the end of its operating life.

#### **28.3.14 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 handling the risk, a general survey of embezzlement and fraud was conducted in 2014 and 2015, as well as a focused survey for these risks in the field acquisitions and contractual engagements. The Company has an inter-departmental team headed by an embezzlement and fraud risk controller. The team prepared a master plan to reduce embezzlement and fraud risks at Company level based on the results of the risk surveys carried out in the years 2014-2015. The plan was approved by the Company CEO, and the team is following the implementation of the reduction plan in the various Company units.

In accordance with the aforesaid plan, the work team has to report once a period to a designated steering committee for embezzlement and fraud headed by the risk holding Deputy CEO.

Following the stated risk surveys and understanding the importance of dealing with embezzlement and fraud risks, the Company has decided to raise the risk rating to high, as of the fourth quarter of 2015.

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 bribery. 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, inter alia, by the OECD organization. This process also continued in 2015 and the Company estimates that it will be completed during the first half of 2016. In addition, the CEO of the Company has given his approval to the program outline.

**29. Additional details in accordance with circular 2013-5-1 of the Government Companies Authority**

**29.1 Money that the Company has received from the State**

See Section Regulation 22 in Chapter D of this annual statement for details on the loans that the Company has received from the state.

**29.2 Disclosure with respect to investee corporations**

Details with respect to held corporations follow:

Name of the Company	Country and place of incorporation	Rights of the Company in the Company (including means and control, asset rights, rights to distribution of profits and details, to the best of the Company's knowledge, with respect to other holders of the held corporation and their rights)	Names of the officers and other representatives who are serving or have served on behalf of the Company in the Company in 2015 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
<b>Jordan Properties Company Ltd.</b>	Israel	Fully owned (99.98%) subsidiary <sup>86</sup> . 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.	As of December 31, 2014, there are no officers or other representatives serving on behalf of the Company in the held corporation <sup>87</sup>	None.	No general meetings were held during 2015.
<b>Migrashei Hakablanim Ltd.</b>	Israel	A fully owned (100%) subsidiary <sup>88</sup> . 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.	As of December 31, 2014, there are no officers or other representatives serving on behalf of the Company in the held corporation <sup>89</sup>	There is no material agreement for the Company. Migrashei Hakablanim Ltd. has a right of lease from the Tel Aviv Municipal Council for a plot in Anielewicz Street, on which there is an office building that is being used by the Company. In exchange for a right of use of the property, the Corporation bears all of the costs related to the maintenance of the property, including taxes and fees.	No general meetings were held during 2015.

<sup>86</sup> 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.

<sup>87</sup> As of the date of publication of the report, the Company is still working to obtain approval to appoint directors on the part of the held company.

<sup>88</sup> 630 deferred shares are held by officers in trust for the Company.

<sup>89</sup> As of the date of publication of the Report, the Company is still working to obtain approval for the appointment of directors on its part in the held company



Name of the Company	Country and place of incorporation	Rights of the Company in the Company (including means and control, asset rights, rights to distribution of profits and details, to the best of the Company's knowledge, with respect to other holders of the held corporation and their rights)	Names of the officers and other representatives who are serving or have served on behalf of the Company in the Company in 2015 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
<b>The National Coal Supply Company Ltd.</b>	Israel	<p>Fully (100%) owned subsidiary. The Company holds 100% of the rights attached to shares, including rights to receive a dividend, voting rights and the right to appoint functionaries and directors by the Company, subject to the provisions of the Government Companies Law and the articles of the Coal Company.</p> <p>According to the articles of the Coal Company, out of the nine members of the Board of Directors, six are representatives of the Company and three of the State.</p>	<p>On March 13, 2014, the Company appointed directors to represent it at The National Coal Supply Company Ltd.: Shakib Gadban, Efraim Osher, Oren Helman, Masha Hafiorski and Michal Yogev-Azulai. The directors mentioned above did not receive additional compensation for their term as stated.service.</p> <p>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.</p>	<p>The Company purchases all of the coal that it requires through the National Coal Supply Company Ltd., in accordance with an agreement that was signed between the parties in July 2004 for the purchase of coal and its supply to the power stations of the company consuming coal. See Section 7.9.6 for details on the agreement.</p>	

Name of the Company	Country and place of incorporation	Rights of the Company in the Company (including means and control, asset rights, rights to distribution of profits and details, to the best of the Company's knowledge, with respect to other holders of the held corporation and their rights)	Names of the officers and other representatives who are serving or have served on behalf of the Company in the Company in 2015 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
<b>The Managing Company of the Advanced Studies Fund of Israel Electric Corporation Ltd., Employees Ltd.</b>	Israel	<p>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%)</p>	<p>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 (pensioner). They receive no compensation for this service.</p> <p>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.</p> <p>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.</p>	None	<p>On May 27, 2015, a general annual meeting convened and decided on the following subjects:</p> <p>presentation of the Financial Statements of the Company including statement of the Business of the Corporation and report of the Board of Directors for 2014, and the financial statements of the advance study fund managed by the Company including the management's review for 2014.</p> <p>Appointment of an external director.</p> <p>Approval of the decision of the Board of Directors of contractual engagement for insurance of office holders and professional liability for 2014-2015. The Company voted by an authorized representative appointed by the Board of Directors of the Israel Electric Company.</p>

Name of the Company	Country and place of incorporation	Rights of the Company in the Company (including means and control, asset rights, rights to distribution of profits and details, to the best of the Company's knowledge, with respect to other holders of the held corporation and their rights)	Names of the officers and other representatives who are serving or have served on behalf of the Company in the Company in 2015 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
<b>The Energy Resource Development Company Ltd.</b>	Israel	<p>The Company holds 49.99% of the shares and capital rights and 30.77% of the rights to appoint directors.</p> <p>The remainder of the rights are held equally by Israel Chemicals Ltd. and Refineries Ltd.</p> <p>The State of Israel holds one foundation share, which grants it certain rights of management and appointment of directors</p>	To the best of the Company's knowledge and as of the date of the report, the company is inactive.	To the best of the Company's knowledge and as of the date of the report, the company is inactive. During 2001, the activity of ERD was discontinued due to a decision of the shareholders to stop the transfer of money for its activity. In this context, an agreement was signed between the shareholders, defining the form of termination of the service of ERD and the sale of its assets.	No general meetings were held during 2015.

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Ofer Bloch,  
Chief Executive Officer

Yiftah Ron-Tal  
Chairman of the  
Board of Directors

Date of Approval: March 21, 2016



# The Israel Electric Corporation Ltd.

## Chapter B

Board of Directors' Report on the  
Status of the Company's Affairs

For the Year Ended  
December 31, 2015

## **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, 2015 ("English Translation") is provided for informational purposes only.

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

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

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

**THE ISRAEL ELECTRIC CORPORATION LIMITED**  
**BOARD OF DIRECTORS' REPORT ON THE STATUS OF THE COMPANY'S AFFAIRS**  
**FOR THE YEAR ENDED DECEMBER 31, 2015**

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The Board of Directors of the Israel Electric Corporation (the "Company") hereby presents the Directors' Report on the status of the Company's affairs for the year ended on December 31, 2015, ("The Report Period") according to the directives of the Securities Regulations (Periodic and Immediate Reports) – 1970 ("The Securities Regulations") and the provisions of the Government Companies Authority ("The Companies Authority").

**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, 2017. 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 1 to the Financial Statements of December 31, 2015 (hereinafter: "Financial Statements").

**b) Condensed Review of the Changes in the Business Environment during the Report Period**

- 1) As of January 1, 2015, the Company is fully implementing the international accounting principles - IFRS in its Financial Statements.  
For additional details see Note 2 a and Note 37 to the Financial Statements.
- 2) For details of the rating of the Company see Note 20.g. to the Financial Statements.
- 3) The Company foresees that its revenues will decrease in 2016, compared to 2015, in an amount exceeding NIS 3 billion (including VAT), due to a decrease in the rate, decrease in electricity demand and entry of private electricity producers into the electricity sector. The Company does not foresee a material impact on its profitability, for details see section 5 in Chapter A - Report of Description of the Business Affairs of the Corporation.
- 4) On January 26, 2015, the Company received the decision of the Electricity Authority, regarding the decrease of the electricity rate. On September 7, 2015, the Authority published a decision pertaining to the 2015 annual update. On December 8, 2015, the Company received the decision of the Electricity Authority, regarding recognition of the costs of installations for emission reduction at Orot Rabin 5-6 and Rutenberg 1-4 (see section 17 below), and after the balance sheet date, on March 10, 2016, the Electricity Authority's decision was received regarding a late hearing of the aforesaid Authority's decision. On December 13, 2015, the Company received the decision of the Electricity Authority, regarding the granting of distribution and supply licenses to distribution companies at kibbutzim (collective settlements) connected to the distribution grid. On December 16, 2015, the Electricity Authority's decision regarding changes and updates to the consumption criteria was received. For details of the electricity rate and the changes in it see Note 3 to the Financial Statements.

**THE ISRAEL ELECTRIC CORPORATION LIMITED**  
**BOARD OF DIRECTORS' REPORT ON THE STATUS OF THE COMPANY'S AFFAIRS**  
**FOR THE YEAR ENDED DECEMBER 31, 2015**

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**a. Explanations of the Board of Directors on the Business Condition of the Company (continued)**

**1. Brief Description of the Company and its Business Environment (continued)**

**b) Condensed Review of the Changes in the Business Environment during the Report Period (9 months) (continued)**

- 5) On February 25, 2015, a special collective agreement was signed between the Company and the New National Labor Federation and the Employee union (hereinafter: the "Collective Agreement"). It was agreed in the Collective Agreement, inter alia, on early retirement of 440 permanent employees in 2015, granting tenure and conditions for eliminating permanent positions following the consents, extending employment of temporary employees employed in projects, deducting salary due to participation of employees in sanctions and strikes, industrial peace and exhausting claims in issues arranged in the agreement.

On May 27, 2015, the Director of Wages at the Ministry of Finance and the Companies Authority approved the stated collective agreement. On October 14, 2015, the authorized authorities approved an addendum to the special collective agreement, which was signed between the Company and the New National Labor Federation and the Employees' Union (hereinafter: the "Addendum to the Agreement"). According to the Addendum to the Agreement, the Company will increase the number of retirees retiring by special early retirement by 20, and an appropriate update will apply to the permanency quotas and suspension of permanent positions which were determined in the special collective agreement.

For additional details see Note 11.f to the Financial Statements.

- 6) For details of the Tamar agreement including exercising options of the agreement and including information with respect to the Take or Pay mechanism set in the agreement, see Note 35.a.1) to the Financial Statements, as well as section 7.9.9.2 of Chapter A Report of the Description of the Business Affairs of the Corporation.

- 7) Following publication of the draft outline for regulating the natural gas sector (hereinafter: the "Outline") for public comments, Mr. Yiftah Ron-Tal, Chairman of the Board of Directors of the Company, delivered the Company's position regarding the Outline to the Minister of National Infrastructures, Energy and Water (hereinafter: the "Minister").

On August 16, 2015, the Government approved the Outline. The Company is studying the significance of the approved outline.

- 8) On June 10, 2015, Mr. Ofer Bloch was appointed Company CEO. For details of his education, qualifications and business experience see Regulation 26 a (Details Regarding Senior Office Holder of the Corporation) in Chapter D of the Company's Periodic Report for 2015.

- 9) For details regarding the supervision of the Ministry of Environmental Protection on the advancement of execution of the emissions abatement project of the Orot Rabin and Rutenberg power stations, the Company's ability to meet the schedules allocated to it, and the implications on the operation of the Company, see section 7.12.2.4 in Chapter A of the Report of Description of the Business Affairs of the Corporation.

- 10) On July 7, 2015, one unit (out of two) of a private electricity producer - Dalia Energies Power Ltd. (hereinafter: "Dalia") began its commercial operation.

The gross maximal output of the abovementioned unit in the Dalia combined cycle is approximately 457 megawatts. The combined cycle can operate both on the basis of natural gas and on the basis of diesel.

On September 4, 2015, Dalia's second unit (out of two) began its commercial operation. The gross maximal output of the abovementioned unit in the Dalia combined cycle is 455 megawatts. The combined cycle can operate both on the basis of natural gas and on the basis of diesel.

Dalia's commercial outline is selling most of the electricity to the system management (the Company) on a competitive basis and the remainder to end users (private consumers). For additional details see Note 35.a.4) to the Financial Statements.



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**a. Explanations of the Board of Directors on the Business Condition of the Company (continued)**

**1. Brief Description of the Company and its Business Environment (continued)**

**b) Condensed Review of the Changes in the Business Environment during the Report Period (9 months) (continued)**

- 11) The Company offered the public debentures in a prospectus subject to completion on May 27, 2015, which was amended on June 3, 2015. The consideration for the debentures in the amount of approximately NIS 923 million, which the Company received on June 9, 2015, was used for partial repayment of index-linked public debentures of Series 24 which were repaid in full on July 9, 2015, in the amount of NIS 1,997 million par value (a total of NIS 2,026 million including linkage differentials). The aforesaid use is in accordance with the designation of the consideration as was defined in the prospectus, which includes, inter alia, recycling an existing debt of the Company.
- 12) During October, 2015, disruptions occurred in the supply of electricity due to the stormy weather which visited the country. Following this, on October 27, November 1, and December 31, 2015, three applications for approval as a class action against the Company were submitted to the Central Region District Court. For additional details see Note 35. b.1)j) to the Financial Statements. In addition, a team was appointed by the Minister in charge to examine the preparations and conduct of the Electric Company in these events, and internal examination teams were appointed by the CEO and Board of Directors of the Company.  
In March 2016, the Company received the summary report of the examination team which was appointed by the Minister as aforesaid. The Company is studying the report and its conclusions.
- 13) On November 5, 2015, the Lod District Court ruled in the proceeding conducted between the Company and the National Labor Federation and the Employees' Union, the Attorney General and Mizrahi Tefahot Trust Company Ltd. The Court partially accepted the Company's request to use money deposited in the trust account since the year 2000 and onwards to cover the Company's liability to pension and compensation. For additional details see Note 12 to the Financial Statements.
- 14) On November 26, 2015, the Company published a shelf prospectus (for details see Note 20 c to the Financial Statements) on the basis of the Company's Financial Statements for December 31, 2014, and on the basis of the Company's Financial Statements for the second quarter of 2015. The shelf prospectus will enable the Company to issue various securities, except for shares (namely non-convertible debentures, option warrants exercisable into Company debentures, and commercial securities) which will be listed on the Tel Aviv Stock Exchange Ltd. during a period of 24 months (which can be extended by another 12 months) on the basis of publication of a shelf offering report.
- 15) On November 26, 2015, the Board of Directors of the Company decided to grant a letter of undertaking to indemnify to the officers of the Company. For additional details see Note 34.f.
- 16) On November 29, 2015, an update was received for the permit from the Natural Gas Authority of the Ministry of National Infrastructures, Energy and Water, to market and sell surplus natural gas. For details regarding the update see section 7.9.9.2 of Chapter A - Report of the Description of the Business Affairs of the Corporation.
- 17) For details of petitions submitted by the Company to the Supreme Court in Jerusalem, sitting as the High Court of Justice, for granting orders against the Electricity Authority, regarding electricity rate update in the transmission and distribution segments, determining rates for management services of the electricity system, and recognition of costs of installations to reduce emissions at the coal powered power stations see Note 3. to the Financial Statements.
- 18) On December 4, 2015, within an arbitration proceeding between the Company and the EMG Company and the Egyptian National Gas Companies, to receive compensation with respect to the heavy damages caused to the Company due to failure to supply the Egyptian gas, in which the Company claimed over four billion Dollars in compensation, the Company received an arbitration award, within which it was ruled, inter alia, in favor of the Company in the amount of approximately USD 1.76 billion

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a. **Explanations of the Board of Directors on the Business Condition of the Company (continued)**

1. **Brief Description of the Company and its Business Environment (continued)**

b) **Condensed Review of the Changes in the Business Environment during the Report Period (9 months) (continued)**

plus interest, as well as partial reimbursement of legal costs. The Company will act to collect the sums it is entitled to under the arbitration award. After the balance sheet date, on February 11, 2016, the Company received an application to appeal the arbitration award which was granted, which was submitted to the Superior Court in Switzerland by the Egyptian National Gas Companies. The Company submitted its response to the Court. For additional details see Note 35.b.5).

19) On December 31, 2015, Mr. Avi Doitchman was appointed Senior Vice President of Finance and Economics of the Company. For details of his education, qualifications and business experience see Regulation 26a (Details Regarding Senior Office Holder of the Corporation) in Chapter D of the Company's Periodic Report for 2015.

20) After the balance sheet date, on January 1, 2016, the Company received the directive of the Minister, that the coal powered generation units will be operated such that the electricity generation rate in these units will be reduced by 15% in an annual calculation relative to the electricity generation in these units in 2015. Pursuant to the Minister's directive, the reduction will be executed according to the terms of operation detailed in it, including that operation of all the coal powered units will be executed with the minimum required, and that in the event that the Minister declares a special state in the electricity sector, the restriction will be lifted until the end of the special state. It was further determined that the Electricity Authority will be instructed to assimilate the surplus cost with respect to this directive in the electricity rates. For additional details see section 7.12.2.4 in Chapter A - Report of Description of the Business Affairs of the Corporation.

21) After the balance sheet date, on January 14, 2016, the Company received the decision of the National Court of Labor, under which the outline of the reform in the Company will be promoted by April 30, 2016, and on March 2, 2016, a hearing was held at the National Court of Labor at which it was determined that the parties will conduct at least four meetings before the Passover holiday in order to promote the negotiations regarding the reform. For additional details see Note 35.c.7) to the Financial Statements.

22) After the balance sheet date, on February 2, 2016, the Company received a letter from the Antitrust Authority, within which it was claimed that the Director of the Antitrust Authority is considering to determine that the Company abused its status as a monopoly in the transmission of electricity and its distribution, as well as imposing a financial fine on the Company in the amount of NIS 13 million, with respect to these offences. It was further written that the Director is considering imposing a financial fine on a number of office holders of the Company. For additional details see Note 1.h. to the Financial Statements.

23) After the balance sheet date, on February 17, 2016, the Company executed buyback of debentures (Series 12) and debentures (Series 13), which were traded on the "TACT Institutional" institutional trading market system of the Tel Aviv Stock Exchange Ltd. (the "TACT Institutional"), at an amount of NIS 768 million par value debentures (Series 12) and NIS 461 million par value debentures (Series M), and for a total payment of NIS 1,556 million by the Company with respect to the Debentures purchased by the Company.

In accordance with the terms of the stated Debentures, the Company is acting to delist the Debentures purchased by the Company from trading on the Retzef Mosadi'im.

24) After the balance sheet date, on February 22, 2016, the Company raised approximately NIS 1,510 million through expansion of negotiable debentures of series 26 and 27 and under a shelf prospectus published on November 26, 2015. For details see Note 20.d to the Financial Statements.

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**a. Explanations of the Board of Directors on the Business Condition of the Company (continued)**

**1. Brief Description of the Company and its Business Environment (continued)**

**c) Information Required in Accordance with the Directives of the Government Companies Authority**

**1) Targets and Strategy**

For general details of the Company's targets and strategies see section 25 of Chapter A.

In December, 2013, the Companies Authority, in collaboration with the Ministry of Environmental Protection, published a guidebook for sustainable development in Government Companies, in order to assist companies to implement principles of sustainable development and corporate responsibility. Following this, a Companies Authority circular on the subject of Sustainable Development in Government Companies - Implementation Instructions was sent in December 2013.

In June, 2014, the Company delivered its policy and strategy report for corporate sustainability on its behalf according to the instructions of the guidebook.

The report includes, inter alia, the sustainability vision and the sustainability policy of the Company in various fields.

The strategic policy for sustainable development was presented to the management of the Company and the Board of Directors and approved as required in the guidebook. In addition, office holders were appointed to synchronize the many activities that are carried out in the fields of the environmental and social sustainability. A steering committee was appointed for the process, headed by the Company CEO, and tracking and reporting modes were set.

As part of the work of the steering committee in the Company, processes of mapping and updating were carried out for the main areas of sustainable development processes in the Company, including defining targets for the multi-disciplinary environmental issues, office holders were appointed to synchronize the many activities executed in the field of environmental and social sustainability, approximately 20 inter-divisionary work teams were appointed (main and secondary) in the environmental and social fields. The work teams are working to realize annual and multi-annual work plans in diverse fields, such as: internal energetic efficiency, prevention of soil, air and water sources pollution, handling hazardous materials, biological diversity, landscape appearance of the Company's facilities, various types of waste, fuel infrastructures, wise use of paper, using water for operating and administrative needs, etc.

As required, reports of the activity to promote the issue, including targets and timetables, were submitted to the Government Companies Authority.

Additionally, various actions in the field of corporate sustainability in the Company are executed, such as:

Awarding the CEO Sustainability Prize, updating the Company's website on sustainability matters, integrating sustainability issues in various internal Company trainings, expanding the platform for dialogue with interested parties (inter alia, employees, investors, business partners and suppliers, customers and end users and the local community) etc.

At the same time, the Company voluntarily organized the formulation of the Corporate Sustainability Reports for 2012, 2013 and 2014 which were published on the Company's website.

**2) The major financial targets of the Company**

The long term targets are presented below (not including the effect of the structural change):

(a) Net financial debt ratio to EBITDA of 6.5 (the EBITDA of 2015 in the amount of NIS 7,152 million. The net financial debt of the Company as of December 31, 2015, is NIS 44,580 million. The net financial debt to EBITDA ratio in practice as of December 31, 2015 is 6.2).

(b) Total debt ratio to total balance sheet will gradually decrease to 81% (as of December 31, 2015, the ratio stands at approximately 80%).

(c) Maintaining the 'BBB-' international rating (for additional details, see Note 20.g. the Financial Statements).

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**a. Explanations of the Board of Directors on the Business Condition of the Company (continued)**

**1. Brief Description of the Company and its Business Environment (continued)**

**c) Information Required in Accordance with the Directives of the Government Companies Authority**

2) The major financial targets of the Company (continued)

(d) Cash balance and short term investments will not be less than NIS 2.2 billion. (In accordance with the decision of the Board of Directors that the excess fuels inventory value and/or unused secured credit lines for a period exceeding one year up to a value of NIS 800 million constitutes completion of the safety cushion in the amount of at least NIS 3 billion). As of the date of signing the financial statements, the Company is meeting the objective.

(e) According to the five-year financial plan, decreasing financial debt by NIS 0.5 billion per year.

3) The Electric Company's strategic emergency awareness and readiness plan:

The Company's preparations for emergency and the main points of the "strategic emergency awareness and readiness plan" were presented and approved for the first time in a meeting of the Board of Directors of the Company of August 14, 2013. In September 2015, the plan's status was presented to the Board of Directors by the Deputy CEO Logistics.

The plan is based on directives of the Government Companies Authority, as detailed in the Companies Authority circular on the subject of July 11, 2012.

The plan includes the policy and targets of the Company for continued functional continuity and emergency electricity supply on the basis of priorities defined primarily for essential plants as well as for all the customers of the Company in times of emergency.

As part of the preparations of the Company for times of emergency, there is a scenario of total/regional war; this scenario is designed to be updated after its approval by the Cabinet.

The emergency plan also includes reference to natural disasters, cyber, epidemic, and electromagnetic-pulse (EMP).

The Company acts in cooperation with guiding entities in the State, prepares emergency plans and procedures, defines service levels for emergency, takes care to confine emergency manpower, operates an organizational and personal resilience array, conducts instructions, training and practice for employees and systems for various situations, and draws conclusions from actual events and drills and monitors their implementation.

The Company has established a risk management system subject to regulatory requirements, including risk identification programs and activities to minimize them.

The company purchased an insurance policy for damages and indirect expenses as a result of natural disasters, fire, explosion, contamination and mechanical damage.

The Company holds stocks of fuels, materials and equipment for emergency and operating failures.

The Company has established an array of headquarters, alternative headquarters that can change locations in times of need, and reporting rules and systems for emergency that are drilled every year.

The Company has a security, firefighting, search and rescue teams array for initial and immediate response, including the necessary emergency measures.

The Company has made preparations for business continuity in the computer, communication, spokespersonship and public information systems.

The Company conducts internal national drills on a regular annual basis, participates in national exercises, exercises by government ministries, designated authorities, home front command, Israeli Police, at the national and district/local level.

During the winter of 2015, a state of emergency was announced by the Company four times.

4) For additional details in accordance with the Government Companies Authority directives, see Note 40 to the Financial Statements.

**THE ISRAEL ELECTRIC CORPORATION LIMITED**  
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a. **Explanations of the Board of Directors on the Business Condition of the Company (continued)**

1. **Brief Description of the Company and its Business Environment (continued)**

d) **Report of gaps between the recognized costs of the electricity rates and the actual costs for 2015 in accordance with the Electricity Authority's decision of February 9, 2015**

This disclosure is provided commencing from this report in accordance with the decision of the Electricity Authority and in the format set by it. Its purpose is to compare sums recognized with respect to each component of the rate with the results in practice. However, the attribution to the various rate components was carried out on the basis of assumptions and estimates executed by the Company, on the basis of its understanding of the electricity rate. Regarding the allocation of costs and the assumptions this allocation is based on, see Note 39 to the Financial Statements regarding the activity segments of the Company. This disclosure does not relate to the financing expenses and the tax.

It should be noted that the Company had reservations regarding the structure of presentation set by the Authority for various reasons, but the Authority did not accept the Company's position in the matter.

**THE ISRAEL ELECTRIC CORPORATION LIMITED**  
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**a. Explanations of the Board of Directors on the Business Condition of the Company (continued)**

**1. Brief Description of the Company and its Business Environment (continued)**

**d) Report of gaps between the recognized costs of the electricity rates and the actual costs for 2015 in accordance with the Electricity Authority's decision of February 9, 2015 (continued)**

Generation segment Section	Rate component in NIS million							Gross weighted recognized return/operating profit
	Total income	Fuels	Purchases of Electricity	Operation - wages	Operation - others (including expenses for pensioners)	Efficiency	Depreciation	
Income according to actual rate/rate in force as calculated by the Company (1) .....	15,813	-	-	-	-	-	-	-
Less/plus consumer debt refund with respect to previous years which is included in the actual rate.....	1,067	-	-	-	-	-	-	-
Less/plus compensation with respect to delay in update for the current year.....	(1,170)	-	-	-	-	-	-	-
Total income in books.....	15,710							
Deviation in actual income due to deviation in consumption distribution (2) .....	-							
Recognition on the basis of cash - East Jerusalem Company and Palestinian Authority (9) .....	131							
Theoretical income from rates before efficiency application less deviation of consumption distribution and recognition on the basis of cash of the East Jerusalem Company and Palestinian Authority (3) .....	15,841	8,167	1,499	1,759	1,522	(519)	1,976	1,437
Efficiency attribution .....	-	-	-	(278)	(241)	519	-	-
Theoretical income from rates after efficiency deduction less deviation of consumption distribution and recognition on the basis of cash of the East Jerusalem Company and Palestinian Authority .....	15,841	8,167	1,499	1,481	1,281	-	1,976	1,437
<u>Classifications compared to the Financial Statements (4)</u>								
Classification 1 - fuel related.....	-	253	-	(156)	(97)	-	-	-
Classification 2 - investments in operating power stations.....	-	-	-	-	(248)	-	248	-
Classification 3 - capital services with respect to joint property.....	-	-	-	-	(136)	-	100	36
Classification 4 - capital services with respect to spare parts.....	-	-	-	-	(70)	-	24	46
Classification 5 - financing of suppliers' credit working capital .....	-	-	-	-	12	-	-	(12)
Total theoretical income from rates classified according to Financial Statements ..	15,841	8,420	1,499	1,325	742	-	2,348	1,507
Actual results according to segment Note (5) .....	15,879	8,431	1,510	1,372	1,015	-	2,278	1,273
Plus/less deducted/added regulatory assets(6)	(103)	-	-	-	6	-	-	(109)
Various income (7).....	(66)	-	-	-	(30)	-	-	(36)
Classification - investment renovations .....	-	-	-	13	104	-	(117)	-
Subtotal .....	15,710	8,431	1,510	1,385	1,095	-	2,161	1,128
Differences (8) .....	(131)	(11)	(11)	(60)	(353)	-	187	(379)

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**BOARD OF DIRECTORS' REPORT ON THE STATUS OF THE COMPANY'S AFFAIRS**  
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**a. Explanations of the Board of Directors on the Business Condition of the Company (continued)**

**1. Brief Description of the Company and its Business Environment (continued)**

**d) Report of gaps between the recognized costs of the electricity rates and the actual costs for 2015 in accordance with the Electricity Authority's decision of February 9, 2015 (continued)**

<u>Generation segment</u> <u>Section</u>	Rate component in NIS million							Gross weighted recognized return/operating profit
	Total income	Fuels	Purchases of Electricity	Operation - wages	Operation - others (including expenses for pensioners)	Efficiency	Depreciation	
<u>Explained differences</u>								
Non-recognition of renovation costs .....	-	-	-	(22)	-	-	-	(22)
Non-recognition of full depreciation costs with respect to spare parts inventory .....	-	-	-	-	-	-	(42)	(42)
Retirement operation cost .....	-	-	-	-	(314)	-	-	(314)
Non-recognition of electricity consumption in the Company's installations .....	(35)	-	-	-	-	-	-	(35)
Palestinian Authority on the basis of cash (9) .....	(131)	-	-	-	-	-	-	(131)
Income/expenses with respect to previous years against which regulatory assets were not recorded .....	(21)	-	-	-	-	-	-	(21)

\* The regulatory assets do not include regulatory assets with respect to financing that were recorded in expenses.

\*\* In the generation segment, the Authority activates reduction coefficients on the operating component only, and has not determined the reduction between wages and others. For the purpose of analyzing the gaps, it has been assumed that the reduction coefficient is identical for all the above mentioned components.

\*\*\* Without neutralizing the impact of not collecting an average rate and recognition on the basis of cash of the East Jerusalem Electricity Company and Palestinian Authority.

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**a. Explanations of the Board of Directors on the Business Condition of the Company (continued)**

**1. Brief Description of the Company and its Business Environment (continued)**

**d) Report of gaps between the recognized costs of the electricity rates and the actual costs for 2015 in accordance with the Electricity Authority's decision of February 9, 2015 (continued)**

<u>Transmission segment</u>	<u>Rate component in NIS million</u>						
<u>Section</u>	<u>Total income</u>	<u>Purchases of Electricity</u>	<u>Operation (including expenses for pensioners)</u>	<u>Depreciation</u>	<u>Advances</u>	<u>Efficiency</u>	<u>Gross weighted recognized return/ operating profit</u>
Income according to actual rate/rate in force as calculated by the Company (1) .....	3,687	-	-	-	-	-	-
Less/plus consumer debt refund with respect to previous years which is included in the actual rate.....	(4)	-	-	-	-	-	-
Less/plus compensation with respect to delay in update for the current year.....	(368)	-	-	-	-	-	-
Total income in books.....	3,315						
Deviation in actual income due to deviation in consumption distribution (2) ...	(27)						
Recognition on the basis of cash East Jerusalem Company and Palestinian Authority(9) .....	69						
Theoretical income from rates before efficiency application less deviation of consumption distribution and recognition on the basis of cash of the East Jerusalem Company and Palestinian Authority (3) .....	3,357	1,132	662	875	188	(330)	830
Efficiency attribution .....	-	-	(77)	(130)	-	330	(123)
Theoretical income from rates after efficiency deduction less deviation of consumption distribution and recognition on the basis of cash of the East Jerusalem Company and Palestinian Authority .....	3,357	1,132	585	745	188	-	707
<u>Classifications compared to the Financial Statements (4) .....</u>							
Classification 1 - interest with respect to employer-employee relations.....	-	-	4	-	-	-	(4)
Total theoretical income from rates classified according to Financial Statements .....	3,357	1,132	589	745	188	-	703
Actual results according to segment Notes (5) .....	3,697	1,143	506	967	-	-	1,081
Plus/less deducted/added regulatory assets (6) .....	(372)	-	-	-	-	-	(372)
Various income (7).....	(10)	-	(28)	-	-	-	18
Subtotal .....	3,315	1,143	478	967	-	-	727
Differences (8) .....	(42)	(11)	111	(222)	188	-	24



**THE ISRAEL ELECTRIC CORPORATION LIMITED**  
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**a. Explanations of the Board of Directors on the Business Condition of the Company (continued)**

**1. Brief Description of the Company and its Business Environment (continued)**

**d) Report of gaps between the recognized costs of the electricity rates and the actual costs for 2015 in accordance with the Electricity Authority's decision of February 9, 2015 (continued)**

Transmission segment Section	Rate component in NIS million						Gross weighted recognized return/ operating profit
	Total income	Purchases of Electricity	Operation (including expenses for pensioners)	Depreciation	Advances	Efficiency	
<u>Explained differences</u>							
Retirement operation cost	-	-	(42)	-	-	-	(42)
<sup>1</sup> This gap derives from delay in update of the rate base in the grid's segments. It is noted that part of this gap is covered by the advance given by the Authority, which was not attributed to a specific component .....	-	-	153	(222)	188	-	119
Non-recognition of electricity consumption in the Company's installations .....	(4)	-	-	-	-	-	(4)
Palestinian Authority on the basis of cash (9) .....	(69)	-	-	-	-	-	(69)
Deviation in actual income due to deviation in the consumption distribution ..	27	-	-	-	-	-	27
Income/expenses with respect to previous years against which regulatory assets were not recorded .....	82	-	-	-	-	-	82

- \* The regulatory assets do not include regulatory assets with respect to financing that were recorded in expenses.
- \*\* The gaps do not include regulatory asset in accordance with the recommendations of the Navigant draft report, as the Electricity Authority has not yet approved the recommendations of the report.
- \*\*\* In the transmission and distribution segments, the Authority uses depreciation coefficients for all the income components and has not determined in which specific component the Company has to increase efficiency. For the purpose of analyzing the gaps, it has been assumed that the reduction coefficient is identical for all the income components in the above mentioned segments.

<sup>1</sup> The position of the Electricity Authority is that some of the gaps derive from factors which are not connected to delays in updating the rate.

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**a. Explanations of the Board of Directors on the Business Condition of the Company (continued)**

**1. Brief Description of the Company and its Business Environment (continued)**

**d) Report of gaps between the recognized costs of the electricity rates and the actual costs for 2015 in accordance with the Electricity Authority's decision of February 9, 2015 (continued)**

**Distribution segment**

<u>Item</u>	Rate component in NIS million					Gross weighted recognized return/ operating profit
	Total income	Operation (including expenses for pensioners)	Depreciation	Advances	Efficiency	
Income according to actual rate/rate in force as calculated by the Company (1) .....	3,344	-	-	-	-	-
Less/plus consumer debt refund with respect to previous years which is included in the actual rate .....	(33)	-	-	-	-	-
Less/plus compensation with respect to delay in update for the current year .....	(35)	-	-	-	-	-
Total income in books.....	3,276					
Deviation in actual income due to deviation in consumption distribution (2) .....	(63)					
Recognition on the basis of cash East Jerusalem Company and Palestinian Authority(9) .....	6					
Theoretical income from rates before efficiency application less deviation of consumption distribution and recognition on the basis of cash of the East Jerusalem Company and Palestinian Authority (3).....	3,219	1,751	1,195	528	(1,259)	1,004
Efficiency attribution .....	-	(547)	(387)	-	1,259	(325)
Theoretical income from rates after efficiency deduction less deviation of consumption distribution and recognition on the basis of cash of the East Jerusalem Company and Palestinian Authority .....	3,219	1,204	808	528	-	679
<u>Classifications compared to the Financial Statements (4)</u>						
Classification 1 - interest with respect to employer-employee relations....	-	17	-	-	-	(17)
Classification 2 - meters' depreciation.....	-	(52)	52	-	-	-
Total theoretical income from rates classified according to Financial Statements .....	3,219	1,169	860	528	-	662
Actual results according to segment Notes (5) .....	3,482	1,928	1,333	-	-	221
Plus/less deducted/added regulatory assets (6) .....	(68)	-	-	-	-	(68)
Various income (7).....	(138)	(146)	-	-	-	8
Subtotal .....	3,276	1,782	1,333	-	-	161
Differences (8) .....	57	(613)	(473)	528	-	(501)

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**a. Explanations of the Board of Directors on the Business Condition of the Company (continued)**

**1. Brief Description of the Company and its Business Environment (continued)**

**d) Report of gaps between the recognized costs of the electricity rates and the actual costs for 2015 in accordance with the Electricity Authority's decision of February 9, 2015 (continued)**

**Distribution segment**

Item	Rate component in NIS million					Gross weighted recognized return/operating profit
	Total income	Operation (including expenses for pensioners)	Depreciation	Advances	Efficiency	
<u>Explained differences</u>						
Retirement operation cost	-	(246)	-	-	-	(246)
<sup>2</sup> This gap derives from delay in update of the rate base in the grid's segments. It is noted that part of this gap is covered by the advance given by the Authority, which was not attributed to a specific component.....	-	(367)	(473)	528	-	(312)
Non-recognition of electricity consumption in the Company's installations .....	(11)	-	-	-	-	(11)
Palestinian Authority on the basis of cash (9) .....	(6)	-	-	-	-	(6)
Deviation in actual income due to deviation in consumption distribution (2) .....	63	-	-	-	-	63
Income/expenses with respect to previous years for which regulatory assets were not recorded .....	(6)	-	-	-	-	(6)

- \* The regulatory assets do not include regulatory assets with respect to financing that were recorded in expenses.
- \*\* The gaps do not include regulatory asset in accordance with the recommendations of the Navigant draft report, as the Electricity Authority has not yet approved the recommendations of the report.
- \*\*\* In the transmission and distribution segments, the Authority uses depreciation coefficients for all the income components and has not determined in which specific component the Company has to increase efficiency. For the purpose of analyzing the gaps, it has been assumed that the reduction coefficient is identical for all the income components in the above mentioned segments.

<sup>2</sup> The position of the Electricity Authority is that some of the gaps derive from factors which are not connected to delays in updating the rate.

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**a. Explanations of the Board of Directors on the Business Condition of the Company (continued)**

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**d) Report of gaps between the recognized costs of the electricity rates and the actual costs for 2015 in accordance with the Electricity Authority's decision of February 9, 2015 (continued)**

Specific instructions:

- (1) Total consumer charges with respect to electricity consumption in the reporting year (including charges with respect to advances, spread, compensation for update delay and other consumer debts and charges that have not yet been invoiced at the end of the reporting period).
- (2) The sum reflects the deviation that is created as a result of the rates for a quantity unit being determined by a theoretical distribution, and the actual distribution is different.
- (3) The theoretical income with respect to the reporting period (meaning without return of consumer debt with respect to the past) if there had been no deviations in the consumption distribution and the rate had been continuously updated. The costs the Company deems should be approved for it with respect to the reporting period and have not yet been approved and has recorded regulatory assets with respect to them at the end of the period. Meaning, this income also includes profit that is defined as unrealized profit according to the accounting principles.
- (4) Sums included in the rate in a certain component and are included in the Financial Statements in a different component.
- (5) Columns 3 to 8 are identical to the total expenses of the segment, except for financing expense and tax.
- (6) Reduction/addition of deducted/added regulatory assets in the expenses items of the Profit and Loss Statement.
- (7) Income from unregulated operation is included in the segment's income. The segment's income includes income that has not been attributed with costs.
- (8) The differences between theoretical income classified according to Financial Statements and the subtotal.  
The income and gross weighted recognized return/operating profit, surplus actual income over the theoretical is presented with a positive mark.  
In all other columns surplus expenses over income is presented with a negative mark.
- (9) The total balance of non-recognition of income by the Company with respect to sales to the East Jerusalem Company and the Palestinian Authority in the Financial Statements of the Company is approximately NIS 205 million.

The Authority, when determining the rate, recognized some of the expense items not according to the classifications recorded in the Financial Statements. Adjustments were made to the income and the expenses of those items that were recognized by the Authority in a different manner than that recorded in the Financial Statements, in order to have a proper comparison between the Company's income and its expenses.

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**a. Explanations of the Board of Directors on the Business Condition of the Company (continued)**

**1. Brief Description of the Company and its Business Environment (continued)**

**d) Report of gaps between the recognized costs of the electricity rates and the actual costs for 2015 in accordance with the Electricity Authority's decision of February 9, 2015 (continued)**

**Following are details of the principal explanations for the gaps according to components**

**1. Fuel -**

The gaps from fuels derive from the following reasons:

- Income/loss from fuels - which is composed of income/loss from price which derives from gaps between the recognized price and the fuels costs consumed from the inventory and a mix income/loss which derives from the Authority's normative recognition which is different from the Company's actual performance.
- Gap from fuels related - derives from gaps between the related costs with respect to fuels in practice and the normative related costs.

**2. Operation**

The gaps in the generation segment mainly derive from the following reasons:

- Non-recognition of the full renovation costs of the power stations.

The decision of the Authority pertaining to the rate base book for the generation segment bases the recognition of the operating costs on the average costs with respect to 2002 - 2006 according to the Company's position. The operating costs in those years do not correctly represent the Company's operating costs for the test period, since the mix used by the power stations to generate electricity in those years is materially different from the present mix. In recent years, the Company has introduced new means of production operating with a combined cycle technology, which is characterized by high utilization. These stations operate at high temperatures, with technology that consumes the equipment in frequent cycles and requires heavier expenses both for maintenance and for renewing the equipment, at a very high cost.

- Cost of employee retirement scheme

In the grid's segments, the gaps derive from a continued delay in the update of the rate base in the transmission and distribution segments.

**3. Depreciation**

The gaps in the depreciation components mainly derive from the delay in update of the rate base in the transmission and distribution segments and from non-recognition of the full depreciation expenses with respect to spare parts inventory.

It is noted that part of gaps of recognition in the grid's segments are covered by the advance, which was recognized by the Electricity Authority and which was not attributed to a specific component.

**4. Income from previous years**

Within the decision of the Authority with respect to the 2015 annual update, many issues that were disputed with the Electricity Authority were solved and constituted a significant addition to the Company's revenues. The major issues with respect to which additional revenues were received:

Recognition of interest costs during construction of the Hagit combined cycle and recognition of interest costs during construction of the joint property attributed to the generation segment. On the other hand, the Authority reduced the rate of recognition of the excessive costs of the Haifa combined cycle units.

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**a. Explanations of the Board of Directors on the Business Condition of the Company (continued)**

**1. Brief Description of the Company and its Business Environment (continued)**

**e) Major Open Issues with the Electricity Authority**

Details of material issues which are in dispute between the Company and the Electricity Authority. The sums detailed in this table represent the Company's estimates only with regard to the financial implications of the existing gaps, there is no certainty that the Electricity Authority will recognize all or part of the sums detailed below:

<b>Issue</b>	<b>Financial implications</b>	<b>Details*</b>
Non-recognition of the full pension costs of the Company's employees	Approximately NIS 8.7 billion, in a calculation performed until June 2015. On the other hand, there is provision for returning sums to consumers of approximately NIS 2.7 billion	The Authority did not reach a decision in the matter of recognition of the pension costs of the Company's employees. The position of the Company is that the sum is composed of (in NIS billions): Recognition gap in pension costs in operation - 6 Interest on surplus funds for reserve which has not yet been recognized - 2.2 Pension costs not recognized in property - 0.5 The matter is under examination by the Authority. The Company does not know what part of the costs will be recognized, but the Company estimates that the entire costs as stated will be recognized for it.
Lack of update of the transmission and distribution rate base	Approximately NIS 1 billion a year	The rate base for the transmission and distribution segments was supposed to remain in effect until the end of 2005 or until determination of a new rate base. Pursuant to the decision of the Authority, a retrospective accounting will apply from April 1, 2012. The Company is requesting retrospective compensation also for the years in which the rate was not updated before 2012. In order to determine a rate base for the transmission and distribution segments, the Electricity Authority hired the Navigant consulting firm. The final report of the consulting firm was received in October 2015. The consulting firm recommended not recognizing approximately 34% of the salary costs. The Authority noted that it is not obliged by the findings of this report. The Company is waiting for a document for a hearing on the matter. On November 30, 2015, the Company submitted a petition to the High Court of Justice, to instruct the Authority to publish, within 45 days, a public hearing for a new rate basis, and to reach a decision within 60 days from the date of publication of the hearing.
The new rate base of the generation segment will not be applied retrospectively		The existing rate base was supposed to be in effect until the end of 2014. The Company requested that the new rate base which will be determined will apply retrospectively from January 1, 2015. The Authority clarified to the Company that as long as a new rate base has not been set and a new decision has not been reached, the rate set in the rate base book for 2010 is in effect.

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1. **Brief Description of the Company and its Business Environment (continued)**  
e) **Major Open Issues with the Electricity Authority (continued)**

<b>Issue</b>	<b>Financial implications</b>	<b>Details*</b>
Lack of a rate solution for the issue of implementing the IFRS in the Company books	In the current rate base, the Company is exposed to erosion of part of the equity	As of January 2015, the Company is fully implementing the IFRS. In the current accounting and rate structure, erosion of the profitability and capital of the Company will be created during an increase of the Consumer Price Index. On December 14, 2015, the Authority reached a decision regarding a change in the formula of the rate base which enables the Company to present some of the balance of linkage differentials in the foreign capital as regulatory asset. The decision applies from January 1, 2016, and provides a partial response to the Company's needs.
Cross subsidization - system costs rate	Approximately NIS 2.5 billion in 2014. It is cross subsidization of the Company's consumers and the private electricity producers' consumers	The Authority published a decision in August 2015 for the system management rate, as of September 13, 2015, and applying to all the electricity consumers in the sector. This rate includes administrative system management costs, costs of services to balance the system, costs with respect to backup services and related arrangements. The position of the Company is that the Authority's recognition of the system costs is only partial in a manner in which cross subsidization still exists between the Company's consumers and the consumers of the private electricity producers, as there are issues that were not included in the system costs determined by the Authority, and some of the costs were under-evaluated. A petition on the matter has been submitted to the High Court of Justice.
Lack of coverage for costs of renovations in the generation segment	Approximately NIS 1.2 billion in 2010-2015	The renovations component in the generation segment is part of the operating costs, regarding which the Authority is basing the recognition on the average costs with respect to the years 2002 - 2006. The position of the Company is that the operating costs in those years do not correctly represent the Company's operating costs for the test period, since the mix used by the power stations to generate electricity in those years is materially different from the present mix. In recent years, the Company has introduced new means of production operating with a combined cycle technology, which is characterized by high utilization. This technology requires heavy expenses in renovations compared to the technology that existed in the past. The opinion of the professional team of the Electricity Authority is that there is surplus rate coverage in other components which are attributed to the generation segment which covers the deficit in the operating costs. The Company was informed that the issue will be discussed in the next rate base for the generation segment but the Company demands a solution during the present base period.

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**a. Explanations of the Board of Directors on the Business Condition of the Company (continued)**

**1. Brief Description of the Company and its Business Environment (continued)**

**e) Major Open Issues with the Electricity Authority (continued)**

<b>Issue</b>	<b>Financial implications</b>	<b>Details*</b>
Non-recognition of construction costs of new generating units	Approximately 650 million NIS non-recognition of property	The Electricity Authority determined the recognized construction costs of the generating units that were activated as of January 1, 2003 ("new generating units") in a normative manner. As a result of this, recognition gaps were created in the construction costs. Most of the gaps result from non-recognition of development and assembly costs and interest costs at time of construction, as a result of deviation from the normative construction period due to delays not under the control of the Company. This sum is with respect to costs beyond the normative base, and the Company applied to the Electricity Authority for their recognition. Additionally, the gap includes pension costs which, as stated, a decision has not yet been reached with respect to them. Within the 2015 annual update, the Authority conclusively decided not to recognize the additional costs beyond the normative base at the Gezer and Alon Tavor units.
Non-recognition of the full capital costs of spare parts inventory in the generation segment	NIS 250 million in the years 2010 - 2015 (capital services)	Similarly to the renovations costs, the costs of spare parts inventory are also recognized within the operating costs on the basis of 2002- 2006. Therefore, the non-recognition here also derives from a change in the mix of the generating units' fleet compared to the past. Spare parts inventory is materially different in its mix and value from the spare parts inventory costs which the Authority used, because during recent years a significant increase has occurred in the level of the inventory maintained, especially in light of the need for equipping in spare parts for combined cycle units, when at the same time, the Company is still required to also maintain inventory for the old units which still operate.
Non-recognition of part of the costs of conversion to gas at Haifa	NIS 105 million in the years 2010 - 2015 (capital costs)	The costs of conversion to gas at Haifa were temporarily determined according to the costs that were recognized at the Reading site. The non-recognition derives from the fact that the costs at Haifa are higher compared to the costs spent for the conversion to gas at Reading and Eshkol. The Electricity Authority demanded explanations for the gaps and the matter is still under examination.
Electricity consumption Company installations	Tens of millions of NIS a year	As of July 2002, the rate mechanism does not include coverage for the Company's costs with respect to electricity consumption in its installations. At the base of the generation rate for 2010, in the rate within the operating costs, a minor cost of approximately NIS 6 million was recognized regarding the costs of electricity consumed in the Company's installations. In light of this, the Company does not receive rate coverage with respect to these costs and cannot charge the full cost recognized for it. In accordance with the update received from the professional team of the Authority, the issue will be handled only within a new rate base for the generation segment. In light of the lack of the Authority's handling of this issue, over the years, the Company incurred cumulative losses of hundreds of millions of NIS.

**a. Explanations of the Board of Directors on the Business Condition of the Company (continued)**



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**1. Brief Description of the Company and its Business Environment (continued)**

**e) Major Open Issues with the Electricity Authority (continued)**

<b>Issue</b>	<b>Financial implications</b>	<b>Details*</b>
Calculation of the Company's income with respect to fuels in accordance with the sectorial model		<p>As of 2014, the Authority calculates the Company's income from fuels while using a sectorial model. The implications:</p> <ul style="list-style-type: none"> <li>• The Company is exposed to non-recognition of rate with respect to the system manager's load policy due to sectorial impacts of one type or another which do not depend on it.</li> <li>• Due to confidentiality of data regarding private electricity producers, the Company cannot control the Authority's calculations.</li> </ul> <p>The Company applied to the Authority, requesting to receive access to data for two employees from the Finances and Economics Division, for calculating the Company's income from fuels and performing necessary controls, while signing a confidentiality document. For the time being, the Company was turned down. In addition, a letter was sent from the CEO to Shaul Meridor and Amir Levi, aimed at handling the exposure by approving the signing of the confidentiality document or, alternatively, an update of the income calculation methodology.</p>
<b>Exogenous costs</b>		
Mechanism for recognition of exogenous costs		Exogenous costs are irregular costs forced onto the Company by virtue of a provision of the law. At present there is no regulated mechanism for handling exogenous costs.
Recognition of the costs of the emission reduction project at the coal powered stations		On November 25, 2015, a decision was published, within which it was decided that the recognition of the project's costs will be based at this stage on the comprehensive investment budget for 2013. In addition, according to the decision, the recognition of the costs of the emission reduction installations is spread over 25 years; the life of the coal powered power stations has been extended and will be 25 years from the date of activation of the installations; interest costs at time of construction will be recognized normatively. In light of the Company's demands, and after a petition was submitted to the High Court of Justice, the Authority published the decision for a "late hearing" on March 10, 2016. See Note 3.f. to the Financial Statements.
Lack of Recognition of 20% of the costs of the arrangements for 2014	NIS 17 million	The Authority claims that the Company's reports are lacking and therefore 20% of the costs of the arrangements submitted to the Electricity Authority were not recognized. The Company delivered additional reports and demanded to receive full recognition as it is only a conduit for transferring funds with respect to arrangements.

\* It is noted that the sums detailed in this table cannot be added, as in some cases overlapping exists between the various sections of the table.

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a. **Explanations of the Board of Directors on the Business Condition of the Company (continued)**

2. **Financial Position**

Data on the Company's financial position on December 31, 2015 and December 31, 2014 are as follows:

	NIS in millions				
	December 31, 2015	December 31, 2014	Increase (decrease)	Percent %	Note No.
<b><u>CURRENT ASSETS</u></b>					
Cash and cash equivalents .....	2,524	4,504	(1,980)	(44%)	a)1)
Short term investments .....	407	2,559	(2,152)	(84%)	a)1)
Trade receivables for sales of electricity .....	4,145	4,546	(401)	(9%)	a)2)
Accounts receivable .....	715	537	178	33%	a)3)
Inventory – fuel.....	839	1,053	(214)	(20%)	a)4)
Inventory – stores .....	132	146	(14)	(10%)	
	<b>8,762</b>	<b>13,345</b>	<b>(4,583)</b>	<b>(34%)</b>	
<b><u>NON-CURRENT ASSETS</u></b>					
Inventory - fuel .....	1,124	1,509	(385)	(26%)	a)4)
Long-term receivables .....	1,659	1,833	(174)	(9%)	c)
Investment in associate .....	74	86	(12)	(14%)	
<b>Assets with respect to post-employment benefits:</b>					
Surplus pension plan assets over pension liability .....	5,286	4,310	976	23%	d)
Funds in trust.....	1,921	1,909	12	1%	
	<b>7,207</b>	<b>6,219</b>	<b>988</b>	<b>16%</b>	
<b>Fixed assets, net:</b>					
Fixed assets in use, net .....	55,636	56,912	(1,276)	(2%)	e)
Fixed assets under construction .....	6,806	6,469	337	5%	
	<b>62,442</b>	<b>63,381</b>	<b>(939)</b>	<b>(1%)</b>	
Intangible assets, net.....	1,295	1,384	(89)	(6%)	
	<b>82,563</b>	<b>87,757</b>	<b>(5,194)</b>	<b>(6%)</b>	
Debit balances of regulatory deferral accounts	837	2,876	(2,039)	(71%)	h)
<b>Total assets and debit balances of regulatory deferral accounts .....</b>	<b>83,400</b>	<b>90,633</b>	<b>(7,233)</b>	<b>(8%)</b>	

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**a. Explanations of the Board of Directors on the Business Condition of the Company (continued)**

**2. Financial Position (continued)**

Data on the Company's financial condition on December 31, 2015 and December 31, 2014 are as follows:  
(continued)

	NIS in millions				Note No.
	December 31, 2015	December 31, 2014	Increase (decrease)	Percent %	
<b><u>CURRENT LIABILITIES</u></b>					
Credit from banks and other credit providers .....	2,756	8,355	(5,599)	(67%)	f)
Trade payables .....	1,753	1,925	(172)	(9%)	
Accounts payable and accruals .....	1,877	1,631	246	15%	
Customer advances, net of work in progress .....	496	453	43	9%	
Provisions .....	726	719	7	1%	
	<b>7,608</b>	<b>13,083</b>	<b>(5,475)</b>	<b>(42%)</b>	
<b><u>NON CURRENT LIABILITIES</u></b>					
Debentures .....	34,923	35,703	(780)	(2%)	g)1)
Liabilities to banks .....	5,248	4,742	506	11%	g)1)
Liabilities with respect to other post- employment benefits .....	2,732	2,930	(198)	(7%)	g)2)
Provision for refunding amounts to consumers ..	2,758	2,675	83	3%	
Deferred taxes, net .....	5,788	5,663	125	2%	
Debentures to the State of Israel .....	2,511	2,534	(23)	(1%)	g)1)
Liability to the State of Israel .....	2,591	2,905	(314)	(11%)	g)1)
Other liabilities .....	756	683	73	11%	
	<b>57,307</b>	<b>57,835</b>	<b>(528)</b>	<b>(1%)</b>	
<b><u>CAPITAL</u></b>					
Share capital .....	908	908	-	-	
Capital reserves .....	803	816	(13)	(2%)	
Capital reserve remeasurement .....	271	140	131	94%	
Retained earnings .....	14,712	14,489	223	2%	
	<b>16,694</b>	<b>16,353</b>	<b>341</b>	<b>2%</b>	
<b>Total liabilities and capital .....</b>	<b>81,609</b>	<b>87,271</b>	<b>(5,662)</b>	<b>(6%)</b>	
Credit balances of regulatory deferral accounts...	1,791	3,362	(1,571)	(47%)	
<b>Total liabilities, capital and credit balances of regulatory deferral accounts .....</b>	<b>83,400</b>	<b>90,633</b>	<b>(7,233)</b>	<b>(8%)</b>	

**THE ISRAEL ELECTRIC CORPORATION LIMITED**  
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**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, 2015 compared to December 31, 2014 at Company level and according to segments of operation (for information of the sectorial reporting of the Company see Note 36 to the Financial Statements).

**a) Current Assets**

**1) Cash and Cash Equivalents and Short-Term Investments**

The decrease in cash and cash equivalents balance and short-term investments for the period mainly arises from the material repayments of the current maturities with respect to debentures and loans (which are included in the item of credit from banks and other credit providers). For details of the repayments see Note 20.d. to the Financial Statements.

**2) Customers**

For details of developments in customers' balance including various customers throughout the Palestinian Authority and the East Jerusalem Electricity Company see Note 6 to the Financial Statements.

**3) Accounts Receivable**

The increase mainly derives from an increase in current maturities of debt balance hedge transactions.

**4) Fuels Inventory**

The decrease in fuels inventory (current and non-current) in the amount of approximately NIS 599 million mainly derives from:

- a decrease of NIS 379 million in the diesel oil inventory due to consumption for electricity generation.
- a decrease of NIS 106 million in the crude oil inventory due to consumption and provision for impairment with respect to the crude oil inventory (see Note 8 to the Financial Statements).
- a decrease of NIS 89 million in the coal inventory due to a worldwide drop in price.

The fuels inventory presented in the current assets reflects the Company's forecast for use of fuels for 2016 year, as well as the crude inventory which is intended for sale in this period. The balance of the fuels inventory, which according to the Company's forecast will serve it beyond 2016 year, as well as the crude inventory intended for sale beyond this period, are presented in the non-current assets item.

**Following are details of the current assets according to electricity chain segments:**

- **Generation segment** - NIS 5,467 million, mainly deriving from customer receivables with respect to electricity sales in the amount of approximately NIS 2,869 million (this section is attributed to segments according to income ratio), fuels inventory (attributed in full to the generation segment) in the amount of approximately NIS 839 million, and cash balance and cash equivalents in the amount of approximately NIS 1,274 million.
- **Transmission segment** - NIS 1,437 million, mainly deriving from customer receivables with respect to electricity sales and cash balance and cash equivalents.
- **Distribution segment** - NIS 1,858 million mainly deriving from customer receivables with respect to electricity sales and cash balance and cash equivalents.

**b) Non-Current Assets (not including fixed assets)**

**The Long Term Assets according to the Electricity Segments are as follows (not including fixed assets):**

Generation segment -	6,444	NIS million
Transmission segment -	843	NIS million
Distribution segment -	4,072	NIS million

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**a. Explanations of the Board of Directors on the Business Condition of the Company (continued)**

**2. Financial Position (continued)**

**c) Long-term Receivables:**

The major decrease derives from withdrawals from the designated account for investment in the transmission and distribution segments. For details see Note 3.g.

**d) Assets with Respect to Benefits after Termination of Employment:**

During the report period, an increase occurred in the item of excess pension plan assets over the actuarial liability due mainly to a decrease in the actuarial liability mainly deriving from an increase in the interest rate used for its capitalization and which was partially offset from the effects of the return on plan assets (pension fund and compensation). For details see Note 11 a to the Financial Statements.

**e) Investments in Fixed Assets**

The sum total of new investments in fixed assets for 2015 amounted to approximately NIS 3,657 million compared to approximately NIS 3,540 million net for the same period last year, an increase of approximately NIS 117 million and in a rate of 3%.

**Company investments in Fixed Assets in the Reporting Period were as follows:**

	<b>In NIS millions</b>
Power stations, CCGTs, structures .....	1,389
Sub-stations and high voltage lines .....	430
Switching stations and ultra-high 400 Kilowatt voltage lines .....	117
Distribution grids and meters .....	920
Inventory – stores .....	453
Joint property and others .....	348
<b>Total .....</b>	<b>3,657</b>

For additional details see Note 13 to the Financial Statements.

**Detailed investments in fixed assets according to electricity chain segments are as follows:**

<b>Generation segment -</b>	29,325	NIS million
<b>Transmission segment -</b>	13,839	NIS million
<b>Distribution segment -</b>	19,278	NIS million

The direct assets were attributed to the appropriate segments and the joint assets (some 3.19% of the Company's total operating assets) were divided according to distribution keys that the Company assesses to be a reasonable estimate for attributing these assets. During the period covered by the report, the Company invested a total of approximately NIS 1,525 million, approximately NIS 705 million and approximately NIS 1,123 million in direct assets in the generation, transmission and distribution segments, respectively. In addition, a sum of approximately NIS 304 million was invested in joint property.

**Detailed Current Liabilities according to Electricity Chain Segments are as follows:**

<b>Generation segment -</b>	3,943	NIS million
<b>Transmission segment -</b>	1,047	NIS million
<b>Distribution segment -</b>	2,618	NIS million

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a. **Explanations of the Board of Directors on the Business Condition of the Company (continued)**

2. **Financial Position (continued)**

f) **Current Liabilities**

**Credit from Banking Corporations and Other Credit Providers**

The decrease derives from material repayments of current maturities with respect to debentures and State guaranteed bank loans (which are included in this item). For additional details see Note 20.d. to the Financial Statements.

g) **Non-Current Liabilities:**

1) **Long Term Financial Liabilities**

The long term financial liabilities of the Company include debentures, liabilities to banking corporations, hedge transactions, debentures to the State of Israel and liabilities to the State of Israel, amounting to NIS 45,273 million.

For details of the composition of the financial liabilities of the Company, see section a.5.b) below.

For details of raisings and material repayments see Note 20.d. to the Financial Statements.

For details of the currency exposure, see linkage basis report in Note 27.f to the Financial Statements.

**Distribution of long term Loans, Debentures, Liabilities to Banks and Other Liabilities of the Company according to Electricity Chain Segments is as follows:**

Generation segment -	24,608	NIS million
Transmission segment -	7,843	NIS million
Distribution segment -	13,578	NIS million

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.

2) **Liabilities with respect to other post-employment benefits**

During the report period, a decrease occurred in the item of liability with respect to other post-employment benefits deriving from an increase in the interest rate used for its capitalization.

**The Distribution of liabilities with Respect to Post Employment Termination Benefits, according to Electricity Chain Segments is as follows:**

Generation segment -	1,425	NIS million
Transmission segment -	193	NIS million
Distribution segment -	1,114	NIS 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 -	1,199	NIS million
Transmission segment -	621	NIS million
Distribution segment -	938	NIS million

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**a. Explanations of the Board of Directors on the Business Condition of the Company (continued)**

**2. Financial Position (continued)**

**h) Regulatory deferral accounts balances**

For details regarding regulatory assets/liabilities and the changes in them during the reporting period see note 15 to the Financial Statements.

**1) Compliance with Terms for Implementing IFRS 14 (see Note 2y to the Financial Statements):**

As of January 1, 2015, the Company is implementing for the first time, by early implementation, the International Financial Reporting Standard 14, regarding regulatory deferral accounts (hereinafter: "IFRS 14"), which means continued implementation of the existing practice regarding recognition in regulatory assets and liabilities. The Company recognizes regulatory deferral accounts in its financial statements, and they are essentially similar to regulatory assets and liabilities which exist in the Company's books prior to the implementation of IFRS 14.

Prior to implementation of IFRS 14, the Company applied the accounting principles of the US Financial Accounting Standards Board (hereinafter: the "FASB" standards) as listed in RE6 chapter (hereinafter "Chapter RE6") which permit, under certain conditions, an accounting treatment other than that acceptable with regard to the timing of expense/income attribution to operations, all for the purpose of reflecting and creating proper matching between expenses and income incurred by the Company on the dates when they are recognized for purposes of the electricity rates.

One of the conditions for applying these standards states that regulated rates are built in a way that covers the specific costs related to the delivery of the regulated service or product.

The Company applied 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.

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.

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**a. Explanations of the Board of Directors on the Business Condition of the Company (continued)**

**2. Financial Position (continued)**

**h) Regulatory deferral accounts balances**

**1) Compliance with Terms for Implementing IFRS 14 (see Note 2y to the Financial Statements):**  
**(continued)**

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 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, these criteria were applied on the basis of the substance of the regulations/ regulation and not on the basis of their format. The rate for the generation segment does not provide full coverage in the short-term to all the costs of the Company, but the Company estimates that expected changes in the structure of the Company's expenses and the rate will result in their full coverage in the long term. 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 (2) 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



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**a. Explanations of the Board of Directors on the Business Condition of the Company (continued)**

**2. Financial Position (continued)**

**h) Regulatory deferral accounts balances**

**1) Compliance with Terms for Implementing IFRS 14 (see Note 2y to the Financial Statements):**  
**(continued)**

**(b) (continued)**

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.

Despite the increase in private generation, the rate mechanism existing at present enables the Company to collect the full cost recognized for it in the rate, as the capital component and 88% of the income from operating at the generation rate are fixed components which are not affected by the demand levels or by a decrease in the Company's generation volume. In addition, the Authority determined a decision in August 2015, regarding system rates, under which costs borne by the Company and which serve all the sector will be collected from all the players in the sector and not just from its consumers. These are costs with respect to backup services, system balancing, system management and surplus costs deriving from implementation of various regulatory arrangements (such as environmental constraints).

- (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. Due to the fact that the Company is acting in accordance with 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.

"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) An increase in 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) Determination of the rate by the regulator in a manner that 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.

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**a. Explanations of the Board of Directors on the Business Condition of the Company (continued)**

**2. Financial Position (continued)**

**h) Regulatory deferral accounts balances**

**1) Compliance with Terms for Implementing IFRS 14 (see Note 2y to the Financial Statements):**  
**(continued)**

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 expenses required to fulfill the Company's 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". Thus, it is meeting the conditions of IFRS 14 for recording regulatory assets/liabilities.

IFRS 14 presents changes to some of the previous accounting principles for the balances of the regulatory deferral accounts, which are primarily related to presentation of these.

**2) Following are explanations pertaining to transaction in regulatory deferral accounts in 2015:**

The decrease in debit balances of regulatory deferral accounts in the amount of approximately NIS 2,039 million mainly derives from:

- 1) A decrease of approximately NIS 1,444 million in the debit balance of regulatory deferral account with respect to a gap between the update dates of the actual rate and the theoretical rate (without the fuels component), and a supplement to the recognized operating costs.
- 2) A decrease of approximately NIS 314 million in the debit balance of regulatory deferral account with respect to purchase of electricity from private electricity producers and photo-voltaic installations. .
- 3) A decrease of approximately NIS 204 million in the debit balance of regulatory deferral account with respect to social rate for needy populations.
- 4) A decrease of approximately NIS 110 million in the debit balance of regulatory deferral account with respect to erosion of the Company liabilities in foreign currency which are transferred to the electricity consumers.

The decrease in credit balances of regulatory deferral accounts in the amount of approximately NIS 1,571 million derived mainly from:

- 1) A decrease of approximately NIS 1,407 million in the credit balance of regulatory deferral account with respect to no consecutive update of the rate's fuels component.
- 2) A decrease of approximately NIS 435 million in the credit balance of regulatory deferral account with respect to consumer participation in financing Emergency Plan Stage B.
- 3) An increase of approximately NIS 383 million in the credit balance of regulatory deferral account with respect to purchase of electricity from private electricity producers and photo-voltaic installations.

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- a. Explanations of the Board of Directors on the Business Condition of the Company (continued)  
3. Comparison and Analysis of Operating Results for the Reporting Period compared to the Corresponding Period in the Previous Year:

a) Statements of Operations and Other Comprehensive Income in Millions NIS:

Statements of Operations	For the year ending on				Change		Explanatory Paragraph
	December 31, 2015		December 31, 2014		In NIS millions		
	In NIS millions	%	In NIS millions	%	In NIS millions	%	No.
Revenues.....	23,058	100%	25,305	100%	(2,247)	(9%)	b)
Cost of operating the electricity system.....	18,286	79%	16,955	67%	1,331	(8%)	c)
<b>Profit from operating the electricity system .....</b>	<b>4,772</b>	<b>21%</b>	<b>8,350</b>	<b>33%</b>	<b>(3,578)</b>	<b>(43%)</b>	
Sales and marketing expenses.....	904	4%	901	4%	3	-	
Administrative and general expenses.....	763	3%	1,157	5%	(394)	(34%)	e)
Expenses from liabilities to pensioners.....	531	2%	(3)	-	534	(17,800%)	
<b>Profit from current operations .....</b>	<b>2,574</b>	<b>11%</b>	<b>6,295</b>	<b>25%</b>	<b>(3,721)</b>	<b>(59%)</b>	
Financial expenses .....	1,778	8%	2,838	11%	(1,060)	(37%)	g)
<b>Profit before income tax .....</b>	<b>796</b>	<b>3%</b>	<b>3,457</b>	<b>14%</b>	<b>(2,661)</b>	<b>(77%)</b>	
Tax on income.....	217	1%	916	4%	(699)	(76%)	
<b>Profit after income tax .....</b>	<b>579</b>	<b>3%</b>	<b>2,541</b>	<b>10%</b>	<b>(1,962)</b>	<b>(77%)</b>	
Company share in loss due to included company .....	(12)	-	(12)	-	-	-	
<b>Profit after included companies .....</b>	<b>567</b>	<b>2%</b>	<b>2,529</b>	<b>10%</b>	<b>(1,962)</b>	<b>(78%)</b>	
Transactions in balances of regulatory deferral accounts, net of tax .....	(344)	(1%)	(2,064)	(8%)	1,720	(83%)	
<b>Profit for the period and transactions in balances of regulatory deferral accounts .....</b>	<b>223</b>	<b>1%</b>	<b>465</b>	<b>2%</b>	<b>(242)</b>	<b>(52%)</b>	
<b>Consolidated Reports of Other Comprehensive Income (Loss):</b>							
Remeasurements of defined benefit plan, net of tax	131	1%	1,143	5%	(1,012)	(89%)	
Hedge accounting cash flow, net of tax .....	(13)	-	(6)	-	(7)	117%	
<b>Other Comprehensive income .....</b>	<b>118</b>	<b>1%</b>	<b>1,137</b>	<b>4%</b>	<b>(1,019)</b>	<b>(90%)</b>	
<b>Comprehensive Income .....</b>	<b>341</b>	<b>1%</b>	<b>1,602</b>	<b>6%</b>	<b>(1,261)</b>	<b>(79%)</b>	

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- a. **Explanations of the Board of Directors on the Business Condition of the Company (continued)**  
3. **Comparison and Analysis of Operating Results for the Reporting Period compared to the Corresponding Period in the Previous Year (continued)**

b) **Revenues**

The total revenues for the reporting period are NIS 23,058 million compared to NIS 25,305 million for the corresponding period the previous year. The decrease of approximately 9% derives mainly from:

- 1) Revenues from the sale of electricity for the reporting period amounted to approximately NIS 22,844 million, compared to approximately NIS 24,893 million for the corresponding period the previous year. This consists of an approximately NIS 2,049 million decrease in revenues from electricity sales, a decrease of approximately 8%, deriving mainly from a decrease in the electricity rate and entry of private electricity producers which causes a change in the consumption distribution.
- 2) Miscellaneous revenues - in the report period amounted to approximately NIS 214 million compared to approximately NIS 412 million in the same period the previous year. A decrease of approximately NIS 198 million deriving mainly from compensation of approximately NIS 87 million from the insurance company with respect to malfunction of Unit 40 of the Gezer power station in the same period the previous year and a decrease in revenues with respect to work from external factors.

**Peak electricity demand -**

Regarding the peak in electricity demand during the period of the report, see section 7.5 in Chapter A - Report of the Business Affairs of the Corporation.

**Details of Company Revenues according to Electricity Chain Segments are as follows:**

- Generation Segment –** Revenue deriving from sales of electricity in the generation segment in the cumulative period amounted to approximately NIS 15,813 million compared to approximately NIS 19,414 million in the same period last year, a decrease in revenue of approximately NIS 3,601 million.
- Transmission Segment –** Revenue deriving from sales of electricity for the transmission period in the cumulative period amounted to approximately NIS 3,687 million compared to approximately NIS 2,761 million in the same period last year, an increase in revenue of approximately NIS 926 million.
- Distribution Segment –** Revenue deriving from sales of electricity for the distribution segment in the cumulative period amounted to approximately NIS 3,344 million compared to approximately NIS 2,718 million in the corresponding period last year, an increase in revenue of approximately NIS 626 million.

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- a. Explanations of the Board of Directors on the Business Condition of the Company (continued)  
3. Comparison and Analysis of Operating Results for the Reporting Period compared to the Corresponding Period in the Previous Year (continued)

c) Cost of Operating the Electricity System

The cost of operating the electricity system in the reported period amounted to approximately NIS 18,286 million, as compared to approximately NIS 16,955 million in the corresponding period last year, an increase of NIS 1,331 million (approximately 8%). The increase was mainly due to an increase in the cost of fuels consumption and purchase of electricity.

1) Fuels consumption cost

The cost of fuels consumed in the reporting period (including provisions and accounting estimates) amounted to a sum of approximately NIS 8,440 million, compared to approximately NIS 8,039 million for the same period the previous year, an increase of approximately NIS 401 million, which constitutes an increase of approximately 5%.

The major part of the change to the cost of fuels consumption derives from a more expensive fuels mix offset with the impact of the decrease in fuel prices.

**Following are details of the changes in NIS millions for the year ended on December 31, 2015**

<u>Fuel Type</u>	<u>Change in Consumption</u>	<u>Change in Prices</u>	<u>Total</u>
Crude .....	136	(96)	40
Coal .....	(100)	(295)	(395)
Diesel oil .....	403	(93)	310
Natural gas.....	(54)	493	439
Liquid gas - LNG .....	263	(210)	53
Methanol	(1)	-	(1)
<b>Total.....</b>	<b>647</b>	<b>(201)</b>	<b>446</b>
<b>Change with respect to crude impairment</b>			<b>(45)</b>
<b>Total after impairment</b>			<b>401</b>

The following are the details of consumed quantities:

<u>Fuel Type</u>	<u>For the Year Ending</u>		<u>Increase</u>	<u>Change Rate</u>
	<u>December 31, 2015</u>	<u>December 31, 2014</u>	<u>(decrease) Tons</u>	<u>in %</u>
Crude (Ton) .....	17,785	4,495	13,290	296%
Coal (Standard Ton)* .....	10,664,831	10,936,940	(272,109)	(2%)
Diesel oil (Ton) .....	90,845	16,571	74,274	448%
Natural gas (Ton)** .....	2,896,993	2,943,956	(46,963)	(2%)
Liquid gas -LNG(Ton)** .....	123,415	75,795	47,620	63%
Methanol	2,659	2,959	(300)	(10%)

\* A ton of coal is calculated according to a calorific rate of 6,244 calories per ton.

\*\* A ton of gas is calculated according to a conversion factor of 52.4 MMBTU units per ton.

2) Purchase of electricity

During the report period there was an increase of approximately NIS 945 million in electricity purchase mainly deriving from the entry of private electricity producers and an increase in the amount of photo-voltaic producers.

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3. **Comparison and Analysis of Operating Results for the Reporting Period compared to the Corresponding Period in the Previous Year (continued)**

d) **Depreciation and Amortization**

Following are details of depreciation and amortization expenses presented in the profit and loss statement in the reporting period and in the same period the previous year:

	The year ended December 31, 2015	The year ended December 31, 2014	Difference	Change in %
<b>Depreciation and Amortization Expenses</b>				
Electricity system operation .....	4,314	4,116	198	5%
Sales and marketing .....	150	142	8	6%
Administrative and general .....	114	118	(4)	(3%)
<b>Total depreciation expenses.....</b>	<b>4,578</b>	<b>4,376</b>	<b>202</b>	<b>5%</b>

**Details of Depreciation and Amortization Expenses by Electricity Chain Segments:**

- **Generation Segment** - The depreciation and amortization expenses presented in the generation segment profit and loss statement during the cumulative period amounted to approximately NIS 2,278 million compared to NIS 2,209 million during the same period of the previous year, an increase of approximately NIS 69 million.
- **Transmission Segment** - The depreciation and amortization expenses presented in the transmission segment in the profit and loss statement during the cumulative period amounted to a total of approximately NIS 967 million, compared with NIS 946 million in the same period in the previous year, an increase of approximately NIS 21 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 1,333 million, compared to NIS 1,221 million during the same period in the previous year, an increase of approximately NIS 112 million.

e) **Administrative and General Expenses:**

A decrease in administrative and general expenses in the amount of approximately NIS 394 million mainly due to a decrease in provision for doubtful debts and expenses with respect to work for external entities during the Report Period.

f) **Expenses from Liabilities to Pensioners, net**

An increase in expenses from liabilities to pensioners, net, during the Report Period, in the amount of approximately NIS 534 million. The increase mainly derives from an agreement for the retirement of 460 employees by early retirement. For additional details see Note 11.f. to the Financial Statements.

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- a. **Explanations of the Board of Directors on the Business Condition of the Company (continued)**  
3. **Comparison and Analysis of Operating Results for the Reporting Period compared to the Corresponding Period in the Previous Year (continued)**

**g) Financial Expenses**

Analysis of financial expenses for the cumulative period compared to the same period in the previous year, are as follows:

<b><u>Sum Difference Analysis</u></b>	<b>For the year ending</b>		<b>Difference</b>
	<b>31/12/15</b>	<b>31/12/14</b>	
	<b>NIS in millions</b>		
<b>A. <u>Financing expenses (income) due to exchange rate differences and linkage differences and revaluation of hedge transactions</u></b>			
Exchange rate differences due to foreign currency financial liabilities mainly deriving from a decrease in the devaluation rate of the Dollar plus the increase in the revaluation rate of the EURO.....	(151)	2,110	(2,261)
Revaluation of hedging transactions resulting from changes in the period of the exchange rates .....	33	(1,605)	1,638
Revaluation of hedging transactions resulting from changes in the period of the Consumer Price Index .....	(161)	(22)	(139)
Revaluation of hedge transactions to their fair value deriving from the changes of the capitalization interest rates and the credit risk which occurred during the report period .....	144	82	62
Linkage differentials due to index linked financial liabilities which decreased in the report period at a rate of 0.9% compared to a decrease of 0.1% in the same period the previous year .....	(157)	(18)	(139)
<b>Expenses due to exchange rate differences and linkage differences and revaluation of hedge transactions .....</b>	<b>(292)</b>	<b>547</b>	<b>(839)</b>
<b>B. <u>Interest and Other Expenses</u></b>			
Interest expenses.....	2,449	2,565	(116)
Other financing expenses (income) .....	(7)	66	(73)
<b>Total interest and other expenses: .....</b>	<b>2,442</b>	<b>2,631</b>	<b>(189)</b>
<b>Total financing expenses before capitalization .....</b>	<b>2,150</b>	<b>3,178</b>	<b>(1,028)</b>
<b>C. <u>Capitalization of credit costs</u></b>			
Financing expenses which were capitalized on projects under construction .....	372	340	32
<b>Total financing expenses .....</b>	<b>1,778</b>	<b>2,838</b>	<b>(1,060)</b>

- (\*) Against the foreign currency exposure (mainly Dollar), the Company implements a policy of hedging for the rate of exchange. Hedging transactions executed by the Company throughout the years carried out by the Company in foreign currency against linked NIS in substance replaced the foreign currency liabilities with fixed interest CPI linked NIS liabilities.

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- a. **Explanations of the Board of Directors on the Business Condition of the Company (continued)**  
3. **Comparison and Analysis of Operating Results for the Reporting Period compared to the Corresponding Period in the Previous Year (continued)**

**g) Financial Expenses (continued):**

According to the provisions of IAS 39, the Company is measuring its financial liabilities at amortized cost while using the effective interest method. On the other hand, the hedging transactions of these liabilities are measured at fair value through profit and loss. The gap between the measurement methods creates accounting exposure for the Company that might be affected by the changes that occurred in various market factors.

The credit risk of the parties to the transaction and relevant interest to capital curves are used when valuing the hedging transactions to their fair value. Accordingly, changes in these factors cause significant changes in the fair value between the measured periods. As a result, an accounting and not a cash flow entry was recorded in the reporting period, of an expense of approximately NIS 144 million, compared to approximately NIS 82 million in the same period the previous year. This entry in the Profit and Loss Statement of the Company derives, as stated, from the accounting gap between the different measurement methods and does not constitute a cash flow expense.

Presently the Company policy in managing its market risks is according to the financial exposure and not the accounting exposure. However, the Company has started implementing hedge accounting for new hedge transactions according to the provisions of the standard in order to minimize the above mentioned accounting exposure. For details see Note 27.h to the Financial Statements.

**The following are the net financing details by electrical segments:**

The financing expenses are divided between the various segments, mainly by the ratio of operated fixed assets.

- **Generation Segment** - The financing expenses presented in the generation segment during the cumulative period amounted to approximately NIS 789 million, compared to NIS 1,286 million during the same period of the previous year, a decrease of approximately NIS 497 million.
- **Transmission Segment** - The financing expenses in the transmission segment during the cumulative period amounted to approximately NIS 403 million, compared with approximately NIS 621 million during the same period in the previous year, a decrease of approximately NIS 218 million.
- **Distribution Segment** - The financing expenses in the distribution segment during the cumulative period, amounted to approximately NIS 586 million, compared to approximately NIS 931 million during the same period in the previous year, a decrease of approximately NIS 345 million.



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**FOR THE YEAR ENDED DECEMBER 31, 2015**

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- a. **Explanations of the Board of Directors on the Business Condition of the Company (continued)**  
3. **Comparison and Analysis of Operating Results for the Reporting Period compared to the Corresponding Period in the Previous Year (continued)**

**h) Business Results during the Reporting Period:**

- 1) A decrease in Company income in the amount of approximately NIS 2,247 million, (9%), deriving mainly from a decrease in the electricity rate and entry of private electricity producers which causes a change in the consumption distribution. For additional details see section b above.
- 2) An increase in fuels costs in an amount of approximately NIS 401 million (5%), derived mainly from a change in the fuels mix offset with the decrease of fuel prices. For additional details see section c above.
- 3) An increase in expenses from liabilities for pensioners, net, in the amount of approximately NIS 534 million, during the report period as a result of the agreement for the retirement of 460 employees by early retirement. For additional details see Note 11.f. to the Financial Statements.
- 4) A decrease in financing expenses of approximately NIS 1,060 million deriving mainly from income with respect to exchange rate differences for foreign currency liabilities and linkage differentials on index linked liabilities in the report period. For additional details see section g above.
- 5) The EBITDA (earnings before interest, taxes, depreciation and amortization) during the reporting period was NIS 7,152 million compared to NIS 10,671 million in the same period the previous year. The major part of the decrease derives from a decrease in the electricity rate and as a result of the Company still collecting from its consumers, in 2014, excess costs with respect to the gas crisis which began in 2012, and from excess collection of current fuels. In comparison, in 2015 there was a single expense with respect to the early retirement agreement.
- 6) A decrease in other comprehensive profit with respect to remeasurements of a defined benefit plan of approximately NIS 1,012 million, deriving mainly from a change in the discount rate that was used to calculate the actuarial liability and implementation of the wage increase assumption. For additional details see Note 11.h. to the Financial Statements.

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**3. Comparison and Analysis of Operating Results for the Reporting Period compared to the Corresponding Period in the Previous Year (continued)**

i) As stated in section a.2.h) above, IFRS 14 presents changes to some of the previous reporting principles which are primarily related to the presentation of regulatory deferral accounts (see Note 2.y to the Financial Statements).

Following is an estimate of the impact of change of representation in items of statement of profit and loss with regard to the manner of representation such that the item of "Transactions in balances of regulatory deferral accounts, net of tax" was presented according to the relevant income and/or expense items prior to implementation of the provisions of IFRS 14.

The impact of these changes is on the manner of presentation in the items of the profit and loss statement only, and they do not affect the operating results of the Company.

	<b>For the year ended December 31, 2015</b>		
	<b>Financial Statements</b>	<b>Adjustment to presentation before implementation of IFRS 14</b>	<b>Presentation before implementation of IFRS 14</b>
<b>Revenues</b> .....	23,058	364	23,422
Cost of operating the electricity system .....	18,286	647	18,933
<b>Profit from operating the electricity system</b> .....	<b>4,772</b>	<b>(283)</b>	<b>4,489</b>
Sales and marketing expenses .....	904	-	904
Administrative and general expenses .....	763	-	763
Expenses for liabilities to pensioners, net.....	531	-	531
<b>Profit from ordinary operations</b> .....	<b>2,574</b>	<b>(283)</b>	<b>2,291</b>
Financing expenses .....	1,778	185	1,963
<b>Profit before income tax</b> .....	<b>796</b>	<b>(468)</b>	<b>328</b>
Income tax.....	217	(124)	93
Company's share of the loss of included company.....	(12)	-	(12)
<b>Profit before regulatory deferred accounts</b> .....	<b>567</b>	<b>(344)</b>	<b>223</b>
<b>Transactions in balances of regulatory deferral accounts, net of tax</b> .....	<b>(344)</b>	<b>344</b>	<b>-</b>
<b>Profit for the period and net transactions in balances of regulatory deferral accounts</b> .....	<b>223</b>	<b>-</b>	<b>223</b>

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- a. Explanations of the Board of Directors on the Business Condition of the Company (continued)  
3. Comparison and Analysis of Operating Results for the Reporting Period compared to the Corresponding Period in the Previous Year (continued)

	For the year ended December 31, 2014		
	Financial Statements	Adjustment to presentation before implementation of IFRS 14	Presentation before implementation of IFRS 14
<b>Revenues</b> .....	25,305	(128)	25,177
Cost of operating the electricity system .....	16,955	2,858	19,813
<b>Profit from operating the electricity system</b> .....	8,350	(2,986)	5,364
Sales and marketing expenses .....	901	-	901
Administrative and general expenses .....	1,157	(21)	1,136
Expenses for liabilities to pensioners, net.....	(3)	-	(3)
<b>Profit from ordinary operations</b> .....	6,295	(2,965)	3,330
Financing expenses .....	2,838	(157)	2,681
<b>Profit before income tax</b> .....	3,457	(2,808)	649
Income tax	916	(744)	172
Company's share of the loss of included company.....	(12)	-	(12)
<b>Profit before regulatory deferred accounts</b> .....	<b>2,529</b>	<b>(2,064)</b>	<b>465</b>
<b>Transactions in balances of regulatory deferral accounts, net of tax</b> .....	<b>(2,064)</b>	<b>2,064</b>	-
<b>Profit for the period and net transactions in balances of regulatory deferral accounts</b> .....	<b>465</b>	-	<b>465</b>

Remarks:

The manner of presentation has no effect on the results of operation of the Company.

Splitting the item "Transactions in regulatory deferral accounts, net" into the various items of income and/or expense was executed in accordance with the accounting policies of the Company prior to implementation of the provisions of IFRS 14.

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- a. Explanations of the Board of Directors on the Business Condition of the Company (continued)  
4. Comparison and Analysis of Operating Results for the Quarter compared to the Corresponding Quarter in the Previous Year (three months):

a) Statements of Operations and Other Comprehensive Income in Millions NIS:

	For the three months ending on				Change		Explanatory Paragraph  No.
	December 31, 2015		December 31, 2014		In NIS		
	In NIS millions	%	In NIS millions	%	millions	%	
Revenues.....	5,219	100%	5,777	100%	(558)	(10%)	b)
Cost of operating the electricity system.....	4,501	86%	4,176	72%	325	8%	c)
<b>Profit from operating the electricity system .....</b>	<b>718</b>	<b>14%</b>	<b>1,601</b>	<b>28%</b>	<b>(883)</b>	<b>(55%)</b>	
Sales and marketing expenses.....	213	4%	221	4%	(8)	(4%)	
Administrative and general expenses.....	190	4%	292	5%	(102)	(35%)	d)
Revenues from liabilities to pensioners.....	16	-	(4)	-	20	(500%)	
<b>Profit from current operations .....</b>	<b>299</b>	<b>6%</b>	<b>1,092</b>	<b>19%</b>	<b>(793)</b>	<b>(73%)</b>	
Financial expenses.....	266	5%	113	2%	153	135%	e)
<b>Profit before income tax.....</b>	<b>33</b>	<b>1%</b>	<b>979</b>	<b>17%</b>	<b>(946)</b>	<b>(97%)</b>	
Tax on income.....	14	-	239	4%	(225)	(94%)	
<b>Profit after income tax.....</b>	<b>19</b>	<b>-</b>	<b>740</b>	<b>13%</b>	<b>(721)</b>	<b>(97%)</b>	
Company share in loss of included company.....	(5)	-	(5)	-	-	-	
<b>Profit before regulatory deferral accounts.....</b>	<b>14</b>	<b>-</b>	<b>735</b>	<b>13%</b>	<b>(721)</b>	<b>(98%)</b>	
Transactions in balances of regulatory deferral accounts, net of tax.....	(47)	(1%)	384	7%	(431)	(112%)	
<b>Profit (loss) for the period and net transactions in balances of regulatory deferral accounts.....</b>	<b>(33)</b>	<b>(1%)</b>	<b>1,119</b>	<b>19%</b>	<b>(1,152)</b>	<b>(103%)</b>	
<b>Consolidated Reports of Other Comprehensive Income (Loss):</b>							
Remeasurements.....	(27)	(1%)	2,120	37%	(2,147)	(101%)	
Cash flow hedging.....	(23)	-	(6)	-	(17)	283%	
<b>Other Comprehensive profit (loss) ...</b>	<b>(50)</b>	<b>(1%)</b>	<b>2,114</b>	<b>37%</b>	<b>(2,164)</b>	<b>(102%)</b>	
<b>Comprehensive Income (loss) .....</b>	<b>(83)</b>	<b>(2%)</b>	<b>3,233</b>	<b>56%</b>	<b>(3,316)</b>	<b>(103%)</b>	

b) Revenues

The total revenues for the quarter are NIS 5,219 million compared to NIS 5,777 million for the corresponding quarter the previous year, a decrease in the rate of approximately 10% resulting from:

- 1) Revenues from the sale of electricity for the quarter amounted to approximately NIS 5,191 million, compared to approximately NIS 5,678 million for the corresponding quarter the previous year. This consists of an approximately NIS 487 million decrease in revenues from electricity sales, a decrease of approximately 9%, deriving mainly from a decrease in the electricity rate and entry of private electricity producers which causes a change in the consumption distribution.
- 2) Miscellaneous revenues - in the quarter amounted to approximately NIS 28 million compared to approximately 99 in the same quarter the previous year.

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4. Comparison and Analysis of Operating Results for the Quarter compared to the Corresponding Quarter in the Previous Year (three months) (continued)

c) Cost of Operating the Electricity System

The cost of operating the electricity system in the quarter amounted to approximately NIS 4,501 million, as compared to approximately NIS 4,176 million in the corresponding quarter last year, an increase of NIS 325 million. The increase was mainly due to an increase of purchase of electricity partially offset by a decrease in fuels expenses.

1) Fuels consumption cost

The cost of fuels consumed in the quarter amounted to a sum of approximately NIS 1,864 million, compared to approximately NIS 1,966 million for the same quarter the previous year, a decrease of approximately NIS 102 million, which constitutes a decrease of approximately 5%.

The major change in the cost of the fuels consumed in the quarter derives from a decrease in the price of fuels, partially offset due to the use of a more expensive fuels mix.

**Following are details of the changes in NIS millions for the three months ended on December 31, 2015**

<u>Fuel Type</u>	<u>Change in Consumption</u>	<u>Change in Prices</u>	<u>Total</u>
Crude .....	295	(269)	26
Coal .....	37	(137)	(100)
Diesel oil .....	46	(32)	14
Natural gas.....	(129)	146	17
Liquid gas - LNG .....	22	(38)	(16)
<b>Total.....</b>	<b>271</b>	<b>(330)</b>	<b>(59)</b>
<b>Change in crude impairment</b>			<b>(43)</b>
<b>Total after impairment</b>			<b>(102)</b>

The following are the details of consumed quantities during the quarter ending:

<u>Fuel Type</u>	<u>For the Three Months Ending</u>		<u>Increase</u>	<u>Change Rate</u>
	<u>December 31, 2015</u>	<u>December 31, 2014</u>	<u>(decrease) Tons</u>	<u>in %</u>
Crude (Ton) .....	8,134	292	7,842	2,686%
Coal (Standard Ton)* .....	2,393,300	2,292,415	100,885	4%
Diesel oil (Ton) .....	9,273	2,821	6,452	229%
Natural gas (Ton)** .....	618,227	723,717	(105,490)	(15%)
Liquid gas -LNG(Ton)** .....	27,416	23,065	4,351	19%
Methanol .....	95	48	47	98%

\* A ton of coal is calculated according to a calorific rate of 6,244 calories per ton.

\*\* A ton of gas is calculated according to a conversion factor of 52.4 MMBTU units per ton.

2) Purchase of electricity

During the quarter there was an increase of approximately NIS 309 million in electricity purchases compared with the same quarter the previous year, mainly deriving from the entry of private electricity producers and an increase in the amount of photo-voltaic producers.

- d) A decrease in administrative and general expenses of approximately NIS 102 million deriving mainly from a decrease in provision for doubtful debts and expenses with respect to works for external factors in the quarter.

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- a. Explanations of the Board of Directors on the Business Condition of the Company (continued)  
4. Comparison and Analysis of Operating Results for the Quarter compared to the Corresponding Quarter in the Previous Year (three months) (continued)

e) Financial Expenses

Analysis of financial expenses for the quarter compared to the same quarter in the previous year, are as follows:

<u>Sum Difference Analysis</u>	<u>For the three months ending</u>		<u>Difference</u>
	<u>31/12/15</u>	<u>31/12/14</u>	
	NIS in millions		
<b>A. <u>Financing expenses (income) due to exchange rate differences and linkage differences and revaluation of hedge transactions</u></b>			
Exchange rate differences due to foreign currency financial liabilities mainly deriving from revaluations of the Dollar and Euro in the quarter compared to devaluations in the same quarter the previous year.....	(198)	944	(1,142)
Revaluation of hedging transactions deriving from changes in the period of the exchange rates .....	126	(688)	814
Revaluation of hedging transactions resulting from changes in the period of the Consumer Price Index .....	(132)	(36)	(96)
Revaluation of hedge transactions to their fair value deriving from the changes of the capitalization interest rates and the credit risk which occurred during the report period .....	58	(742)	800
Linkage differentials with respect to index linked financial liabilities which decreased in the quarter at a rate of 0.7% compared to 0.2% in the same quarter the previous year.....	(90)	(36)	(54)
<b>Total exchange rate differences and linkage differences and revaluation of hedge transactions .....</b>	<b>(236)</b>	<b>(558)</b>	<b>322</b>
<b>B. <u>Interest and Other Expenses</u></b>			
Interest expenses.....	588	675	(87)
Other financing expenses .....	3	80	(77)
<b>Interest and other expenses:.....</b>	<b>591</b>	<b>755</b>	<b>(164)</b>
<b>Financing expenses before capitalization .....</b>	<b>355</b>	<b>197</b>	<b>158</b>
<b>C. <u>Capitalization of credit costs</u></b>			
Financing expenses which were capitalized on projects under construction .....	89	84	5
<b>Total financing expenses .....</b>	<b>266</b>	<b>113</b>	<b>153</b>

(\*) Against the foreign currency exposure (mainly Dollar), the Company implements a policy of hedging for the rate of exchange. Hedging transactions executed by the Company throughout the years carried out by the Company in foreign currency against linked NIS in substance replaced the foreign currency liabilities with fixed interest CPI linked NIS liabilities.

f) EBITDA (earnings before financing expenses, taxes, depreciation and amortization) during the quarter was NIS 1,473 million compared to NIS 2,185 million in the same quarter the previous year. The major part of the decrease derives from a decrease in the electricity rate and as a result of the Company still collecting from its consumers, in 2014, excess costs with respect to the gas crisis which began in 2012, and from excess collection of current fuels.

**THE ISRAEL ELECTRIC CORPORATION LIMITED**  
**BOARD OF DIRECTORS' REPORT ON THE STATUS OF THE COMPANY'S AFFAIRS**  
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a. **Explanations of the Board of Directors on the Business Condition of the Company (continued)**

5. **Liquidity for the Reporting Period**

a) **General for the Reporting Period:**

The cash and cash equivalents balance as of December 31, 2015 is NIS 2,524 million, and as of December 31 2014 is NIS 4,504 million. In 2015, the cash flow of the Company amounted to a negative cash flow of approximately NIS 1,980 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 7,624 million, compared to a positive flow of approximately NIS 10,366 million in the corresponding period last year.

The change in the cash flow from current operations in the amount of approximately NIS 2,742 million derives mainly from decreases in the electricity rate following the 2015 annual update, the first from February, at a rate of approximately 11.8%, and the second from September 13, at a rate of an additional 5.89%, and as a result of the Company still collecting from its consumers, in 2014, excess costs with respect to the gas crisis which began in 2012, and from excess collection of current fuels. In comparison, in 2015 there was a single expense with respect to the early retirement agreement.

2) **Cash Flow for Investment Activities:**

Cash used for investment activities in the period reached a negative flow of approximately NIS 913 million, compared to a negative flow of approximately NIS 5,884 million in the corresponding period last year.

The change in the cash flow from investment activity in the amount of approximately NIS 4,971 million derives mainly from repayment of deposits in banks which served for repayments of debentures and loans.

3) **Cash Flow from Financing Activity:**

Cash flow for financing activities in the report period amounted to a negative flow of approximately NIS 8,691 million, compared to a negative flow of approximately NIS 3,379 million in the corresponding period last year.

The change in the cash flow for financing activity in the amount of approximately NIS 5,312 million derives mainly from large repayments of debentures and loans in the report period, compared with large issues of debentures in the same period the previous year. For additional details see Note 20.d. to the Financial Statements.

For additional details regarding the cash flow of the Company see the statement of cash flows of the Company.

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a. Explanations of the Board of Directors on the Business Condition of the Company (continued)

5. 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.d. to the Financial Statements.

2) Long Term Loans

The balance of long-term financial liabilities of the Company on December 31, 2015 and December 31, 2014, is approximately NIS 45,273 million, and is approximately NIS 45,884 million, respectively, detailed as follows:

	<u>As at December 31, 2015</u>	<u>As at December 31, 2014</u>
	<u>Millions of NIS</u>	
<b>Liabilities in Index-Linked NIS</b>		
Index-linked debentures to the public.....	10,697	14,855
Debentures to the State of Israel.....	2,511	2,534
Other index-linked loans.....	345	397
<b>Total Linked NIS Liabilities</b> ..... (1)	<b>13,553</b>	<b>17,786</b>
<b>Non-linked NIS Liabilities</b>		
Non-linked NIS debentures in public offerings.....	1,094	657
Non-linked NIS loans..... (3)	1,250	2,650
<b>Total Non-Linked NIS</b> .....	<b>2,344</b>	<b>3,307</b>
<b>Dollar Linked Liabilities</b>		
Money raised from a private offering for the sale of debentures in the US in US Dollars .....	2,790	2,781
Loans in US Dollars..... (2)	3,971	4,366
Offering debentures to institutional investors in Europe and the US, listed for trade on the Singapore stock exchange, in US Dollars .....	19,120	19,056
<b>Total Liabilities Linked to US Dollars</b> .....	<b>25,881</b>	<b>26,203</b>
Money raised from a private offering for the sale of debentures in Japan in Yen .....	2,430	2,441
Loans in Euros .....	1,639	2,101
<b>Total</b> .....	<b>45,847</b>	<b>51,838</b>
Premiums, discount and deferred expenses .....	277	299
Classification into current maturities.....	(2,431)	(7,770)
Long term hedge transactions .....	1,596	1,535
Financial lease classification .....	(16)	(18)
<b>Total debentures, liabilities to banks, debentures to the State of Israel and long term liabilities to the State of Israel</b> .....	<b>45,273</b>	<b>45,884</b>

(1) Including loans and debentures guaranteed by the State of Israel equaling NIS 1,058 million as of December 31, 2015, and NIS 3,152 million as of December 31, 2014.

(2) Including loans guaranteed by the State of Israel equaling NIS 551 million as of December 31, 2015, and NIS 607 million as of December 31, 2014.

(3) Including loans guaranteed by the State of Israel equaling NIS 2,400 million as of December 31, 2014.



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a. **Explanations of the Board of Directors on the Business Condition of the Company (continued)**

5. **Liquidity for the Reporting Period (continued)**

b) **Financing Sources (continued)**

2) **Long-Term Loans (continued)**

**Details of Loans Recorded in the Company's Books, Secured by a State Guarantee are as follows:**

<u>Contract Details</u>	<u>Source Currency</u>	<u>Balance in NIS in Millions as of December 31, 2015</u>	<u>Weighted Interest*</u>	<u>Date of final repayment</u>
Loan from Bank Hapoalim	NIS	47	4.96	July 25, 2016
Loan from Citi Bank	\$	551	5.84	June 17, 2025
Debenture series 25	NIS	1,011	1.70	July 9, 2017
<b>Total</b>		<u>1,609</u>		

\* Weighted interest, since the loan was received in several installments.  
The Interest includes a guarantee commission.

3) **Average Long Term Credit as of December 31, 2015**

The credit is taken from banking corporations and others. The average credit for the reporting periods was approximately NIS 49,486 million and is mainly long term loans and debentures (including hedging transactions, deferred, premium/discount of debentures).

4) **Future Repayments**

In 2017 and 2018, the Company is required to repay principal sums with respect to debentures and loans, in amounts of NIS 4,436 million and NIS 7,124 million, respectively. In accordance with the aforesaid, the Company estimates that it will be required to raise capital in material amounts in 2017 and 2018, inter alia in order to refinance some of the debentures and loans which will be repaid by the Company.

5) **Suppliers' and Customers' Credit**

	<u>As of December 31</u>			
	<u>2015</u>		<u>2014</u>	
	<u>Days</u>	<u>Credit average</u>	<u>Days</u>	<u>Credit average</u>
Trade payables	46	1,707	44	1,649
Trade receivables (*)	47	3,096	42	2,794
Trade receivables excluding the debts of the Palestinian Authority and the East Jerusalem Electricity Company (see Note 6 to the Financial Statements)(*) .....	27	1,662	26	1,591

(\*) The credit days presented above represent the credit days from the invoice issue date until the payment date.

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**b. Details about the Exposure to Market Risks and their Management:**

**1. The Company's person responsible for market risk management**

The Company's person responsible for market risk management is the Senior Vice-President of Finance and Economics. Until March 29, 2015, Mr. Tamir Polikar served in this position, and he was replaced by, Mr. Yitzhak Mandelman as Acting Senior Vice-President of Finance and Economics. As of January 1, 2016, Mr. Avi Doitchman is serving as Senior Vice-President of Finance and Economics of the Company, and therefore also as the person responsible for market risks management. For details of the education, qualifications and business experience of Mr. Avi Doitchman see Regulation 26a (Details of a Senior Position Holder in a Corporation), in Chapter D of the Annual Financial Statements of the Company for 2015.

**2. Description of the Company's Market Risks**

The Electric Company sells its products at a price set by an outside body - the Electricity Authority. Determination of the rate is based on the principle of cost as stated in Note 3 a to the Financial Statements. However, when determining the recognized cost for the Company, the Electricity Authority determined costs of the different components in the rate, which occasionally do not match the Company's actual costs. As a result, regarding the bulk of its activities, the Company is not exposed to market risks, with the exception of the following:

**a) Currency Risks**

**1) Financial Liabilities:**

The major part of the Company's revenues is nominally in NIS. At the same time, as of December 31, 2015, an amount of NIS 29,950 million and constituting 65% of the long term financial obligations of the Company (before entering into hedging transactions), is in foreign currency. Therefore, fluctuations in exchange rates cause changes in the financing expenses of the Company that may affect the financial results of the Company.

Due to the considerable volume of the long term obligations in foreign currency, the business results of the Company are expressed in profits or losses, affected by fluctuations in the NIS – foreign currency exchange rates.

When the Electricity Authority determined the electricity rate for the generation segment, it defined a hedging mechanism.

The sum hedged by the mechanism is linked to a "determining basket" defined by the Electricity Authority as linked to the U.S. Dollar and the Euro at the rate of 75% and 25%, respectively. The hedged sum is intended to reflect part of the financing expenses or income derived from the exposure of the Company to foreign currency and to transfer it to electricity consumers.

Regarding the balance of the exposure, in excess of the hedged amount in the rate, the Company took various steps intended to reduce the effect of fluctuations in exchange rates by decreasing the balance of the exposure to foreign currency, by entering into hedging transactions. Yet, the market capacity may be limited and cause a deviation in the Company's exposure to foreign currency in relation to the desired exposure rate according to the Company's policy.

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**b. Details about the Exposure to Market Risks and their Management (continued)**

**2. Description of the Company's Market Risks (continued)**

**a) Currency Risks (continued)**

**2) Payments to Suppliers**

The Company is exposed to exchange rates fluctuations deriving from part of the procurement agreements of goods and services for building generation units, as follows:

Purchase cost of generation units equipment was determined normatively according to the Gas Turbine Handbook (hereinafter: "GTH") price list, published in U.S. Dollars. The Electricity Authority recognizes the purchase cost in foreign currency translated into NIS at the known exchange rate on the normative purchase date. Therefore, the rate does not provide hedging against changes in index rates versus changes in foreign currency rates after the purchase date.

In addition, the Company is exposed to exchange rate fluctuations due to:

- Current payments to suppliers denominated in foreign currency and/or linked to foreign currency with respect to which there is no compensation in the electricity rate.
- Payments to gas suppliers with respect to the period from the date of recognition of the electricity rate until the actual payment date. The recognized price in the electricity rate is identical to the price paid by the Company. However, the recognized rate of exchange in the rate is a high checks rate determined by the Bank of Israel Ltd. on the third business day that precedes the end of the month for the gas consumption in the following month.

**b) Interest Risks**

The Company is exposed to changes in interest rates dictated by the market, regarding financial liabilities raised by the Company which bear variable interest. Moreover, an increase in interest rates of the market may considerably increase the costs of the debt raising which the Company is required to raise. This exposure may affect the financial results of the Company.

**c) Input Price Change**

The input basket for the other rate components, except for fuels costs, part of the operating costs and part of the capital costs was linked to changes in the CPI. Therefore, the Company is exposed to market risks deriving from a real increase in the prices of inputs, which the Company purchases.

**d) Accounting Exposure Risk with Respect to Measurement of Hedging Transactions at Fair Value**

According to the provisions of IAS39, the Company is measuring its financial liabilities at amortized cost and using the effective interest method, while the hedging transactions for these liabilities are measured at fair value through profit and loss. The gap between the measurement methods creates an accounting exposure for the Company that may be affected by changes that occurred in currency rates, CPI and interest rates.

Presently, the Company's policy in managing its market risks is according to financial exposure and not accounting exposure. However, in order to reduce this accounting exposure, the Company is henceforth implementing hedge accounting for new hedge transactions according to the instructions of the standard. For details see Note 27. h. to the Financial Statements.

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**b. Details about the Exposure to Market Risks and their Management (continued)**

**2. Description of the Company's Market Risks (continued)**

**e) Capital Market Changes Affecting the Pension Funds and Pension Obligation**

As a member of the Central Pension Fund, the Company is obliged to maintain a financial fund in the Central Pension Fund (the "Fund") that will enable pension payments to entitled pensioners and employees, according to the actuarial liability, calculated by the actuary of the Fund. The Fund calculates the actuarial liability of the Company for employees in the pension plan to determine the sum that the Company should deposit as a fund. For details of the payment arrangements between the Fund and the Company as detailed in the Articles of the Fund, see Note 11.k. 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 11 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 Government debentures, corporate debentures, CPI linked bank deposits and shares. Therefore, the yield of the Fund is affected by the inherent risks of markets behavior and its effect on the composition and value of the assets in the fund.
- 2) Average duration risks – the changes in yields of Government debentures have a higher effect on the financial value of the liabilities (the reserve) compared to the financial value of the assets (the fund) caused by the longer average duration of the reserve compared to that of the fund. Reduction of market risks requires therefore diversification of investments in terms of the mix of held financial assets, credit rating and adjusting the average duration to the average duration of the reserve, as far as possible.
- 3) Credit risks – failure of a third party to meet its obligations to the Fund may decrease the value of Fund assets.

**f) Credit risks**

For details see Note 27.e. to the Financial Statements.

**g) Accounting exposure to the CPI**

As of January 1, 2015, the Company has transitioned to full implementation of the IFRS in the Company's Financial Statements. (See Note 2.a.1 to the Financial Statements). Following the transition to nominal financial reporting, an accounting exposure to the CPI was created for the Company. For details see Note 3.d. to the Financial Statements.

**h) General**

For additional details regarding the Company's policy pertaining to exposure to the various risks and the hedge policy implemented by the Company, see Note 27 to the Financial Statements.

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**b. Details about the Exposure to Market Risks and their Management (continued)**

**3. The Company's Policy for Managing Market Risks**

As a rule, the Company acts in the matter of finances and investments, according to the procedure of the Company, so as to minimize financial risks, while spreading its investments in different banks.

The Company's policy for managing the market risks to which it is exposed is as follows:

**a) The Company's policy for Managing Market Risks of Exposure to Currency Risks**

The Company's policy is to manage market risks arising from the economic exposure of the Company. In order to minimize the Company's exposure to foreign currency fluctuations, the Board of Directors of the Company has reached decisions concerning the Company's exposure.

For details of the policy of handling the exposure to foreign currency and variable interest see Note 27 c. to the Financial Statements.

**b) The Company's policy regarding interest risk**

For details, see Note 27 c. to the Financial Statements.

**c) The Policy of the Company to Contend with Market Risks Affecting the Pension Fund**

The Company acts to deal with market risks affecting the ability of the Fund to effect payments to entitled employees out of its assets, as follows:

- 1) On all matters regarding the funds, the Company designates the market risks management for economic exposure.
- 2) A dedicated department is charged with the task of controlling the financial activity of the Fund and supervising the conformance to legal directives and the management services agreement between the Company and the management company of the Fund.
- 3) The Company has a representative on the Fund's Board of Directors and in its committees (in addition to a representative of Company employees).  
These directors participate in defining the suitable policy for managing the funds, including providing a solution to the risk of average duration gaps between the assets and the liabilities by adjusting, as best as possible, the average duration of the assets to investments, with due consideration of the borrower's risks and investment volume and also investing the major share of Fund assets in NIS linked assets.
- 4) According to the Regulations of Supervision of Financial Services (Provident Fund) (Rules for Administering a Central Pension Fund), 2012, the Capital Market Division circular 2012-3-2 and the articles of the Fund that were approved by the Minister of Finance on March 31, 2014, have a spread mechanism of the actuarial deficit in a manner that facilitates the cash flow of the Company to the Fund. For details see section 5 below.
- 5) On March 31, 2014, the change in the articles of the Main Pension Fund was approved by the Supervisor of the Capital Market in the Ministry of Finance. For details see Note 11.k.1)f) to the Financial Statements.
- 6) The Fund manages the pension funds according to its policy and not according to the Company's policy. It is known that the Fund is comprised of different assets, mainly Government debentures, corporate debentures, shares and index linked deposits in banks. Therefore, the yield of the Fund is affected by the inherent risks of markets behavior and its effect on the composition and value of the assets in the Fund.

**d) The Scope of Authority in the Company's Management in Managing the Exposure to Market Risks**

As per the Company's policy concerning the treatment of exposure deriving from market risks, as detailed above, the Head of the Finance Department is authorized to approve currency exchange transactions and interest swap transactions. The Head of the Finance Department is not limited to quantities in respect to authority to approve hedge transactions. In addition, the Board of Directors has determined that certain Company employees shall perform, on behalf of the Company, hedge transactions in accordance with its policy.

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**b. Details about the Exposure to Market Risks and their Management (continued)**

**3. The Company's Policy for Managing Market Risks (continued)**

**e) Supervising and Realizing the Risk Management Policy**

**1) General**

The Company maintains a periodic monitoring for the management of financial market risks by carrying out monthly tracking of its financial liabilities and their hedges.

The Company tracks its liabilities over the reporting period and will perform hedges based upon its needs and according to set policy.

**2) Supervision by the Board of Directors**

Once a quarter, as part of the Committee of Examination of the Financial Statements, the Company will report on the linkage balance and the state of the comprehensive currency exposure of the Company to foreign currency, as of the balance date. With a material devaluation of 8% and upwards during each quarter, the Company will examine the state of the exposures and will report to the Committee of Budget, Financial Management and Risk Management of the Board of Directors.

**3) Company Control Mechanisms**

The Company's Internal Audit occasionally tracks the performance of decisions made by the Board of Directors and its committees on the subject of exposure to currency risks, to prevent, inter alia, deviation from the Company's policy for managing market risks. The audit is conducted according to the accepted audit standards and to work plans approved by the Audit Committee of the Board of Directors.

The Company has a team that is responsible for implementing the Company policy for handling the exposure to foreign currency and variable interest, which monitors the progression of the exposure once a month and recommends appropriate hedging transactions.

**f) Linkage Base and Sensitivity Tests Report**

See Note 27 to the Financial Statements for information regarding linkage terms of the financial balances and sensitivity tests of the Company as of December 31, 2015 and the comparison period.

**Following are sensitivity tests for the fuels inventory owned by the Company:**

<b>As of December 31, 2015</b>							
				Fair value in NIS millions			
	20%	10%	5%		(5%)	(10%)	(20%)
<b>Crude</b>	23	12	6	116	(6)	(12)	(23)
<b>Diesel</b>	44	22	11	221	(11)	(22)	(44)
<b>Coal</b>	112	56	28	562	(28)	(56)	(112)
<b>Liquid gas</b>							
<b>LNG</b>	3	2	1	17	(1)	(2)	(3)
<b>Total</b>	<u>182</u>	<u>92</u>	<u>46</u>	<u>916</u>	<u>(46)</u>	<u>(92)</u>	<u>(182)</u>
<b>As of December 31, 2014</b>							
				Fair value in NIS millions			
	20%	10%	5%		(5%)	(10%)	(20%)
<b>Crude</b>	49	25	12	245	(12)	(25)	(49)
<b>Diesel</b>	107	53	27	535	(27)	(53)	(107)
<b>Coal</b>	121	60	30	604	(30)	(60)	(121)
<b>Liquid gas</b>							
<b>LNG</b>	7	3	2	33	(2)	(3)	(7)
<b>Total</b>	<u>284</u>	<u>141</u>	<u>71</u>	<u>1,417</u>	<u>(71)</u>	<u>(141)</u>	<u>(284)</u>

It should be noted that the Company purchases fuel for its own use only and cannot sell fuel for commercial purposes (except in exceptional cases with special permission and for operating purposes). The fair value presented is before tax effects.

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**c. Aspects of Corporate Governance**

**1. Contributions**

The Company is prevented from making contributions in light of Companies Authority directives.

**2. Directors possessing accounting and financial expertise**

According to the provisions of the Companies Law, the Board of Directors of the Company determined that the minimal number of directors in the Company possessing accounting and financial expertise will be 5 Directors, taking into account, inter alia, the Company's size, type of activity, and number of members of its Board of Directors. The Company estimates that this number will enable the Board of Directors to meet the duties imposed on it according to law and the incorporation documents of the Company.

Following the retirement of the Directors Mordechai Ben Ami, Dr. Ziv Reich and Dr. Ofir Bashan, the number of directors with accounting and financial expertise serving in the Company is three Directors, and thus the number of Directors with accounting and financial expertise is less than the minimal number set by the Board of Directors of the Company.

As of the date of the statement of financial position, the Company has three Directors possessing accounting and financial expertise:

Accountant Arie Rapoport, Adv. Erik Forer, and Accountant Raik Abu Reish.

Following the reappointment of the director Mordechai Ben Ami on February 10, 2016, and determination of his accounting and financial expertise by the Board of Directors of the Company on February 25, 2016, four Directors with accounting and financial expertise are serving in the Company as of the date of publication of the report.

The authority to appoint Directors does not lie with the Company but with the Minister of Finance and the Minister of National Infrastructures, Energy and Water, after consultation with the Appointment Review Committee. On March 10, 2015, May 20, 2015, September 10, 2015, and January 13, 2016, the Company applied to the Director General of the Companies Authority and expressed its concerns regarding the need to urgently appoint additional Directors with accounting and financial expertise to the Board of Directors of the Company, including directors with accounting and financial expertise.

**3. Independent Directors**

The Company did not adopt into its articles of association a provision regarding the number of independent directors.

**4. The Company's Internal Auditor**

**a) Details of the Internal Auditor**

- 1) Accountant Nitza Rogozinski.
- 2) On April 27, 2014, accountant Nitza Rogozinski began her position as internal auditor and ombudsman of the Company.
- 3) The Internal Auditor meets the conditions set in section 146(b) to the Companies Law and the provisions of sections 3a and 8 to the Internal Audit law, 1992 (hereinafter: the "Internal Audit law").
- 4) The Internal Auditor is an employee of the Company and does not fulfill another function in the Company in addition to internal auditing, except for the function of Supervisor for Public Complaints and Supervisor for Employee Complaints. Fulfilling the additional function does not harm the fulfillment of her main function.
- 5) the Internal Auditor does not hold any securities of the Company or of anybody related to it and the Internal Auditor does not have material business relationships or other material relationships with the Company and does not fulfill any function outside the Company that creates or may create conflict of interests with her function as Internal Auditor.

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**c. Aspects of Corporate Governance (continued)**

**4. The Company's Internal Auditor (continued)**

**b) Manner of Appointment of the Internal Auditor**

On November 21, 2013, the Board of Directors of the Company, in accordance with a Companies Authority circular on the subject, approved the format of selection of the internal auditor as was presented by the Audit Committee. A search committee that was appointed for the process examined the candidates that participated in the process under the set format, ranked the candidates according to predetermined criteria, and recommended accountant Nitza Rogozinski as the most suitable candidate for the function.

On February 6, 2014, the Board of Directors of the Company decided to adopt the decision of the Audit Committee and appoint accountant Nitza Rogozinski as Internal Auditor of the Company.

**c) Identity of the Supervisor of the Internal Auditor**

- 1) The CEO and the Chairman of the Board of Directors of the Company supervise the Internal Auditor and Public Complaints Commissioner on behalf of the organization.
- 2) The identity of the supervisors conforms to the directives of section 148 and section 49 of the Government Companies Law.
- 3) The obligations and the authorities of the Internal Auditor are set in the procedure "The Internal Audit and Public Complaints Commissioner" of the Company. This Internal Audit procedure is approved by the Audit Committee.
- 4) During the months of August - September 2015, the Board of Directors approved (Audit Committee, Human Resources and Organization Committee of the Board of Directors and the Plenum) the structural change of the internal audit. Additionally, the position of the internal auditor was approved as a standard Deputy CEO.



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**c. Aspects of Corporate Governance (continued)**

**4. The Company's Internal Auditor (continued)**

**d) Work Plan**

- 1) The annual work plan of the audit is discussed and approved by the Audit Committee and by the Board of Directors. The work plan for 2015 was approved by the Audit Committee and approved by the Board of Directors in December 2014.
- 2) The duties and authorities of the internal auditor are determined in accordance with section 4(a) to the Internal Audit Law and by the Audit Committee, according to the authority delegated to it for this purpose in the past by the Company's Board of Directors. On May 24, 2012, the Board of Directors approved a motion to reconfirm its previous decision to delegate to the Audit Committee its authority to determine the duties and authorities of the Internal Auditor.
- 3) The internal audit's work plan includes resources for executing planned audits and audits to follow-up the implementation of recommendations from audit reports and reports of the State Comptroller. In addition, the work plan includes allocation of resources for unscheduled audits as stated: 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 Unit conducts audits during the year, pursuant to direct and anonymous complaints (not from the field of consumption) received by the Company.
- 4) An annual report is prepared every year, summarizing the auditing activity during that year. The annual report of the Internal Audit is submitted to the Chairman of the Board of Directors, the Chairman of the Audit Committee of the Board of Directors and the CEO.
- 5) At the end of 2015, a draft audit report was distributed, dealing with: "The Company's engagements in transactions with related parties and exceptional transactions" (including transactions that require approval according to Section 270 of the Companies Law and exceptional transactions as defined in the Companies Law).
- 6) During the period of January – December 2015, the Internal Audit submitted audit reports, including follow-up reports in the area of computerized information systems.
- 7) The work plans (multi-annual and annual) of the internal audit are based on the risk surveys and embezzlement and fraud surveys of the Company. The plans also include examination of risk management in the Company, in accordance with the requirements in the circular of the Companies Authority, and the risk management unit is one of the audited units.
- 8) During 2013, a risk survey and a multi-year work plan for the internal audit for 2014-2016 were prepared. The risk survey and the multi-year work plan (2014-2016) were approved by the audit committee and the board of directors on December 2013.  
In December 2013, the Audit Committee and the Board of Directors approved the internal audit work plan for 2014.  
In December, 2014, the Audit Committee and the Board of Directors approved the update of the multi-annual work plan. The update is based, inter alia, on the results of the embezzlement and fraud risks survey conducted in the Company and the results of the executed audits. In addition, the internal audit work plan for 2015 was approved.  
In June, 2015, the Audit Committee discussed the status of execution of the 2015 work plan. The Audit Committee approved the work plan update in accordance with the prioritization of the tasks. The work plan update was also approved by the plenum of the Board of Directors on June 25, 2015.

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**c. Aspects of Corporate Governance (continued)**

**4. The Company's Internal Auditor (continued)**

**e) Audit of Held Companies**

An independent Internal Auditor was appointed for the National Coal Supply Corporation ("The Coal Company"). The supervision of the work of the internal auditor at the Coal Company is performed by the Audit Committee and the Board of Directors of the Coal Company. As agreed upon in June 2012 between the Internal Auditor and the Chairman of the Board of Directors of the Coal Company, the Internal Auditor of the Company receives all the material related to the internal audit in the Coal Company that he requires to perform his work.

**f) Scope of Employment**

- 1) The Internal Auditor is employed on a full-time basis.
- 2) The number of employment hours of the Audit Unit during the report year:

	Internal Audit - Work Plan	Internal Audit - Additional Requirements	Handling Complaints by Suppliers, Customers and Company Employees, which are not from the field of consumption	Handling Public Complaints from the Field of Consumption
Audit of activities in Israel .....	Approx 20,600	Approx 9,300	Approx 10,300	Approx 15,700

- 3) As of the reporting date, the Internal Audit unit has 21 budgeted positions for employees in the field of internal audits and complaints in the field of integrity and 9 employees who handle public complaints in the field of consumption (Ombudsman Department), in addition to the Internal Auditor and 3 administration employees. . 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.
- 4) According to the multi-year and annual updated work plan, which were approved by the Audit Committee and by the Board of Directors, the Company estimates that the work scope of the Internal Audit is required and sufficient to cover the material issues in the Company about once every three years.

**g) Performance of the Audit**

- 1) Audits are conducted according to accepted professional standards, in accordance with the laws and in conformance to the Internal Audit Law and to the directives of the Government Companies Authority, furnished from time to time in circulars of the Government Companies Authority.
- 2) The Board of Directors and the Audit Committee assess that the Internal Auditor conformed to the requirements specified in the professional standards.

**h) Access to Information**

The Internal Auditor and her representatives are granted free, continuous and direct access to every hard copy or digital document, data, database, or information, including financial data, for performing their tasks. The Internal Auditor and her representatives are entitled to enter every asset and inspect it, in conformance with the contents of Section 9 of the Internal Audit Law.

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**c. Aspects of Corporate Governance (continued)**

**4. The Company's Internal Auditor (continued)**

**i) Reports of the Internal Auditor**

- 1) The audit reports are submitted in writing. An annual report is submitted annually, and it includes a summary of the work of the Internal Audit, a follow-up on implementation of decisions and recommendations as detailed in section d) 4 above.
- 2) During the work year, the Internal Auditor submits final versions of audit reports are submitted 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.
- 3) During January – December 2015, 115 reports were distributed: 49 audit reports, 59 examination reports, and 7 examination documents. During this period, the Audit Committee of the Board of Directors held 11 discussions on the Internal Auditor's findings and recommendations which took place on January 22, 2015, February 26, 2015, March 26, 2015, April 30, 2015, May 14, 2015, June 4, 2015, July 9, 2015, August 27, 2015, September 24, 2015, October 22, 2015, and December 10, 2015.

**j) Evaluation of the Board of Directors of the Internal Auditor's Activities**

The scope, nature and activity of the Internal Audit are sufficient and reasonable in order to realize the audit objectives in the Company. In addition, the material subjects are covered once every 3 years as required by the provisions of the law.

In November 26, 2015, the Board of Directors approved the Audit Committee's proposal of October 22, 2015, to perform a procedure to select an examiner who will conduct a quality inspection of the Internal Audit.

**k) Remuneration**

The Internal Auditor is an employee of the Company.

The Board of Directors estimates that her wages do not affect the ability of the Internal Auditor to exercise her professional consideration.

**5. Internal Enforcement Plan in the Field of Securities**

On June 14, 2012, the Board of Directors of the Company approved an outline of an internal enforcement plan that was formulated by the Company, according to criteria published by the Securities Authority on August 15, 2011, for recognizing an internal enforcement plan in the field of securities as an effective enforcement plan (hereinafter: the "Criteria").

As of the date of publication of the report, the Company has completed the milestones set by it for adoption of an internal enforcement plan by the Company, and the Board of Directors of the Company appointed a designated committee of the Board of directors - a Corporate Responsibility Committee, that deals, inter alia, with adoption and implementation of the internal enforcement plan in the Company according to the duties designated for it within the outline of the plan. Additionally, the Board of Directors appointed a supervisor in charge of the internal enforcement in the Company in the field of securities, and national enforcement and compliance team, unit enforcement and compliance teams and additional factors that constitute part of the internal enforcement array of the Company were also appointed. In addition, the Company completed the preparation and formulation of master procedures of the Company in the field of the internal enforcement and it is taking intensive enforcement actions for implementing and assimilating the internal enforcement plan in the Company, including by conducting tutorials to all the relevant enforcement factors of the Company.

Additionally, in 2014, the Company entered a contractual engagement with the firm of Ziv Haft Consultation and Management Ltd. for the execution of an external enforcement survey to locate potential gaps and failures in the operations of the Company and the exposure of the Company to the securities laws.

On December 16, 2014, an internal audit report dealing with "preparation and assimilation of an administrative enforcement plan" was distributed in the Company. According to the report, the preparation and implementation process of the internal enforcement plan in the Company was conducted appropriately and there were no findings that indicated exceptions from the provisions of the law. The Board of Directors and

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**c. Aspects of Corporate Governance (continued)**

**5. Internal Enforcement Plan (continued)**

management of the Company allocated resources, held meetings and carried out follow-up and continuous monitoring in order to prepare an effective enforcement plan in accordance with the requirements of the Securities Authority.

According to the provisions of the administrative enforcement arrangement signed by the Company and the Securities Authority, which was approved by the administrative enforcement committee on November 28, 2013 (hereinafter in this section: the "Arrangement" or the "Enforcement Arrangement"), in February 2014, the Company appointed an external inspector whose duty is, inter alia, to ensure completion of the formulation and effective implementation of the enforcement plan and its procedures, and to quarterly submit a report to the Securities Authority on the findings of his inspection (hereinafter: the "External Inspector"). (For additional details regarding the enforcement Arrangement see immediate report of November 28, 2013, reference number: 2013-01-208542).

According to the provisions of the stated Arrangement, from the date of his appointment, the External Inspector delivered quarterly supervision reports to the Securities Authority, which were described in the quarterly Board of Directors' Reports of the Company.

On November 23, 2015, the External Inspector delivered the seventh quarterly supervision report to the Securities Authority. Following are its main points:

- 1) The inspector was of the impression that during the seventh report period, the Company continued to act vigorously for the effective implementation of the enforcement plan and that the activity of the national team thus far, with emphasis on the seventh report period, shows that the Company is working hard to tighten the connection between the national team and the various units in the Company. The inspector reiterated the importance of strengthening ties with the aforesaid units for the effective success of the enforcement plan
- 2) The inspector is of the opinion that the annual enforcement report for 2014-2015 shows a deepened awareness among various factors in the Company for the enforcement plan and its importance. However, the inspector is of the opinion that it is advisable to refine for the units, in preparation for the coming enforcement reports, the importance of filling the enforcement reports and providing detailing as required.

On March 7, 2016, the External Inspector delivered the eighth quarterly supervision report to the Securities Authority. Following are its main points:

- 1) The inspector was of the impression that during the eighth report period, the Company continued to act in various channels in order to refine the importance of information flow in the Company
- 2) The inspector is of the opinion that the initiated audits executed by the national team on issues related to the enforcement plan are of great importance for effective implementation of the enforcement plan and recommends that the national team will persist in carrying out these audits.
- 3) Within the report, the inspector summed up the supervision acts executed by him within the supervision period which was set in the enforcement arrangement, and the issues he focused on during this period.

Upon submission of the eighth supervision report, the supervision period set in the enforcement arrangement has ended. However, and in view of the great importance attached by the Board of Directors to the supervision of issues and fields over which the external inspector supervised, on October 15, 2015, the Board of Directors decided to extend the period of engagement with the external inspector by an additional year, and the inspector's quarterly reports during this year will be submitted to the Corporate Responsibility and Regulation Committee.

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**c. Aspects of Corporate Governance (continued)**

**6. Financial Statements Approval Process**

a) For details of the Financial Statements Review Committee (hereinafter: the "Committee"), approval process of the Financial Statements as required by the Securities Regulations see the 2015 corporate governance questionnaire.

b) The following attended the meeting held on March 10, 2016:  
Accountant Arie Rapoport, Chairman of the Committee, Accountant Raik Abu Reish Member of the Committee, Adv. Arik Forer, Member of the Committee, Mr. Ofer Bloch CEO, Accountant Avi Doitchman Senior Vice President of Finance and Economics, Advocate Yael Nevo General Counsel and Company Secretary, Accountant Nitza Rogozinski Internal Auditor, representatives of the Accounting and Economics Division, representatives of the Finance Division, representative of the office of the Auditor Brightman Almagor Zohar & Co., representatives of the law firm of Herzog Fox Neeman, representatives of the Companies Authority, the financial advisors of the Company, and Mr. Emanuel Berzac, Company actuary.

The following attended the meeting held on March 17, 2016:

Accountant Arie Rapoport Chairman of the Committee, Accountant Raik Abu Reish Member of the Committee, Adv. Arik Forer Member of the Committee, Mr. Ofer Bloch CEO, Mr. Yitzhak Balmas Deputy CEO, Accountant Avi Doitchman Senior Vice President of Finance and Economics, Advocate Yael Nevo General Counsel and Company Secretary, Accountant Nitza Rogozinski Internal Auditor, representatives of the Accounting and Economics Division, representatives of the Finance Division, representative of the office of the Auditor Brightman Almagor Zohar & Co., representatives of the law firm of Herzog Fox Neeman, representatives of the Companies Authority, and the financial advisors of the Company.

c) Other Steps taken in the Company to Ensure the Correctness of the Company Financial Statements and the Board of Directors' Report

The Company operates in accordance with the Government Companies Regulations (an additional Report on actions taken and presentations given to ensure the correctness of the Financial Statements and the Board of Directors' Report) – 2005, in which the Company is obliged to attach to its Annual and Quarterly Financial Statements an additional report on actions taken and presentations given to ensure the correctness of the periodic or quarterly report, as applicable, including signed statements from all of the Company officers signing those reports.

For the processes performed by the committee and the Board of Directors prior to the approval of the Financial Statements, see the 2015 corporate governance questionnaire.

There is a Disclosure Committee in the Company, headed by the CEO of the Company, Mr. Ofer Bloch, and the goal of the Committee is to ensure in an optimal manner that the financial statements of the Company include full presentations and disclosures as required.

The duties of the committee:

The disclosure committee holds a discussion before the financial statements are presented for discussion at the committee for reviewing financial statements.

- 1) Reviewing periodic and annual reports and approving infrastructure and notes to the reports.
- 2) Discussing information relevant to the report being discussed.
- 3) Discussing relevant correspondence with the Securities Authority, Government Companies Authority, Electricity Authority and other regulators.
- 4) Discussing defects found as a result of the disclosure, information flow and solution providing processes.
- 5) Improving the disclosure processes.
- 6) Discussing the materialization of risks of accounting reports and financial statements.
- 7) Tracking and controlling reports of the division heads that require disclosure in the financial statements.

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**c. Aspects of Corporate Governance (continued)**

**6. Financial Statements Approval Process (continued)**

**c) Other Steps taken in the Company to Ensure the Correctness of the Company Financial Statements and the Board of Directors' Report (continued)**

The members of the committee are: Company CEO - the chairman of the committee, Senior Vice Presidents, General Counsel and Company Secretary, Head of Accounting and Economics Division, Head of Finances Division, Head of Accounting and Financial Statements Department, and the Head of the SOX Department. The committee convenes twice a quarter, in the beginning of the Financial Statement production process, and towards the end of the production of the Financial Statement, prior to its publication.

In addition, the Company has determined a "working Procedure for the approval of Financial Statements, critical accounting policy changes and changes in actuarial assumptions" which determined, inter alia, a mechanism for detecting, treating and reporting events and information that may influence the critical accounting policies and / or actuarial assumptions on which the Company operates, including the transfer of reports and discussions to the relevant parties in the Company, including the CEO, Senior Vice President of Finance and Economics, Head of Human Resources Division, the Chairman of the Committee examine the Financial Statements of the Board of Directors, members of the committee to examine the Financial Statements of the Board of Directors, the Chairman of the Board of Directors and Board members.

**7. The Link between Rewards to Senior Position Holders and Interested Parties in the Company and Their Contribution to the Company**

On March 21, 2016, 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, and suit their contribution to the Company during the report period .

For additional details regarding the compensation policy in the Company see section 8 below.

**8. Policy for the Compensation of Officers under Amendment No. 20 to the Companies Law**

**Compensation Policy for Senior Office Holders**

On December 19, 2013 and December 26, 2013, the Compensation Committee and the Board of Directors approved, respectively, the compensation policy for senior office holders of the Company ("Compensation Policy"). The abovementioned approval by the Board of Directors was given after the Board of Directors discussed and considered the recommendations of the Company's compensation committee on the matter, while considering the criteria set by the Companies Law and paying attention to the considerations and principles detailed below. The compensation package was adapted to the size of the Company, the nature of its activity, the aspiration of the Company to keep its office holders, and the Company being a Government Company subject to the provisions of the Government Companies Law and its various regulations, directives of the Government Companies Authority and section 29 to the Budget Foundations Law - 1985, that restrict the Company's abilities to act independently in matters of employment salary and benefits. The compensation policy was approved at the general meeting of January 9, 2014.

On September 16, 2014, and October 2, 2014, the compensation committee and the plenum of the Board of Directors (respectively) approved an amendment to the Compensation Policy, regarding the compensation and incentive bonus for senior office holders of the Company, according to the Government Companies Authority's circular of March 25, 2014. The amendment was approved in the general meeting on February 4, 2015.

For additional details and the complete version of the compensation policy see the Immediate Report of the Company of January 9, 2014, ref. no.: 2014-01-011125, and February 4, 2015, ref. no.: 2015-01-024979.

In November 2015, an updated circular of the Companies Authority was published, regarding principles for a model for compensation and incentive for senior employees. The Company will act in accordance with the above mentioned circular when determining the compensation policy for 2016.

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**c. Aspects of Corporate Governance (continued)**

**9. External Auditors of the Company**

- a) The External Auditors of the Company are the Brightman Almagor Zohar & Co. auditing firm. On December 31, 2007, during the annual shareholders general meeting, Brightman Almagor Zohar & Co. auditing firm was appointed as the Company's external auditors for the 2008 fiscal year. Following this, the appointment of the Brightman Almagor Zohar & Co. was re-approved in each of the Company's annual general meetings for 2009, 2010 and 2011 (which were held on December 31, 2008, May 31, 2010 and August 2, 2011, respectively), and all the above detailed appointments were approved by the Government Companies Authority in accordance with the provisions of section 44(a) to the Government Companies Law of 1975.
- b) At the Annual General Meeting of November 22, 2012, and at the Annual General Meeting of January 9, 2014, and at the Annual General Meeting of February 4, 2015, the discussion regarding the appointment of an external auditor and determining the fees was deferred to a postponed annual general meeting according to the requirements of the Government Companies Authority, which announced that since the committee for appointment and pay of accountant for a government company (hereinafter: the "**Committee**") has yet to reach a decision in this matter, due to cessation of its activity and its conversion into a severed committee, the discussion of this matter should be postponed to a postponed annual meeting that will convene in accordance with the provisions of the law and the articles of the Company.
- c) At the Annual General Meeting of December 21, 2015, the shareholders of the Company discussed the appointment of an external auditor and determining his fees and a decision was reached to choose the Somekh Chaikin & Co firm as the external auditor of the Company (hereinafter: the "auditor"), which is expected to serve as an external auditor until the end of the next annual general meeting of the Company. In accordance with section 44(a) of the Government Companies Law, 1975, the appointment of the auditor will enter into effect on the date on which the Companies Authority gives its approval, insofar as will be given. The Company applied to the Companies Authority and requested its aforesaid approval. Until the granting of the aforesaid approval, the firm of Brightman, Almagor, Zohar & Co will continue in its position as the external auditor of the Company. In accordance with the notice of the Companies Authority of March 3, 2016, completing the appointment of the new accountants of government companies is subject to approval by the State Comptroller, whereby there is no obstacle to continue the appointment proceedings, and in these circumstances, the current external auditors of the government companies will continue in their position until the appointment of the new accountants as aforesaid is completed.

The Board of Directors will examine the work hours report and fees submitted by the auditor in light of the stated circulars of the Companies Authority, emphasizing the level of the rates and the distribution among the professionals and will submit the conclusions of its examination for approval by the Companies Authority.

The total fees of the outside auditor in respect with audit services and other services relating to tax services audit and other related services for the years 2014 – 2015 are detailed below:

	<b>For the year ended on December 31</b>			
	<b>2015</b>		<b>2014</b>	
	<b>Brightman Almagor Zohar &amp; Co.</b>			
	<b>Hours</b>	<b>NIS thousands</b>	<b>Hours</b>	<b>NIS thousands</b>
a. Fees for audit services, for services related to audits and for tax services .....	20,721	4,559	20,133	4,228
b. Other fees - total fees for services provided by the outside auditor which are not included in paragraph (a) above .	3,975	875	2,950	620

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**c. Aspects of Corporate Governance (continued)**

**9. External Auditors of the Company (continued)**

**Hours dedicated by the External Auditor in providing other related services in 2015:**

Offering Circular abroad and a draft prospectus in Israel.....	2,475
Special tax work.....	1,200
Special confirmations.....	300
<b>Total hours dedicated to accompanying services .....</b>	<b><u>3,975</u></b>

**Hours dedicated by the External Auditor in providing other related services in 2014:**

Outline of distribution abroad and a draft prospectus in Israel .....	1,900
Communication with the Government Companies Authority .....	100
Special tax work .....	650
Special confirmations.....	300
<b>Total hours dedicated to other accompanying services .....</b>	<b><u>2,950</u></b>

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.

On March 17, 2016, the Financial Statements Review Committee discussed and was satisfied that the scope of work of the external auditor relating to the financial statements of the reporting year are appropriate for executing proper auditing and review work.



**THE ISRAEL ELECTRIC CORPORATION LIMITED**  
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**d. Instructions for Disclosure Related to the Financial Reporting of the Company**

**1. The Financial Reporting of the Company**

The Consolidated Financial Statements of the Company comply with the provisions of the Government Companies Regulations (accounting principles for the preparation of Financial Statements of the Israel Electric Company Ltd.) (Temporary Order) – 2004 including their articles (hereinafter: the “Government Companies Regulations”) and the provisions of the Securities Regulations (Annual Financial Statements), 2010 and the Government Companies Regulations (accounting principles for the preparation of Financial Statements of the Israel Electric Company Ltd.) (Temporary Order) – 2004 including their amendments.

As of January 1, 2015, the Company is fully implementing the International Financial Reporting Standards (IFRS). See details in Note 2 to the Financial Statements.

The Company consolidates the Coal Company in its Financial Statements. The financial data in the Board of Directors’ Report are data from the Consolidated Financial Statements of the Company.

**2. Events that Occurred after the Statement of Financial Position Date**

See Note 38 to the Financial Statements.

**3. Critical Accounting Estimates**

a) Preparation of the Financial Statements in accordance with accepted accounting principles requires the Management of the Company to make evaluations and estimates which affect the reported values of the assets, liabilities, revenues and expenses and also the disclosure concerning contingent assets and liabilities. For details on the use of critical accounting estimates of the Company, see Note 2 aa to the Financial Statements.

b) Following are additional details regarding the critical accounting estimates of the Company:

1) Employee benefits:

For details of the critical accounting estimates related to employee benefits see Note 11 to the Financial Statements.

There is a difference of approximately NIS 7.4 billion between the actuarial liability according to the Financial Statements of the Fund as of December 31, 2015 and the actuarial liability according to the Financial Statements of the Company as of December 31, 2015, (with respect to the pension payments). The difference derives from a difference in calculation methodology between the bodies, which partly derives from different professional approaches, according to the rules that oblige each of the bodies: the Company calculates the actuarial liability in accordance with the accounting rules applied to the Company (in accordance with the International Financial Reporting Standards, including IAS 19 and the directives of the Securities Authority), while the Fund acts in accordance with the instructions of the Capital Market, Insurance and Savings Division Officer, where the Actuary of the Fund noted that the assumptions used to prepare the statement of financial position comply with the instructions of the Capital Market, Insurance and Savings Division Officer for preparing actuarial statements of financial position.

The main difference between the assumptions derives from the discount rate, used to calculate the actuarial liability, i.e. the Fund capitalizes the actuarial liability according to the discount rate of government debentures and the Company according to corporate debentures, (see Note 11.k. to the Financial Statements), and the assumption of the real increase in salary assumption, rate of employee promotion, seniority increment, labor agreements, salary erosion, etc.

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**d. Instructions for Disclosure Related to the Financial Reporting of the Company (continued)**

**3. Critical Accounting Estimates (continued)**

b) (continued)

2) Asset impairment according to Accounting Standard 36.

Sensitivity according to the change in the weighted average cost of capital (WACC)

WACC	(1%)	(0.5%)	Set capital costs	0.5%	1%
Surplus of recoverable value over book value in NIS millions..	1,301	1,145	991	838	657

3) Fair value for financial instruments - see Note 27 to the Financial Statements.

**4. Material and Highly Material Valuations**

a) In light of the update of Legal Position number 105-23 concerning parameters to examine the materiality of valuation, the Company policy in all that relates to materiality of valuations conforms to the position of the Securities Authority. Accordingly, a material valuation in the Company is a valuation that satisfies at least one of the following tests:

- (1) Statement of financial position test – examining the valuation in relation to the total assets of the Company constitutes at least 5% of the total assets of the Company, as presented in the consolidated statement of financial position as of the last date of the reported period.
- (2) Results test –the effect of the change in the value as a result of valuation of the net profit or comprehensive income, as the case may be, constitutes at least 5% of the net profit or comprehensive income of the Company, respectively, as well as constituting at least 2.5% of the Company's equity as of the end of the reporting period.

A highly material valuation is a valuation that fulfills a quantity threshold that is twice the material valuation according to the above detailed parameters (namely, 10% instead of 5% and 5% instead of 2.5%).

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**d. Instructions for Disclosure Related to the Financial Reporting of the Company (continued)**

**4. Material and Highly Material Valuations (continued)**

**b) Disclosure with respect to a valuation that served as the basis to determine the value of data in the Financial Statements**

Highly Material Valuations

Details of valuations classified as highly material according to the above mentioned materiality tests, in accordance with regulation 8b(i) to the Securities Regulations are presented below:

- 1) The Company conducts very high materiality valuations of the actuarial liability with respect to benefits to employees in accordance with IAS 19.

Identification of Valuation subject	Actuarial obligation for employee benefits in accordance with International Accounting Standard 19 (IAS 19)
The timing of the evaluation:	December 31, 2015
Determined in accordance with the evaluation	NIS 26,266 million
Identifying the appraiser and his characteristics:	Assessment was carried out by Ernst & Young (Israel) Ltd. (hereinafter: Ernst & Young) by Emanuel Berzack and the Actuarial department staff supervised by him. Emanuel Berzack B.Econ.Sc. (Actuarial Statistics) University Witwatersrand, South Africa, is an authorized Actuary (full member of the Israel Association of Actuaries – FILAA, and the Institute of Actuaries in England – FIA). His professional experience - over the past 12 years includes actuarial estimates of employee benefits of similar types to that of the Company, pension liabilities of pension funds, insurance liabilities of insurance companies, duties of an actuary or an examining actuary examines or auditor.
Dependency on evaluation order	The Company actuary is not dependent on the work or the Company, except for the fact that he receives fees for this work and for additional consulting services. The fees are not dependent on the outcome of the work. On March 29, 2011 the new actuary of the Company from Ernst & Young (Israel) Ltd., who provides actuarial services to the Company from the first quarter of 2010, received a letter of indemnification from the Company.
Evaluation model which the appraiser used	Discounted Cash Flow (hereinafter: "DCF")
Assumptions according to which the appraiser performed the valuation, depending on the model estimates:	Weighted grossed up interest rate in the current value of the liability is 2.85% Real update of salary during the work period - Individual salary development model of active employees and including salary increase between current salary agreements. Real update of post-employment pension amounts –pension development model since January 2012 the pension is linked to the actual linkage CPI of the pension to CPI of January 2013 (according to the annual change of the CPI in 2012) and so in future. Pensioners and survivors mortality including updating mortality rates – according to the Ministry of Finance circular of July 11, 2012. For additional actuarial assumptions, see the Actuary's Opinion in Annex A.
The body in the Company that decided to enter an agreement with the appraiser	Head of Accounting and Economics Section.

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**d. Instructions for Disclosure Related to the Financial Reporting of the Company (continued)**

**4. Material and Highly Material Valuations (continued)**

**b) Disclosure with respect to a valuation that served as the basis to determine the value of data in the Financial Statements (continued)**

2) Very high materiality valuations regarding assets impairment implementation of the provisions of IAS 36

Identification of Valuation subject	Asset impairment - examination of the Company's asset impairment as part of implementation of the provisions of IAS 36 - the assets of the three segments of operation of the Company.
The timing of the evaluation:	December 31, 2015
Value of the evaluation subject immediately before the date of the evaluation, had the accepted accounting principles, including depreciation and amortization, not required its change of value according to the valuation:	NIS 67,554 million (book value).
Net asset value of the object of the evaluation determined in accordance with the evaluation	NIS 68,545 million.
Identifying the appraiser and his characteristics:	Ascola Economic and Financing Consulting through a related company Wise Consulting Group is a company specializing in providing economic, strategic and financial consultation services. The company's services include: valuation, constructing financial models, economic profitability studies and economic opinions for the courts, support in tenders, strategy and the game theory. The work is executed by Accountant. Yoel Sakara. Accountant Sakara has a B.A. in Economics and Accounting from the University of Haifa and an M.A. in Accounting from the University of Bar Ilan.
Dependency on evaluation order	No
Evaluation model which the appraiser used	Discounted Cash Flow method - DCF
The major assumptions according to which the appraiser performed the valuation, depending on the model of estimates:	Forecast of future cash flows, expected to be caused by one cash yielding unit, was conducted on the basis of the present rate structure and on the basis of assumptions that represent, inter alia, the economic conditions that will exist during the useful lifespan of the units' assets, the major ones of which are: <ul style="list-style-type: none"> <li>- When examining the cash yielding units, the Company identified the three segments of operation of the Company as one cash yielding unit.</li> <li>- The present rate structure in the generation segment, as determined in February 2010, will end at the end of 2014, and a new rate is expected to enter into force in January 2017. The new rate base will provide full cover for the investment and operating costs of the Company, according to the Electricity Sector Law.</li> <li>- The new rate base for the transmission and distribution segments, when published, will apply from April 1, 2012. The new rate base for the transmission and distribution segments will provide full cover for the investment and operating costs of the Company as of this date.</li> <li>- The effect of the draft of the Navigant report on the new rate base for the transmission and distribution segments was not expressed in the cash flow forecast, but its impact was examined in the sensitivity tests.</li> </ul>

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**d. Instructions for Disclosure Related to the Financial Reporting of the Company (continued)**

**4. Material and Highly Material Valuations (continued)**

**b) Disclosure with respect to a valuation that served as the basis to determine the value of data in the Financial Statements (continued)**

- 2) Very high materiality valuations regarding assets impairment implementation of the provisions of IAS 36 (continued)

	<ul style="list-style-type: none"> <li>- The fuels expenses to be borne by the Company will be covered in the electricity rate throughout all the forecast periods.</li> <li>- The weighted capital cost 3.6% net of tax with respect to the periods regarding which it was assumed that full cover will apply - capitalization rate equal to the yield rate that will be granted by the Electricity Authority was assumed.</li> <li>- The debts of the Palestinian Authority and East Jerusalem with respect to past and future services will be collected in full but at a postponed date.</li> </ul>
The body in the Company that decided to enter an agreement with the appraiser	Head of Accounting and Economics Section.

**5. Disclosure of the Forecasted Cash Flow of the Company for Financing Repayment of Corporate Liabilities**

As of the report date, the warning signs detailed in regulation 10(b)14(a) of the Securities Regulations do not apply to the Company.

The Company has cash flow from current operation for the report period amounting to approximately NIS 7,624 million. The cash balance as of December 31, 2015 amounts to NIS 2,524 million, and the Company's positive working capital of December 31, 2015, is approximately NIS 1,154 million. For details of the Decision of the Company's Board of Directors of October 2015, regarding the Company's safety cushion, see Chapter A - Report of Description of the Business Affairs of the Corporation, section 18.1.

**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 Senior Vice Presidents, 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.

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**d. Instructions for Disclosure Related to the Financial Reporting of the Company (continued)**  
**6. Evaluations of the Effectiveness of Internal Controls and Disclosure Controls over the Financial Statement (continued)**

a) (continued)

According to Government Companies Authority Regulations (Additional Report on Actions Taken and Presentations Made to Assure Correctness of Additional Reports on the Subject of the Effectiveness of Internal Controls on Financial Reporting) – 2007, Government companies, among them the Company, are required to attach to their annual Financial Statements, starting with the report published as of December 31, 2009, an additional report concerning actions taken to ensure the correctness of the financial reporting, among them, establishing a system of internal controls, with the main purposes of: to examine the processes affecting the Company's records which detail its transactions, to confirm the existence of controls and test their effectiveness and to ascertain with a reasonable level of certainty that Company receipts and expenditures are only made in accordance with the approval of properly authorized Company bodies. Therefore, the Company engaged the firm of Ziv Haft to act as an expert guide and ensure correct presentation of the financial reporting. The Company established administration, control and work units to implement the regulations. A steering committee, comprised of senior management functionaries and experienced consultants in the field was established and also a Control Committee and a work team. Roles of these committees and convening schedules were defined.

The Company completed preparations required to implement regulations, all according to the accepted standards, methodologies, updated models and COBIT, with the assistance of the expert and in full cooperation of the auditor of the Company. A dedicated computerized system was integrated in the project to implement the regulations in the Company, to manage the project and perform current on-going maintenance of the control upon completion of the project. The system allows documentation of risks and controls in any process, documentation of the performed tests and results thereof. The system also provided the ability to monitor faults corrections and to generate various control and administration reports.

In its additional report on the internal controls over the financial reporting in accordance with the Government Companies Regulations, attached to these financial statements, attached to the prospectus, the Board of Directors and the Management of the Company announced that the internal controls in the Company over the financial reporting of the Company for the period ending on December 31, 2015 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.

As for the material weakness, the Company strengthened the controls. In 2011, the Company established a procedure, which was approved by its Board of Directors, on the subject of rights and benefits according to which payroll and pension payments are paid and actuarial obligations and current obligations with respect to wages. The procedure is implemented in practice. Regarding salary rights deriving from the past, the Company received an opinion from its legal advisors, and in 2011 it applied to the Commissioner of Wages for his approval of the validity of salary rights that have not yet been approved. A comprehensive response or approval has not yet been received from the Commissioner.

The Company estimates that these corrective actions strengthened the material weakness in the internal controls over the financial reporting in subjects related to employees' salary rights item, from this date onwards. Regarding salary rights deriving from the past, the Company worked to obtain an opinion from its legal advisors on the validity of the Company's obligation to its employees.

Brightman, Almagor, Zohar & Co., the external auditors of the Company, which audited the Financial Statements of the Company for the period ending on December 31, 2015, 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.

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**d. Instructions for Disclosure Related to the Financial Reporting of the Company (continued)**

**6. Evaluations of the Effectiveness of Internal Controls and Disclosure Controls over the Financial Statement (continued)**

- b) On November 24, 2009, the Finance Committee of the Knesset approved an amendment to the Securities Regulations (Periodic and Immediate Reports) - 1970 ("The Amendment"). This amendment requires all reporting corporations that have securities registered for trade in the Tel Aviv Stock Exchange to declare the effectiveness of their internal controls over financial reporting and disclosure.

On October 7, 2010, the Companies Authority published regulations (Additional Reporting on the Effectiveness of the Internal Controls over Financial Reporting) (Amendment) – 2010 and Regulations (Additional Report Regarding Actions Taken and Representations Made to Ensure the Accuracy of the Financial Statements and the Directors' Report) (Amendment) – 2010. Implementation of the aforementioned amendments in the regulations is intended to enable the Chairman of the Securities Authority to exercise his authority, according to section 9b(f) and 38c(f) to the Securities Regulations and determine that a Government Company that is also a reporting company according to the Securities Law – 1968, that implements the said regulations of the Companies Authority will report the effectiveness of the internal controls in the format stipulated in the Companies Authority Regulations.

The Company appealed to the Chairman of the Securities Authority, requesting him to exercise his authority to determine that the Company, under its definition as a Government Company that complies with all Government Authority Regulations, including the aforementioned, will report the effectiveness of the internal controls in the format specified by the Companies Authority Regulations.

In response to the request of the Company, the Chairman of the Securities Authority decided on January 4, 2011, to accept the Company's request to report the effectiveness of the internal controls in the format specified by the Companies Authority Regulations, as long as the Company fulfills these regulations. This arrangement is subject to the commitment of the Company to review the facts presented to the staff of the Securities Authority in the request on every report date and report any change to them. This includes a review of changes in the regulations or in Government Companies Regulations, changes in the status of the Company which affect the laws applied to it, changes in the implementation mode of Government Companies Regulations in the Company and any other change relevant to this subject. As at the date of the report, the Company fulfilled the requirements of the stipulations and found that there was no change in the regulations or any other relevant change.

**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 318 main sites, as well as a ledger of less important assets (about 13,742 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 27 sites, and with respect to 42 additional sites, caveats were recorded, 89 lease contracts were signed with the Israel Lands Administration, 262 contracts for purchasing transformation rooms were executed, 35 easements for access to a transformers room were registered and 418 others were identified.

b) Post-employment Employee Benefits

See Note 11 to the Financial Statements and also Annex A to the Interim Financial Statements – the opinion of the Company's Actuary as of December 31, 2015.

**THE ISRAEL ELECTRIC CORPORATION LIMITED**  
**BOARD OF DIRECTORS' REPORT ON THE STATUS OF THE COMPANY'S AFFAIRS**  
**FOR THE YEAR ENDED DECEMBER 31, 2015**

**e. Dedicated Disclosure to Debentures Holders**

**1. Details of the Bonds of the Corporation**

**a) Following are details of debentures (series 25) issued by the Company, as of December 31, 2015, as required in the eighth addition to the Securities Regulations:**

1)	<u>Debentures (Series 25)</u>
Issue date (initial)	July 8, 2012, according to the prospectus of the Company of June 26, 2012
Total nominal value on the issue date (initial)	NIS 500,000,000 nominal value.
Nominal value as of December 31, 2015	NIS 1,000,000,000 nominal value
Revaluated nominal value in accordance with linkage conditions for the report date (December 31, 2015)	NIS 1,010,879,392
Accumulated interest (as of December 31, 2015)	NIS 5,762,013
Its fair value as included in the last Financial Statements	The fair value of the marketable series is the stock exchange value, see below
Stock exchange value of debenture series on December 31, 2015	NIS 1,026,600,000
Interest type (fixed or variable) and rate	Fixed annual interest at 1.20% rate
Principal payment dates	One payment on July 9, 2017
Interest payment dates	On July 9 of each of the years 2013 to 2017
Linkage basis	Linked (principal and Interest) to the CPI published on June 15, 2012, of May 2012
It was determined that the debentures can be converted to another security	No
The entity is entitled to early redemption or enforced conversion of the debentures to other securities insofar that it exists and the conditions for exercising exist	The Company will be permitted, with the advance written agreement of the Comptroller General, to have the debentures available for early redemption (in full or in part), and in case the provisions detailed in the trust deed will apply, all subject to the guidelines of the Securities Authority and the provisions of the articles of the stock exchange and the guidelines thereof, as will be on the relevant date.
A guarantee was issued for payment of the entity's liability, in accordance with a trust deed	A warranty by the State of Israel was issued
Pledged Assets	A floating charge was provided over all the Company's assets in favor of the guarantor – the State of Israel
Series rating	Aaail (Midroog)
Is this debenture series considered material under regulation 10 (b)(13) of the Securities Regulations	No

**2) Details of trustee for the liabilities - debentures (series 25):**

Name of trustee company:	Reznik Paz Nevo Trust Ltd.
Name of responsible person:	Yossi Reznik, CPA
Address:	14, Yad Harutzim Street, Tel Aviv
Telephone:	03-6389200
Fax:	03-6393316
Website:	<a href="http://www.rpn.co.il">www.rpn.co.il</a>

**3) The debentures cannot be converted.**



**THE ISRAEL ELECTRIC CORPORATION LIMITED**  
**BOARD OF DIRECTORS' REPORT ON THE STATUS OF THE COMPANY'S AFFAIRS**  
**FOR THE YEAR ENDED DECEMBER 31, 2015**

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**e. Dedicated Disclosure to Debentures Holders (continued)**

**1. Details of the Bonds of the Corporation (continued)**

**c) Details of debentures (series 25) issued by the Company, as of December 31, 2015, as required in the eighth addition to the Securities Regulations (continued):**

**4) Rating of Debentures (Series 25) by a Rating Company:**

The series is rated Aaail according to Midroog.

For details of the rating of the Company see Note 20 g to the Financial Statements.

**5) Commitment to Fulfill the Conditions of the Debentures (Series 25)**

As on the date of the report, the Company fulfilled all the conditions and commitments according to the deed of trust for the debentures (series 25) and there was no cause to place the debentures (series 25) for immediate repayment, and the Company did not receive any notice from the trustee to the debentures (series 25) on its failure to fulfill the conditions and commitments according to the said deed of trust.

**THE ISRAEL ELECTRIC CORPORATION LIMITED**  
**BOARD OF DIRECTORS' REPORT ON THE STATUS OF THE COMPANY'S AFFAIRS**  
**FOR THE YEAR ENDED DECEMBER 31, 2015**

**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 26) as of December 31, 2015, as required in the eighth addition to the Securities Regulations, which were issued during the report period:**

1)

<b><u>Debentures (Series 26)</u></b>	
Issue date (initial)	June 7, 2015, according to the prospectus of the Company of May 27, 2015
Total nominal value on the issue date (initial)	NIS 436,978,000 nominal value.
Nominal value as of December 31, 2015	NIS 436,978,000 nominal value
Its nominal value revalued in accordance with linkage conditions for the report date (December 31, 2015)	NIS 436,978,000
Accumulated interest (as of December 31, 2015)	NIS 4,544,571
Its fair value as included in the last Financial Statements	The fair value of the marketable series is the stock exchange value (see below)
Stock exchange value of debenture series on December 31, 2015	NIS 511,919,727
Interest type (fixed or variable) and rate	Fixed annual interest at 4.8% rate
Principal payment dates	The principal will be repaid in eight unequal annual payments which will be paid on October 12 of each of the years 2016-2023 (inclusive) according to the following rates from the nominal value of the original principal: 3% on each of the dates of October 12, 2016 to October 12, 2020 (inclusive), 25% on October 12 2021, 30% on October 12, 2022 and 30% on the final repayment date of October 12, 2023
Interest payment dates	On October 12 and April 12 of each year from October 12, 2015 until October 12, 2023
Linkage basis	Without linkage
It was determined that the debentures can be converted to another security	No
The entity is entitled to early redemption or enforced conversion of the debentures to other securities insofar that it exists and the conditions for exercising exist	Yes. The complete conditions are detailed in section 7 of the Trust Deed.
A guarantee was issued for payment of the entity's liability, in accordance with a trust deed	No
Pledged Assets	A floating charge was provided over all the Company's assets in favor of the Trustee – Hermetic Trust (1975) Ltd.
Series rating	ilAA (S&P Ma'alot) Aa3.il (Midroog)
Is this debenture series considered material under regulation 10 (b)(13) of the Securities Regulations	No

2) Details of trustee for the liabilities - debentures (series 26):

Name of trustee company:	Hermetic Trust (1975) Ltd.
Name of responsible person:	Adv. Dan Avnon
Address:	113, Hayarkon Street, Tel Aviv 30835
Telephone:	03-5274867
Fax:	03-5271451
Website:	<a href="http://www.hermetic.co.il">www.hermetic.co.il</a>

3) The debentures cannot be converted.

THE ISRAEL ELECTRIC CORPORATION LIMITED  
BOARD OF DIRECTORS' REPORT ON THE STATUS OF THE COMPANY'S AFFAIRS  
FOR THE YEAR ENDED DECEMBER 31, 2015

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e. **Dedicated Disclosure to Debentures Holders (continued)**

1. **Details of the Bonds of the Corporation (continued)**

b) **Following are details of debentures (Series 26) issued by the Company, as of December 31, 2015, as required in the eighth addition to the Securities Regulations (continued):**

4) **Rating of Debentures (Series 26) by a Rating Company:**

The series is rated ilAA according to S&P Ma'alot and Aa3.il according to Midroog.  
For details of the rating of the Company see Note 20.g. to the Financial Statements.

5) **Commitment to Fulfill the Conditions of the Debentures (Series 26)**

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 26) and there was no cause to place the debentures (series 26) for immediate repayment, and the Company did not receive any notice from the trustee to the debentures (series 26) on its failure to fulfill the conditions and commitments according to the said deed of trust.

6) After the balance sheet date, the Company raised funds through expansion of negotiable debentures of series 26. For details see Note 20.d. to the Financial Statements.

**THE ISRAEL ELECTRIC CORPORATION LIMITED**  
**BOARD OF DIRECTORS' REPORT ON THE STATUS OF THE COMPANY'S AFFAIRS**  
**FOR THE YEAR ENDED DECEMBER 31, 2015**

**e. Dedicated Disclosure to Debentures Holders (continued)**

**1. Details of the Bonds of the Corporation (continued)**

**c) Following are details of debentures (Series 27) issued by the Company, as of December 31, 2015, as required in the eighth addition to the Securities Regulations, which were issued during the Report Period:**

1)

<b><u>Debentures (Series 27)</u></b>	
Issue date (initial)	June 7, 2015, according to the prospectus of the Company of May 27, 2015
Total nominal value on the issue date (initial)	NIS 403,595,000 nominal value.
Nominal value as of December 31, 2015	NIS 403,595,000 nominal value
Revaluated nominal value in accordance with linkage conditions for the report date (December 31, 2015)	NIS 403,595,000
Accumulated interest (as of December 31, 2015)	NIS 3,366,655
Its fair value included as included in the last Financial Statements	The fair value of the marketable series is the stock exchange value (see below)
Stock exchange value of debenture series on December 31, 2015	NIS 463,488,498
Interest type (fixed or variable) and rate	Fixed annual interest at 3.85% rate
Principal payment dates	The principal will be repaid in thirteen unequal annual payments which will be paid on April 12 of each of the years 2017 until 2029 (inclusive) in accordance with the following rates of the nominal value of the original principal: 1% on each of the dates April 12 2017 until April 12 2026, 20% on April 12, 2027, 35% on April 12, 2028 and 35% on the final repayment date on April 12, 2029
Interest payment dates	On October 12 and April 12 of each year as of October 12 2015 until October 12 2029
Linkage basis	Linked (principal and Interest) to the CPI published on May 15, 2015, of April 2015
It was determined that the debentures can be converted to another security	No
The entity is entitled to early redemption or enforced conversion of the debentures to other securities insofar that it exists and the conditions for exercising exist	Yes. The complete conditions are detailed in section 7 of the Trust Deed
A guarantee was issued for payment of the entity's liability, in accordance with a trust deed	No
Pledged Assets	A floating charge was provided over all the Company's assets in favor of the Trustee – Hermetic trust (1975) Ltd.
Series rating	iIAA (S&P Ma'alot) Aa3.il (Midroog)
Is this debenture series considered material under regulation 10 (b)(13) of the Securities Regulations	No

2) Details of trustee for the liabilities - debentures (series 27):

Name of trustee company:	Hermetic Trust (1975) Ltd.
Name of responsible person:	Adv. Dan Avnon
Address:	113 Hayarkon Street, Tel Aviv, 30835
Telephone:	03-5274867
Fax:	03-5271451
Website:	<a href="http://www.hermetic.co.il">www.hermetic.co.il</a>

3) The debentures cannot be converted.

**THE ISRAEL ELECTRIC CORPORATION LIMITED**  
**BOARD OF DIRECTORS' REPORT ON THE STATUS OF THE COMPANY'S AFFAIRS**  
**FOR THE YEAR ENDED DECEMBER 31, 2015**

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**e. Dedicated Disclosure to Debentures Holders (continued)**

**1. Details of the Bonds of the Corporation (continued)**

**c) Details of debentures (Series 27) as of September 30, 2015, as required in the eighth addition to the Securities Regulations, which were issued during the Report Period (continued):**

4) Rating of Debentures (Series 27) by a Rating Company:

The series is rated ilAA according to S&P Ma'alot and Aa3.il according to Midroog.  
For details of the rating of the Company see Note 20.g. to the Financial Statements.

5) Commitment to Fulfill the Conditions of the Debentures (Series 27)

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 27) and there was no cause to place the debentures (series 27) for immediate repayment, and the Company did not receive any notice from the trustee to the debentures (series 27) on its failure to fulfill the conditions and commitments according to the said deed of trust.

6) After the balance sheet date, the Company raised funds through expansion of negotiable debentures of series 27. For details see Note 20.d. to the Financial Statements.

**THE ISRAEL ELECTRIC CORPORATION LIMITED**  
**BOARD OF DIRECTORS' REPORT ON THE STATUS OF THE COMPANY'S AFFAIRS**  
**FOR THE YEAR ENDED DECEMBER 31, 2015**

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**f. Miscellaneous**

**1. Environmental Plan, Environmental Hazards and Management thereof**

The Company generates and supplies electricity in Israel, while taking steps to protect the environment and reduce environmental hazards along the electricity chain (generation, transmission, transformation and distribution). The Electricity Sector is developed while perpetually balancing different considerations, including: electricity quality, reliability of the supply, cost to the economy and environmental considerations.

The activity of the Company is involved with different environmental aspects due to the emission of pollutants into the air, storage and use of hazardous and flammable materials, ground and water sources pollution, industrial sewage, asbestos, magnetic fields and more.

The environmental requirements applied to the activity of the Company became stricter in recent years, as well as the supervision and enforcement of these requirements.

The Company estimates that this trend is expected to continue and even become stricter in the coming years, according to international awareness and requirements and, inter alia, in accordance with that which is customary in Western countries.

The issue of air quality is a most relevant environmental issue for the activities of the Company. The general order signed in December 2010 and which applies to the Company's power plants determines, inter alia, the obligation to install emission reduction devices in the Company's coal fired power stations. The reduction devices include primary measures ("PM") and Selective Catalytic Reduction ("SCR"), to reduce emission of nitrogen and Flue Gas Desulphurization ("FGD") to reduce emission of sulfur dioxide. For additional details regarding the emission reduction project see Chapter A - Report of the Business Affairs of the Corporation sections 7.12.17, 7.12.2.2, and 7.12.2.4.

**2. Dividend Distribution and Appropriation of Income**

According to the directives of the Accounting and Finance Circular of the Government Companies Authority "Financial Statements 2011-5-1" ("The Government Companies Authority Circular"), the Company is required to relate to the appropriation of its income in this report. See details on this subject in Section 4 in Chapter A - Report of the Business Affairs of the Corporation and Note 26 to the Financial Statements.

**3. Taxation**

See Note 22 to the Financial Statements.

**4. Legal Proceedings and Labor Disputes**

See Note 35 b and 35 c to the Financial Statements.

**5. Agreements including Agreements Requiring Government Approval**

For details of the contractual engagements of the Company including those requiring Government approval see Note 35 a to the Financial Statements.

**6. Limitations and Supervision on Activities of the Company**

See Section 21 in Chapter A - Report of the Business Affairs of the Corporation.

**7. Transactions of the Company with Related Parties and Interest Holders, Including Indemnification Letters**

See Note 34 to the Financial Statements.

**8. Discussion of Risk Factors**

See Section 28 in Chapter A - Report of the Business Affairs of the Corporation.

**THE ISRAEL ELECTRIC CORPORATION LIMITED**  
**BOARD OF DIRECTORS' REPORT ON THE STATUS OF THE COMPANY'S AFFAIRS**  
**FOR THE YEAR ENDED DECEMBER 31, 2015**

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**f. Miscellaneous (continued)**

**9. The State Comptroller's Report**

For details of the State Comptroller's report see section 21.5.5 in Chapter A - Report of the Business Affairs of the Corporation.

**10. Corporate Sustainability Report**

At the end of 2012, the Company decided to join the leading companies of the country and the world and establish a policy administration infrastructure on the subject of corporate responsibility and to present a corporate sustainability and responsibility report that transparently presents its operation in the field.

As part of the decision, a steering committee for sustainability was appointed in the Company, a work plan was planned, to assimilate the social reporting process, corporate responsibility trustees were appointed, and special courses were held for the teams involved in writing reports according to the GRI universal reporting model.

Up to now, reports were written for 2012-2014, including an extensive description of the social and environmental activities.

The Company undertook the liability to increase the transparency of its activity and implement corporate sustainability and responsibility with regard to its interested parties, and the reports are a continuation of this liability.

The Company is committed to an annual report from now on, and has appointed a senior entity at a rank of Company Deputy CEO who is in charge of managing the process.

Therefore, in 2014 and 2015, the Company published a corporate sustainability report which complies with the fourth reporting standard (G4) that was set by the international organization GRI, which has not yet become compulsory in Israel, and after a process of due diligence was rated "as suitable for the maximum level of transparency".

The Electric Company is one of the pioneering companies in Israel that has chosen on its own initiative to meet the challenge in advance and report in accordance with the new directives. As opposed to the 2012 report, information regarding material environmental, social and financial issues, as arose from a survey carried out among interested parties of the Company, was published for the first time. The material issues selected received extensive exposure, including details of the policy we base our activity on in these fields and providing extensive data concerning them. The concept of the Company's corporate sustainability is not only expressed in activities to protect the environment, assimilate an ethical code, formulate a corporate governance code, implementing the Freedom of Information Law, nurturing community ties, but also nurturing transparency and accountability norms because of understanding the needs of all the interested parties.

**THE ISRAEL ELECTRIC CORPORATION LIMITED  
BOARD OF DIRECTORS' REPORT ON THE STATUS OF THE COMPANY'S AFFAIRS  
FOR THE YEAR ENDED DECEMBER 31, 2015**

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**The Board of Directors and Management wish to express their appreciation to the Company's employees and its managers.**

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Ofer Bloch  
Chief Executive Officer

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Yiftah Ron-Tal  
Chairman of the  
Board of Directors

Date of Approval: March 21, 2016





# The Israel Electric Corporation Ltd.

## Supplement

Additional Report Regarding the Effectiveness of the  
Internal Control Over Financial Reporting

For the Year Ended  
December 31, 2015

## **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, 2015 ("English Translation") is provided for information purposes only.

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

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

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

**SECOND ADDENDUM  
(REGULATION 2)**

**A REPORT OF THE BOARD OF DIRECTORS AND THE MANAGEMENT ON THE INTERNAL CONTROLS OVER FINANCIAL REPORTING IN ACCORDANCE WITH GOVERNMENT COMPANIES REGULATIONS (ADDITIONAL REPORT REGARDING THE EFFECTIVENESS OF THE INTERNAL CONTROLS OVER FINANCIAL REPORTING), 2007**

The Management, under supervision and upon approval of the Board of Directors of the Israel Electric Corporation Ltd., is responsible for establishing and maintaining adequate internal controls over financial reporting of the Company. The internal controls over financial reporting is a process designed to provide a reasonable measure of assurance regarding the reliability of the financial report and the preparation of the financial statements for external purposes, in accordance with generally acceptable accounting principles and the directives of the Government Companies Law. Due to its inherent limitations, the internal controls over financial reporting are not intended to provide an absolute assurance that a material misstatement will be prevented or discovered.

The Management and the Board of Directors conducted an assessment of effectiveness of the internal controls over financial reporting of the Company and its efficiency, based on criteria defined in a control model named "COSO Model".

Based on this evaluation, the Company's Management and Board of Directors concluded that the internal controls over financial reporting of the Company for the period ended on December 31, 2015, are not effective, due to a material weakness of the internal controls over financial reporting, as detailed below:

The Company did not maintain effective controls to ensure that the rights and benefits according to which payroll and pension payments are made and actuarial obligations are included, are authorized in conformity with requirements of the law.

Correction of the material weakness

The Company took actions to reinforce the controls pertaining to this matter and established a procedure, which was approved by the Company's Board of Directors, in 2011, concerning the rights and the benefits according to which payroll and pension payments are made and actuarial obligations are included. The procedure is implemented in practice. In relation to salary rights originating in the past, the Company has received an opinion from its legal counsel and in 2010 has applied to the Wages Commissioner for his approval of the effectiveness of salary rights for which an approval has not yet been issued. The Commissioner's comprehensive approval or reference has not yet been received.

The Company believes that these actions have strengthened the internal control over financial reporting in the matters pertaining to the prospective treatment of the employee salary rights balance. As to salary rights originating in the past, the deficiency will not be removed until the Commissioner's approval of the effectiveness of past salary rights is received.

The Opinion of the External Auditor

The external auditor of the Company, Brightman Almagor Zohar & Co., who audited the financial statements of the Company for the period ended on December 31, 2015, 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.

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Mr. Avi Doitchman  
Senior Vice-President of  
Finances and Economics

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Mr. Ofer Bloch  
Chief Executive Officer

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Mr. Yiftah Ron-Tal  
Chairman, Board of Directors

March 21, 2016



**Translated from the Hebrew language**

**Auditors' Report to the Shareholders of the Israel Electric Corporation Limited.**

**According to the Government Companies Regulations (Additional Reports on the Effectiveness of Internal Controls Over Financial Reporting), 2007**

We have audited the internal controls over financial reporting of the Israel Electric Corporation Limited (hereafter- the "Company") as of December 31, 2015, based on criteria established in Internal Controls - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (hereafter- "COSO").

The Company's Board of Directors and Management are responsible for maintaining effective internal controls over financial reporting and for their assessment of the effectiveness of internal controls over financial reporting, included in the accompanying Board of Directors and Management's report on Internal Controls over Financial Reporting (hereafter- "the assessment of the Board of Directors and Management"). Our responsibility is to express an opinion on the Company's internal controls over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (PCAOB) in the United States of America with regard to an audit of internal controls over financial reporting as was adopted by the Institute of Certified Public Accountants in Israel. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal controls over financial reporting were maintained in all material respects. Our audit included obtaining an understanding of internal controls over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal controls based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

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A Government corporation's internal controls over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with the financial reporting principles applying to the Company (such principles applying to the Company are explained in note 2a to the financial statements as of December 31, 2015). 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, 2015), 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.

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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, 2015, 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, 2015, 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, 2015 and 2014 and for each of the years ended on those dates and our report dated March 21, 2016 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 21, 2016

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# The Israel Electric Corporation Ltd.

## Chapter C Consolidated Annual Financial Statements

For the Year Ended  
December 31, 2015

## **Prominent Disclaimer**

This English translation of the **“Consolidated Annual Financial Statements”** for the year ended December 31, 2015 ("English Translation") is provided for information purposes only.

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

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

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



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**Translated from the Hebrew language**

**Auditors' Report  
To the Shareholders of the Israel Electric Corporation Limited**

We have audited the accompanying consolidated statements of financial position of the Israel Electric Corporation Limited (hereafter – the "Company") as of December 31, 2015 and 2014, and the related consolidated statements of profit or loss and other comprehensive income, changes equity and cash flows for each of the years ended on those dates. 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, 2015 and 2014 and their results of operations, changes in equity and cash flows for each of the years ended on those dates, in conformity with International Financial Reporting Standards (IFRS) and the requirements of the Securities Regulations (Annual Financial Statements), 2010.

Without qualifying our above opinion, we draw attention to the following matters:

1. The contents of Note 1e regarding the structural change including the content of the draft of recommendations of the Steering Team and the letter of the Chairman of the Government Companies Authority on the subject of the reform in the Company and in the electricity sector. As stated in that Note, as of the date of the financial statements, the implementation of the structural change has not yet begun in any outline, and despite the publication of the draft recommendation of the Steering Team and the exchange of correspondence on this subject, there is still uncertainty regarding the final

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format of the structural change, the date of its implementation or its implications on the Company, its business and its results.

2. The contents of Note 1f regarding the "Assets Arrangement", particularly regarding significant uncertainty and highly material amounts that the Company may be obligated to pay under that arrangement.
3. The contents of Note 11g 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 35b (subsections 1, 6 and 9) regarding class action suits and other material claims that were filed against the Company.

Notes 39 and 40 and in other Notes in these financial statements include additional information pursuant to requirements of the Governmental Companies Authority (by virtue of section 33b to the Government Companies Law), excluding information regarding land rights as discussed in Note 13h.

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, 2015, 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 21, 2016 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**

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Tel Aviv, March 21, 2016

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**ADDENDUM  
(REGULATION 2)  
ADDITIONAL REPORT**

**IN ACCORDANCE WITH GOVERNMENT COMPANIES REGULATIONS  
(ADDITIONAL REPORT REGARDING ACTIONS TAKEN AND REPRESENTATIONS MADE TO ENSURE THE ACCURACY OF THE  
FINANCIAL STATEMENTS, AND THE REPORT OF THE BOARD OF DIRECTORS), – 2005**

I, Avi Doitchman, 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, 2015 (“the reports”).
2. To the best of my knowledge and after reviewing the reports, they do not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by the reports.
3. To the best of my knowledge and after reviewing the reports, the Financial Statements and other financial information included in the Directors’ Report fairly present, in all material respects, the financial condition, results of operations, changes in equity and cash flows of the Company as of, and for, the periods presented in the reports.
4. The Company's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures for the Company. Accordingly, we have designed such disclosure controls and procedures, or had established under our charge such disclosure controls and procedures, designed to ensure that material information relating to the Company is made known to us by others in the Company particularly during the period in which the reports were prepared.
5. The Company's other certifying officers and I have disclosed to the Company's auditors and to the Company's Board of Directors, based on our most recent evaluation:
  - a. All significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the Company's ability to record, process, summarize and report financial information.
  - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the Company's internal controls over financial reporting.

There is nothing in the aforesaid to derogate from my responsibility or the responsibility of anyone else, pursuant to any law.

March 21, 2016

---

Avi Doitchman  
Senior Vice-President of Finance and Economics

**ADDENDUM  
(REGULATION 2)  
ADDITIONAL REPORT**

**IN ACCORDANCE WITH GOVERNMENT COMPANIES REGULATIONS  
(ADDITIONAL REPORT REGARDING ACTIONS TAKEN AND REPRESENTATIONS MADE TO ENSURE THE ACCURACY OF THE  
FINANCIAL STATEMENTS, AND THE REPORT OF THE BOARD OF DIRECTORS), – 2005**

I, Ofer Bloch, 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, 2015 (“the reports”).
2. To the best of my knowledge and after reviewing the reports, they do not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by the reports.
3. To the best of my knowledge and after reviewing the reports, the Financial Statements and other financial information included in the Directors’ Report fairly present, in all material respects, the financial condition, results of operations, changes in equity and cash flows of the Company as of, and for, the periods presented in the reports.
4. The Company's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures for the Company. Accordingly, we have designed such disclosure controls and procedures, or had established under our charge such disclosure controls and procedures, designed to ensure that material information relating to the Company is made known to us by others in the Company particularly during the period in which the reports were prepared.
5. The Company's other certifying officers and I have disclosed to the Company's auditors and to the Company's Board of Directors, based on our most recent evaluation:
  - a. All significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the Company's ability to record, process, summarize and report financial information.
  - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the Company's internal controls over financial reporting.

There is nothing in the aforesaid to derogate from my responsibility or the responsibility of anyone else, pursuant to any law.

March 21, 2016

---

Ofer Bloch  
Chief Executive Officer

**ADDENDUM  
(REGULATION 2)  
ADDITIONAL REPORT**

**IN ACCORDANCE WITH GOVERNMENT COMPANIES REGULATIONS  
(ADDITIONAL REPORT REGARDING ACTIONS TAKEN AND REPRESENTATIONS MADE TO ENSURE THE ACCURACY OF THE  
FINANCIAL STATEMENTS, AND THE REPORT OF THE BOARD OF DIRECTORS), – 2005**

I, 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, 2015 (“the reports”).
2. To the best of my knowledge and after reviewing the reports, they do not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by the reports.
3. To the best of my knowledge and after reviewing the reports, the Financial Statements and other financial information included in the Directors’ Report fairly present, in all material respects, the financial condition, results of operations, changes in equity and cash flows of the Company as of, and for, the periods presented in the reports.
4. The Company's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures for the Company. Accordingly, we have designed such disclosure controls and procedures, or had established under our charge such disclosure controls and procedures, designed to ensure that material information relating to the Company is made known to us by others in the Company particularly during the period in which the reports were prepared.
5. The Company's other certifying officers and I have disclosed to the Company's auditors and to the Company's Board of Directors, based on our most recent evaluation:
  - a. All significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the Company's ability to record, process, summarize and report financial information.
  - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the Company's internal controls over financial reporting.

There is nothing in the aforesaid to derogate from my responsibility or the responsibility of anyone else, pursuant to any law.

March 21, 2016

---

Yiftah Ron-Tal  
Chairman of the  
Board of Directors

**THE ISRAEL ELECTRIC CORPORATION LIMITED**  
**CONSOLIDATED STATEMENTS OF FINANCIAL POSITION**  
**(NEW ISRAELI SHEKELS, IN MILLIONS)**

	Note	As of December 31	
		2015	2014
<b><u>CURRENT ASSETS</u></b>			
Cash and cash equivalents.....	4	2,524	4,504
Short term investments .....	5	407	2,559
Trade receivables for sales of electricity .....	6	4,145	4,546
Other current assets .....	7	715	537
Inventory - fuel.....	8	839	1,053
Inventory - stores .....		132	146
Total current assets .....		<u>8,762</u>	<u>13,345</u>
<b><u>NON-CURRENT ASSETS</u></b>			
Inventory - fuel.....	8	1,124	1,509
Long-term receivables .....	9	1,659	1,833
Investment in associate.....	10	74	86
<b>Assets with respect to benefits after employment termination:</b>			
Excess pension plan assets over pension liability .....	11	5,286	4,310
Funds in trust .....	12	1,921	1,909
		<u>7,207</u>	<u>6,219</u>
<b>Fixed assets, net</b>			
Fixed assets in use, net .....	13	55,636	56,912
Fixed assets under construction.....		6,806	6,469
		<u>62,442</u>	<u>63,381</u>
Intangible assets, net .....	14	1,295	1,384
Total non-current assets .....		<u>73,801</u>	<u>74,412</u>
<b>Total assets</b>		<u><b>82,563</b></u>	<u><b>87,757</b></u>
Debit balances of regulatory deferral accounts .....	15	837	2,876
<b>Total assets and debit balance of regulatory deferral accounts ....</b>		<u><b>83,400</b></u>	<u><b>90,633</b></u>

The accompanying notes are an integral part of the Financial Statements.

**THE ISRAEL ELECTRIC CORPORATION LIMITED**  
**CONSOLIDATED STATEMENTS OF FINANCIAL POSITION**  
**(NEW ISRAELI SHEKELS, IN MILLIONS)**

	Note	As of December 31	
		2015	2014
<b><u>CURRENT LIABILITIES</u></b>			
Credit from banks and other credit providers .....	16	2,756	8,355
Trade payables .....		1,753	1,925
Other current liabilities .....	17	1,877	1,631
Customer advances, net of work in progress.....	18	496	453
Provisions .....	19	726	719
<b>Total current liabilities</b> .....		<b>7,608</b>	<b>13,083</b>
<b><u>NON CURRENT LIABILITIES</u></b>			
Debentures .....	20	34,923	35,703
Liabilities to banks .....	20	5,248	4,742
Liabilities with respect to other benefits after employment termination.....	11	2,732	2,930
Provision for refunding amounts to consumers.....	21	2,758	2,675
Deferred taxes, net.....	22	5,788	5,663
Debentures to the State of Israel .....	23	2,511	2,534
Liability to the State of Israel .....		2,591	2,905
Other liabilities.....		756	683
<b>Total non current liabilities</b> .....		<b>57,307</b>	<b>57,835</b>
<b>Total liabilities</b> .....		<b>64,915</b>	<b>70,918</b>
<b><u>EQUITY</u></b>			
Share capital .....	24	908	908
Capital reserves.....	25	803	816
Capital remeasurement reserve.....	25	271	140
Retained earnings .....	26	14,712	14,489
<b>Total equity</b> .....		<b>16,694</b>	<b>16,353</b>
<b>Total liabilities and equity</b> .....		<b>81,609</b>	<b>87,271</b>
Credit balances of regulatory deferral accounts .....	15	1,791	3,362
<b>Total liabilities, equity and credit balance of regulatory deferral accounts</b> .....		<b>83,400</b>	<b>90,633</b>

The accompanying notes are an integral part of the Financial Statements.

Mr. Avi Doitchman  
Senior Vice-President  
of Finance and Economics

Mr. Ofer Bloch  
Chief Executive Officer

Yiftah Ron-Tal  
Chairman of the  
Board of Directors

March 21, 2016

Date of approval of the Financial Statements



**THE ISRAEL ELECTRIC CORPORATION LIMITED**  
**CONSOLIDATED STATEMENTS OF PROFIT (LOSS) AND OTHER COMPREHENSIVE INCOME**  
**(NEW ISRAELI SHEKELS, IN MILLIONS)**

	Note	For the Year ended December 31	
		2015	2014
<b><u>Consolidated Statements of Profit (Loss):</u></b>			
Revenues .....	28	23,058	25,305
Cost of operating the electricity system:	29		
Fuels .....		8,440	8,039
Purchases of electricity .....		2,653	1,708
Operation of the generation system .....		4,042	4,252
Operation of the transmission and distribution system .....		3,151	2,956
		<u>18,286</u>	<u>16,955</u>
Profit from operating the electricity system .....		<u>4,772</u>	<u>8,350</u>
Sales and marketing expenses .....	30	904	901
Administrative and general expenses .....	31	763	1,157
Expenses (income) for liabilities to pensioners .....		531	(3)
		<u>2,198</u>	<u>2,055</u>
Profit from current operations .....		<u>2,574</u>	<u>6,295</u>
Financial expenses .....	33	1,778	2,838
Profit before income taxes .....		<u>796</u>	<u>3,457</u>
Taxes on income .....	22	217	916
Profit after income tax .....		<u>579</u>	<u>2,541</u>
Company's share of the loss of associated company .....		(12)	(12)
<b>Income before regulatory deferral accounts .....</b>		<u>567</u>	<u>2,529</u>
Movement in regulatory deferral accounts balances, net of tax .....		(344)	(2,064)
<b>Profit for the year .....</b>		<u><b>223</b></u>	<u><b>465</b></u>
<b><u>Consolidated Statements of Other Comprehensive Income (Loss):</u></b>			
<b>Amounts that will be attributed in the future to the Statement of Profit (Loss):</b>			
Loss with respect to cash flow hedging, net of tax .....		(13)	(6)
<b>Amounts that will not be attributed in the future to the Statement of Profit (Loss):</b>			
Remeasurement of a defined benefit plan, net of tax .....	11 m	131	1,143
<b>Other comprehensive income for the year, net of tax .....</b>		<u><b>118</b></u>	<u><b>1,137</b></u>
<b>Comprehensive income for the year .....</b>		<u><b>341</b></u>	<u><b>1,602</b></u>

The accompanying notes are an integral part of the Financial Statements.

**THE ISRAEL ELECTRIC CORPORATION LIMITED**  
**CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY**  
**(NEW ISRAELI SHEKELS, IN MILLIONS)**

	Paid-up share capital	Capital reserves	Capital remeasurement reserves	Retained earnings	Total
	In NIS millions				
<b>Balance as of January 1, 2014 .....</b>	<b>908</b>	<b>822</b>	<b>(1,003)</b>	<b>14,024</b>	<b>14,751</b>
Profit for the year .....	-	-	-	465	465
Other comprehensive income (loss) for the year .....	-	(6)	1,143	-	1,137
<b>Balance as of December 31, 2014</b>	<b>908</b>	<b>816</b>	<b>140</b>	<b>14,489</b>	<b>16,353</b>
Profit for the year .....	-	-	-	223	223
Other comprehensive income (loss) for the year .....	-	(13)	131	-	118
<b>Balance as of December 31, 2015 .....</b>	<b>908</b>	<b>803</b>	<b>271</b>	<b>14,712</b>	<b>16,694</b>

For details regarding assignment of profits and the dividend distribution policy see Note 26 below.

**The accompanying notes are an integral part of the Financial Statements.**

**THE ISRAEL ELECTRIC CORPORATION LIMITED**  
**CONSOLIDATED STATEMENTS OF CASH FLOW**  
**(NEW ISRAELI SHEKELS, IN MILLIONS)**

	For the Year ended December 31	
	2015	2014
<b><u>Cash flow from operating activities:</u></b>		
Profit before regulatory deferral accounts according to the statement of profit and loss .....	567	2,529
Adjustments required to present cash flow from operating activities - Annex A .....	7,057	7,837
<b>Net cash provided by operating activities .....</b>	<b>7,624</b>	<b>10,366</b>
<b><u>Cash flow from investing activities:</u></b>		
Investment in fixed assets and intangible assets .....	(3,364)	(3,721)
Proceeds from sale of fixed assets .....	41	47
Long-term receivables, net.....	238	(291)
Repayment (deposit) of bank deposits, net .....	2,172	(1,919)
<b>Net cash used in investing activities.....</b>	<b>(913)</b>	<b>(5,884)</b>
<b><u>Cash flow from financing activities:</u></b>		
Issuance of long-term debentures .....	916	5,552
Other long-term loans received .....	1,082	197
Repayment of long-term debentures.....	(4,430)	(2,973)
Repayment of other long-term loans.....	(3,202)	(3,847)
Deposit/(repayment) of hedging transactions, net.....	(245)	82
Increase (decrease) of short-term credit from banks, net .....	(196)	271
Interest and commissions paid, net .....	(2,616)	(2,661)
<b>Net cash used in financing activities .....</b>	<b>(8,691)</b>	<b>(3,379)</b>
<b>Increase (decrease) in cash and cash equivalents .....</b>	<b>(1,980)</b>	<b>1,103</b>
<b>Balance of cash and cash equivalents at the beginning of the period .....</b>	<b>4,504</b>	<b>3,401</b>
<b>Balance of cash and cash equivalents at the end of the period .....</b>	<b>2,524</b>	<b>4,504</b>
<b>Additional information about cash flow deriving from income tax payments: .....</b>	<b>4</b>	<b>4</b>

The accompanying notes are an integral part of the Financial Statements.

**THE ISRAEL ELECTRIC CORPORATION LIMITED**  
**CONSOLIDATED STATEMENTS OF CASH FLOW**  
**(NEW ISRAELI SHEKELS, IN MILLIONS)**

**ANNEX A - ADJUSTMENTS REQUIRED TO PRESENT CASH FLOW FROM OPERATING ACTIVITIES**

	<b>For the Year ended December 31</b>	
	<b>2015</b>	<b>2014</b>
<b>Income and expenses not affecting cash flow:</b>		
Loss from investment in an associate .....	12	9
Depreciation and amortization .....	4,716	4,442
Increase in deferred taxes, net	212	922
Decrease in liabilities with respect to employee benefits, net .....	434	265
Financing expenses recognized in statement of profit and loss .....	1,778	2,835
Revaluation of debts collectible .....	6	96
Capital loss on sale of fixed assets .....	44	51
	<b>7,202</b>	<b>8,620</b>
<b>Changes in assets and liabilities:</b>		
Decrease (increase) in trade receivables for sales of electricity (including those presented in long-term receivables) .....	401	(267)
Decrease (increase) in other current assets including long-term receivables) .....	95	(123)
Decrease in inventory (including noncurrent inventory) .....	612	194
Deposits in funds less payments to pensioners	(1,429)	(728)
Increase in customer advances for work ordered, net of work in progress.....	8	55
Increase (decrease) in trade payables (including long term) .....	(167)	128
Increase (decrease) in other current liabilities.....	335	(42)
	<b>(145)</b>	<b>(783)</b>
	<b>7,057</b>	<b>7,837</b>

**The accompanying notes are an integral part of the Financial Statements.**

**THE ISRAEL ELECTRIC CORPORATION LIMITED**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**AS OF DECEMBER 31, 2015 (NEW ISRAELI SHEKELS)**

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**NOTE 1:- GENERAL**

**a. Company Activities**

- 1) The Israel Electric Corporation Limited (hereinafter: "The Company") engages 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 and the directives of the Restrictive Trade Practices Law – 1988 (hereinafter: "Restrictive Trade Practices Law") apply to the Company (see section h below). 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 section 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 is regulated under the Electricity Sector Law, 1996 (hereinafter: the "Electricity Sector Law") and its regulations and the Company operates accordingly. The provisions of the Electricity Sector Law state that its purpose is to regulate the activity in the electricity sector for the benefit of the public, while securing reliability, availability, quality, efficiency and while creating conditions for competition and minimization of costs.

In accordance with the Electricity Sector Law, the Minister of National Infrastructures, Energy and Water ("The Minister") is the person in charge of execution of the law. On January 1, 2016, the Amendment to the Electricity Sector Law (hereinafter - "Amendment to the Law") entered into effect. Within the Amendment to the Electricity Law, which entered into effect on January 1, 2016, a new authority, named the "Electricity Authority", was established at the Ministry of National Infrastructures, Energy and Water, instead of the Public Utilities Authority - Electricity and the Electricity Administration at the Ministry of National infrastructures, Energy and Water. According to the aforesaid, in this report, the term "Electricity Authority" should be construed while paying attention to the dates it relates to - if it is about information relating to dates prior to January 1, 2016, it means the Public Utilities Authority - Electricity, and if it is about information relating to dates as of January 1, 2016 onward, it means the Electricity Authority which was established within the aforesaid Amendment to the Electricity Sector law.

In accordance with the Amendment to the Law, the Electricity Authority will assist the Minister in formulating his policy in the field of the electricity sector. Additionally, according to the Amendment to the Law, the Electricity Authority shall be responsible for giving licenses in accordance with the Electricity Sector Law, and licenses for a volume exceeding 100 megawatt will require the Minister's approval. Additionally, the Authority will be responsible for supervision of fulfillment of the provisions of the law and the licenses granted by virtue thereof. In addition, the Electricity Authority is authorized to fulfill 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, inter alia, the setting of electricity charge rates, ways to update them and executing costs control for this purpose, 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, granting license and supervising the fulfillment of the terms set in the licenses, as well as supervising the fulfillment of the provisions of the Electricity Sector Law by a license holder, and enforcing them.

Within the Amendment of the Electricity Sector Law, minor changes were set in the appointment of the Authority and its composition. Additionally, it was determined that insofar as the Minister is of the opinion that the Authority's decision is not in line with his/the Government's policy in the field of the electricity sector or the objectives of the law, he may instruct the Authority to conduct an additional discussion of the matter. This authorization does not include decisions on the issue of rates regarding which the sole professional discretion of the Authority has been maintained.

It was further determined that the Chairman of the Authority will be directly subordinate to the Minister.

**THE ISRAEL ELECTRIC CORPORATION LIMITED**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**AS OF DECEMBER 31, 2015 (NEW ISRAELI SHEKELS)**

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**NOTE 1:- GENERAL (continued)**

**b. The Electricity Sector Law (continued)**

**1) General (continued)**

As of the date 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 activity, in accordance with the Electricity Sector Law, which have been extended over the years, and it also operates as an electricity system administrator pursuant to the directives of the Electricity Authority. As of the date of this report, the licenses of the Company have been extended within the Amendment to the Law until January 1, 2017, provided that the Electric Company will act according to their provisions, the provisions of the Electricity Sector Law and the provisions of any other law. 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, 2017 (hereinafter: "Additional Extension") will require the approval of the Ministers in consultation with the Authority and the Companies Authority and the approval of the Economic Affairs Committee of the Knesset and for a period not exceeding a year in accordance with the provisions of the Electricity Sector Law in its present version, extension of the licenses of the Company beyond the Additional Extension will require a legislative amendment. For details regarding the extension of the licenses granted to the Company pursuant to the transitory provisions of the Electricity Sector Law for power stations which were included in the Company's development plan which was approved by January 1, 2009 (hereinafter: the "New Generation Licenses"), see Note 1.e below.

**2) Presenting Separate Financial Statements as Required by the Implementation of the Electricity Sector Law**

The Electricity Sector Law states that an essential service provider license holder shall prepare Financial Statements in a format as the Ministers prescribe, after consulting the Minister of Justice with respect to their extent of elaboration, the accounting principles to be used for their compilation, and the declarations and notes that are to be attached.

Accordingly, in accordance with the Electricity Sector Regulations (Conditions and Procedures for the Granting of a License) - 1997, and in accordance with the licenses of the Company, the Company, as an essential service provider, is required to submit Financial Statements separately for each area, for each activity and for each profit center, and to submit consolidated statements with respect to its activities in accordance with all of the licenses that are in its possession. A "profit center" is defined in these regulations as "a unit that has a closed income and expense structure, without cross subsidy with the operations of another unit".

Notwithstanding, the Company conducts its activities as separate profit centers, but does not submit audited Financial Statements for profit centers as required in the Electricity Sector Regulations and in most of its licenses (including the new generation licenses that the Company has received,) and it also does not submit audited Annual Financial Statements separately for each area, for each activity, for each generation unit or power station, but submits audited Financial Statements for the operations of the Company in its entirety.

According to the resolution of the Electricity Authority of January 15, 2015, according to section 9 b of the licenses, the Company had to submit to the Electricity Authority, by the middle of March, 2015, a schedule for completing the process of preparing a report by profit centers in accordance with the requirements of its licenses. On April 19, 2015, the Company applied to the Electricity Authority in a letter, stating that this issue constitutes a component of the discussions between the parties with respect to the structural change of the electricity sector, and also constituted part of the discussions of the Steering Team and the draft of its recommendations. In light of this, and since as yet there has been no determination of and no agreement regarding a structure with respect to which a report concerning profit centers as stated can be prepared, the Company cannot provide a logical estimate of schedules for completion of the process, and instead it is requesting to conduct a discussion as soon as possible with all the parties concerned, in order to formulate an outline which will enable the Company to complete the process of preparation of the report pursuant to profit centers as required.

On May 26, 2015, a discussion was held on the subject in the presence of the Company representatives and the Electricity Authority representatives and it was decided that a further discussion on the subject would be held. As of the date of the report, a discussion as stated has not yet been scheduled by the Electricity Authority.

The issue of financial reporting and administering the activity of the Company according to audited profit centers constitutes a component in the draft of recommendations of the Steering Team that was formed with respect to the structural change, according to which the Company shall operate through audited profit centers that will enable complete transparency and attribution of costs in a model that will be agreed upon by the Ministry of National Infrastructures, Energy and Water, the Ministry of Finance, the Electricity Authority and the Company. The issue of the profit centers is also related to in the letter of Mr. Uri Yogev, addressed to Mr. Avi Nisenkorn, Chairman of the New

**THE ISRAEL ELECTRIC CORPORATION LIMITED**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**AS OF DECEMBER 31, 2015 (NEW ISRAELI SHEKELS)**

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**NOTE 1:- GENERAL (continued)**

**b. The Electricity Sector Law (continued)**

**2) Presenting Separate Financial Statements as Required by the Implementation of the Electricity Sector Law (continued)**

National Labor Federation, regarding the "Position of the State regarding the Israel Electric Company Ltd." (hereinafter: the "Yogev Letter"), a copy of which was sent to the Company on September 8, 2014. According to the letter, the different activity sectors of the Company will be managed as separate audited profit centers. 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, and due to the provisions of the Electricity Sector regulations (terms and procedures for receiving a license and the provisions of a license holder) 1997 and the Company licenses, 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 (within the meaning of this term in Note 1 e) and the Yogev Letter, see Note 1 e below.

**3) Reporting Costs of Electricity System Management Services (hereinafter: "System Management") as a Separate Segment**

Regarding the decisions of the Electricity Authority on the subject, see Note 3 e to the Annual Financial Statements.

**c. Decisions of the Government Regarding the Electricity Sector and Activities of the Company**

Over the years, the Governments of Israel have made decisions that concern the electricity sector. Some of the decisions have not yet been implemented due to various considerations. The main subjects affected by material decisions of the Government are as follows:

1) Promotion and integration of independent power producers in electricity generation while using the Company's transmission system. A Government guideline target is increasing the generation capacity of private producers to 20% of the total generation capacity installed in Israel by 2020. For additional information see Note 35)a.4) below.

2) Incorporating two Government Companies, held by the State of Israel, to operate in the electricity sector: System Management Company Ltd. and New Power Stations. To the best of the Company's knowledge, these companies are inactive.

3) A change to the structure of the electricity sector and the structure of the Company and, to the extent required, a change to the Electricity Sector Law (see paragraph e below).

4) Establishing a Communications Company

A Government resolution (number 2024) was published on July 15, 2010, regarding the increase in the quantity of broadband infrastructure suppliers by the Company. For additional details see Note 10 below.

Additionally, on March 6, 2011, the Israel Government published a decision (resolution number 2949), allowing the Company to establish, along with another, a company that will use the fixed communications infrastructure on top of the electricity grid and operate it for the purpose of providing telecommunications services (hereinafter- the company or the communications company) and to enable the Electric Company to hold shares and means of control in the communications company, this in the terms specified in the decision.

5) Government Policy on Energy Generation from Renewable Sources and Reduction of Greenhouse Gases Emissions

On July 17, 2011, the Government decided (decision number 3484) 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.

On September 20, 2015, a Government decision (number 542) was published on the reduction of greenhouse gas emissions and efficient energy consumption in the economy, within which a national objective was determined for greenhouse gases emissions per capita in 2025 and 2030. For this purpose, it was determined, inter alia, that the electricity consumption will be reduced by at least 17% by the year 2030 compared with the expected electricity consumption for the same year, and generating electricity from renewable energy will be at least 13% of the total electricity consumption in 2025 and at least 17% of the total electricity consumption in 2030.

**THE ISRAEL ELECTRIC CORPORATION LIMITED**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**AS OF DECEMBER 31, 2015 (NEW ISRAELI SHEKELS)**

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**NOTE 1:- GENERAL (continued)**

**c. Decisions of the Government Regarding the Electricity Sector and Activities of the Company (continued)**

- 6) On October 5, 2014, the Ministerial Committee for Social and Economic Affairs (Socio-Economic Cabinet) (hereinafter: the "Cabinet") approved a "Multi-annual Plan to Execute an Issue of Minority Holdings in Government Companies" (Cabinet decision number SE/42, with validity of a Government resolution from October 19, 2014 numbered 2103 (SE/42) hereinafter; the "Decision").

Within the Decision it was decided, inter alia, to approve a multi-annual plan to execute issues of minority holdings in government companies (hereinafter: the "Plan"), and to promote the creation of an appropriate legal infrastructure for executing the issue of minority stakes in government companies in order to implement the Plan.

The Cabinet classified the Company as a company in which the State has an interest in maintaining long term government control. Accordingly, under the Plan outline, in 2017, subject to a Government decision to perform a structural change in the Company, as far as a decision will be reached, and minding the nature of the structural change that will be formulated, an issue of minority holdings of the Company will be executed at a total amount of up to 25% of the share capital of the Company (fully diluted). Additionally, within the Decision, the Cabinet instructed the Companies Authority to act so that the companies included in the Plan (including the Company) will distribute dividends to the State in a total amount of approximately NIS 500 million in each of the years 2015-2017, all subject to the progress of the privatization proceedings according to the timetables set and subject to the distribution analysis and permits required under the law, as amended, insofar as will be required.

- 7) On January 1, 2016, the Amendment to the Electricity Law entered into effect; for details see section b.1) above.

**d. The Government Companies Law**

The Company is a Government Company, and the arrangements set by the Government Companies Law and the regulations promulgated under it apply to it. Subject to the arrangements set under the Government Companies Law, the general company laws apply to the Company.

Additionally, additional laws apply to the Company as a Government Company, including certain provisions of the Budget Foundations Law (section 29, regarding the determination of employees' terms of employment), the State Comptroller Law (the Company is a controlled entity), the Internal Audit Law, the Mandatory Tenders Law and its regulations, the Freedom of Information Law, Women's Equal Rights Law, Equal Rights of Persons with Disabilities Law, Safety Arrangements for Public Entities Law, Antitrust Law and the Law for Increased Enforcement of Labor Law. For additional information required according to the Companies Authority, see Note 40 below.



**THE ISRAEL ELECTRIC CORPORATION LIMITED**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**AS OF DECEMBER 31, 2015 (NEW ISRAELI SHEKELS)**

---

**NOTE 1:- GENERAL (continued)**

**e. Structural Change**

The purpose of the Electricity Sector Law is to regulate the activity in the Electricity sector for the public's benefit, while ensuring reliability, availability, quality, efficiency, and while creating conditions for competition and minimizing costs. The Electricity Sector Law determines provisions by virtue of which it is obligatory to maintain separation between the electricity generation, transmission, distribution and supply activities and management of the system, under conditions prescribed by the Electricity Sector Law, through distributing the activities among several separate entities ("The Structural Change"), while specifying transition instructions and a timetable for implementing the instructions, which enable the Company to generate, transmit, distribute, supply, sell and trade in electricity, and also act as the electricity system's administrator, according to the licenses, granted to the Company in accordance with the Electricity Sector Law, up to January 1, 2017.

1) The major points of the Electricity Sector Law regarding the Structural Change

The Electricity Sector Law states that a person will not perform an act of generation (except generation of a certain output of electricity which is not sold to others), transmission, distribution or supply of electricity, commercial trade in electricity or management of an electricity system (hereinafter, jointly: "Activity in the Electricity Sector") except in accordance with a license granted to him for that purpose in accordance with the Electricity Sector Law (hereinafter: "License") by the Electricity Authority; however, a generation or supply license exceeding 100 megawatts, a distribution license exceeding 5% of the annual consumption rate, a transmission license or a system management license will become effective upon approval by the Minister.

The Electricity Sector Law sets conditions for granting licenses for activity in the electricity sector, including, inter alia, several restrictions. The main restrictions are detailed below.

- a) As a rule a license will not be granted to a person for more than one activity, however:
- (1) It is possible to grant a generation license together with a supply license to one person, with due attention to the development of competition in the electricity sector.
  - (2) No license is to be granted if after the receipt of the license, a person, with the exception of the State of Israel, would hold a license for the administration of the system or shall be a holder of means of control in a holder of such a license, and shall also be a holder of a license for the generation, distribution or supply of electricity, or if they would hold means of control in the holder of such a license. However, a holder of a license for the administration of the system or its subsidiary, may also, if so determined in his license and if crucial for the reliability of the supply of electricity, be granted licenses for generation, so long as these licenses are not granted for 5% or more of the generation capacity in the Electricity Sector, and, if the Minister finds that special circumstances exist – 10% or more of such magnitude.
- b) No generation license or distribution license shall be issued to a party holding means of control of a transmission license holder.
- c) No transmission license shall be issued to a holder of means of control of a generation license holder or a distribution license holder.
- d) No generation license shall be issued if one of the following is fulfilled:
- (1) The license applicant holds means of control of a distribution license that holds 10% or more of the distribution volume in the Electricity Sector;
  - (2) The license applicant holds means of control of a distribution license holder, and after receipt of the requested license shall hold 10% or more of the volume of the generation capacity in the Electricity Sector;
  - (3) A person shall hold after the receipt of the requested license 30% or more of the volume of the generation capacity in the Electricity Sector;
  - (4) The license applicant is a holder of a transmission license.
- e) No distribution license shall be issued if one of the following is fulfilled:
- (1) The license applicant holds means of control of a generation license holder that holds 10% or more of the volume of the generation capacity in the Electricity Sector;
  - (2) The license applicant holds means of control of a generation license holder, and after receipt of the requested license shall hold 10% or more of the volume of the distribution in the Electricity Sector;
  - (3) A person will hold after the receipt of the requested license 25% or more of the distribution volume in the Electricity Sector.

The Ministers, upon consultation with the Electricity Authority and the Companies Authority, are entitled to establish rates that differ from those which have been stated in sections (d) and (e) above if they find this to be crucial for the promotion of the purposes of the Electricity Sector Law, and they are also entitled to establish additional restrictions on the granting of licenses.

**THE ISRAEL ELECTRIC CORPORATION LIMITED**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**AS OF DECEMBER 31, 2015 (NEW ISRAELI SHEKELS)**

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**NOTE 1:- GENERAL (continued)**

**e. Structural Change (continued)**

2) Special transitional provisions and milestones for the Company in the Electricity Sector Law

- a) The licenses of the Company that have been issued to it pursuant to the Electricity Sector Law, and that were in effect prior to the end of the "transition period" as defined in the Law (10 years from the day of commencement of the law, i.e., March 4, 2006) (hereinafter: the "Transition Period"), shall remain in effect with respect to all of the activities that have been performed thereby through to the time prescribed in the Electricity Sector Law as extended from time to time, which is, on the date of the report, January 1, 2017, provided that the Company will operate in accordance with their provisions, the provisions of this law and the provisions of any other law.

It is the position of the Company that the extension applies to all of its licenses, including 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.

As part of the Amendment to the Electricity Sector Law, the validity of the licenses of the Company was extended until January 1, 2017. 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, 2017 (the "Additional Extension") will require the approval of the Ministers in consultation with the Authority and the Companies Authority, and with the approval of the Economic Affairs Committee of the Knesset, for a period not exceeding one year. In accordance with the provisions of the Electricity Sector Law in its present version, extension of the licenses of the Company to a date beyond January 1, 2018 will require a legislative amendment. In addition, in light of the Electricity Authority's position regarding its authority to extend the new generation licenses as explained above and for the sake of caution, the Company applied to the Electricity Authority for an extension for the new generation licenses. Within the Electricity Authority's decision of February 14, 2016, the validity of the Company's new generation licenses was extended until January 1, 2017. The Minister's approval for the aforesaid extension has not yet been received.

Based on past experience, the Company expects its licenses to be extended for additional periods, but in view of the uncertainty as to the implementation of the structural change, the Company has no certainty as to whether, for what periods and under what conditions some or all of the licenses of the Company will be extended, and under what conditions or which licenses shall be granted to it after the implementation of the Structural Change, to the extent implemented. The Company's assessment is that after the implementation of the Structural Change, the Company will receive new licenses in accordance with the outline of the organizational structure as will be determined.

- b) The granting of replacement licenses – the Electricity Authority is entitled, with the approval of the Minister, to grant replacement licenses for all or some of the licenses of the Company that were in effect prior to the end of the transition 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, 2017). An additional extension of replacement licenses to a date later than January 1, 2017 (in this section below: "Additional Extension") will require the approval of the Ministers in consultation with the Authority and the Companies Authority and the approval of the Economic Affairs Committee of the Knesset and for a period not exceeding a year. In accordance with the provisions of the Electricity Sector Law in its present version, extension of the licenses of the Company beyond the Additional Extension will require a legislative 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.

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**NOTE 1:- GENERAL (continued)**

**e. Structural Change (continued)**

**2) Special transitional provisions and milestones for the Company in the Electricity Sector Law (continued)**

- c) Granting Generation Licenses to New Facilities – the Electricity Authority is entitled, upon approval of the Minister, to grant generation licenses, even when the recipients do not fulfill the limitations prescribed by the Electricity Sector Law for granting generation licenses to power stations included in the development plan of the Company, which was approved by the Minister, in consultation with the Electricity Authority (according to section 19 of the Electricity Sector Law) up to January 1, 2009, for a period in which the licenses of the Company that were effective on the eve of the end of the transition period, are still effective, meaning, January 1, 2017. An additional extension beyond January 1, 2017 will require the approval of the Ministers in consultation with the Authority and the Companies Authority and the approval of the Economic Affairs Committee of the Knesset and for a period not exceeding a year. Extension of the licenses of the Company beyond this date will require a legislative amendment, although the Company's position is that extension of the licenses of the Company as described above applies to all its licenses, including the new generation licenses. The Company applied to the Electricity Authority on December 24, 2015, and requested to extend the validity of the new generation licenses until January 1, 2017. As described above, within the Electricity Authority's decision of February 14, 2016, the validity of the Company's new generation licenses was extended until January 1, 2017. The Minister's approval for the aforesaid extension has not yet been received
- d) The granting of generation and distribution licenses to a government company or to a government subsidiary – the Electricity Authority is entitled, with the approval of the Minister, to grant a government company or a government subsidiary generation licenses and distribution licenses for an electricity system that has been operated in accordance with the licenses of the Company that were in effect at the end of the Transitional Period and the licenses that have been issued pursuant to section 2 c) above, even without the restrictions that have been stated in the Electricity Sector Law as described in the Chapter with respect to Provisions of the Electricity Sector Law with regard to the Structural Change, Sections 1 c 3) and 1 e 3) above, as long as the following conditions are met:
- (1) Generation licenses shall only be granted if, subsequent to the receipt of a license, the license holder will possess power stations that operate based on a mixture of certain types of fuels that includes diesel oil, natural gas and coal; however, with respect to coal, the license applicant may not generate electricity through the use of coal itself, but it is to have rights to receive electricity that is generated at a coal powered power station.
  - (2) Distribution licenses shall be granted in such a manner that the costs of the license holders with respect to the electricity facilities that are used for their operations, at the time of the granting of the licenses, will be as similar as possible; however, the Ministers are entitled, after having consulted with the Electricity Authority and the Companies Authority, to determine otherwise, should they find this to be crucial for the advancement of the purposes of the Electricity Sector Law.
  - (3) After the receipt of the license, the license holder shall not hold, through another corporation, 30% or more of the volume of the generation capacity in the Electricity Sector, or 25% or more of the distribution capacity in the Electricity Sector.
  - (4) The validity of the license shall be contingent upon such that as from July 1, 2013, no government company or government subsidiary shall hold, jointly and severally, more than 51% of the means of control in a holder of a distribution or generation license that has been given pursuant to this section of the Law.
- e) The holding of means of control in a holder of a transmission license – the Ministers shall determine, in an order, by the time prescribed in the Law (as of the date of the report – January 1, 2017) upon consultation with the Electricity Authority and the Companies Authority, whether a government company or a government subsidiary, holding means of control of a holder of a generation or distribution license, will be also be able to hold means of control of a holder of a transmission license. An additional extension beyond this date will require the approval of the Ministers in consultation with the Authority and the Companies Authority and the approval of the Economic Affairs Committee of the Knesset and for a period not exceeding a year, and an extension of the licenses of the Company beyond this date will require a legislation amendment.
- f) The granting of a supply license together with a distribution license – notwithstanding the provisions that have been stated in Section 1 above, a supply license may be given to a government company or to a government subsidiary that is a holder of a distribution license by law, until the time that has been prescribed by the Law (as of the date of the report - January 1, 2017). An additional extension beyond January 1, 2017 will require the approval of the Ministers in consultation with the Authority and the Companies Authority and the approval of the Economic Affairs Committee of the Knesset and for a period not exceeding a year, and an extension for an

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**NOTE 1:- GENERAL (continued)**

**e. Structural Change (continued)**

**2) Special transitional provisions and milestones for the Company in the Electricity Sector Law: (continued)**

additional period beyond this date will require 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, 2017). An additional extension beyond January 1, 2017 will require the approval of the Ministers in consultation with the Authority and the Companies Authority and the approval of the Economic Affairs Committee of the Knesset and for a period not exceeding a year, and an extension for an additional period beyond this date will require a legislation amendment.

- g) Prohibition on providing certain services in the electricity sector - a Government company or a subsidiary of a Government company that holds a controlling share in a license holder by force of the transitional 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 transitional directives in the Electricity Sector Law will not act in these fields for another corporation, that holds a license by force of the Electricity Sector Law.

**3) The Position of the Company with respect to the implementation of the Structural Change in accordance with the provisions of the Electricity Sector Law**

In the opinion of the Company, and subject to that stated at the end of this section, the provisions of the Electricity Sector Law, as currently worded, permit, subject to receipt of all of the approvals required by law, for a gradual process to be held within which the Company would be recognized as a holding company that would control a number of subsidiaries that would have generation licenses, a number of subsidiaries that would have distribution licenses, and a single subsidiary that would hold a transmission license, as stipulated below:

- a) A number of subsidiaries holding a generation license, each of which would hold licenses for 30% of the generation capacity of the Electricity Sector, at the most, and each of which generation companies would have power stations that would operate based on a mix of field of various types, including: diesel oil, natural gas and coal (subject to an exception with respect to generation using coal);
- b) At least four subsidiaries holding a distribution license, each of which would hold licenses for 25% of the distribution level in the Electricity Sector, at the most, the costs with respect to the electricity facilities used by each of the companies being as similar as possible;
- c) A company with a transmission license, if the Ministers determine, by January 1, 2017, that a government company or a government subsidiary holding means of control of a generation or distribution license holder would be able to hold means of control of a transmission license holder as well;
- d) The Company, as a parent company, would not be able to hold more than 51% of the means of control in the generation or distribution companies (this restriction would apply to the Company in the case of the Company receiving new generation or distribution licenses for its subsidiaries);
- e) The system administration activity would be carried out within a separate corporation in which the Company would have no holdings.
- f) The Company would be entitled to hold a subsidiary or subsidiaries for providing engineering design services for power stations, construction of power stations, logistics, information technologies and purchase of fuel of various types (which would not hold a license for carrying out activity in accordance with the Electricity Sector Law);
- g) The holding structure that has been described above is subject to the approval of the Minister.

Despite that stated at the head of this section, implementing the provisions of the Electricity Sector Law in the manner described above requires preparation in advance.

The provisions of the Electricity Sector Law are complex and the Company is of the opinion that they may be construed in different ways, including such that there is a possibility that the Structural Change will be carried out in a manner that is different from the aforesaid, such that the Company will also not operate in some of the activity segments listed in sub-section a)-d) and f) above.

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**NOTE 1:- GENERAL (continued)**

**e. Structural Change (continued)**

4) The Draft Report of the Steering Team

On July 22, 2013, the Ministers appointed a Steering Team for the execution of a reform in the electricity sector and the Electric Company, headed by Mr. Uri Yogev, who is at present the Director General of the Companies Authority, with the participation of senior members of the Ministry of National Infrastructures, Energy and Water and the Ministry of Finance and others (hereinafter: "The Steering Team").

On March 23, 2014, the draft of recommendations of the Steering Team (hereinafter: the "Draft of the Steering Team") was published for comments by the public until May 11, 2014. The Draft Report included recommendations regarding, inter alia, the following issues: (a) electricity system management; (b) the electricity marketing model; (c) trade in natural gas; (d) the generation, distribution and supply segments; (e) smart metering; (f) arrangement of the Electricity Company's assets (for additional details regarding that stated in the draft report of the steering team regarding the assets' arrangement, see Note 1.f.5) below; (g) structural change of the Company; (h) reorganization and managerial flexibility; (i) the capital structure of the Company; (j) business entrepreneurship; (k) rate outline.

5) The Position of the Company Regarding the Recommendations Draft of the Steering Team

On May 7, 2014, the Company presented the Steering Team with its initial reaction and position with regard to all the recommendations included in the recommendations Draft of the Steering Team regarding the reform in the Electric Company and the electricity sector. The Company's comments are focused on two major issues: the scope of the future development of the electricity sector (with emphasis on the generation segment) and ensuring long-term stable financial strength for the Company.

6) Negotiations between the State, employees' union and management of the Company

On October 27, 2013, the General Director of the Companies Authority announced that a team will be established for conducting discussions with the employee union, management of the Company and the National Labor Federation regarding issues pertaining to the rights of the Company's employees and the implications of the structural change on them. Following this, the State, employees' union, management of the Company and the National Labor Federation conducted negotiations, but there were large gaps between the parties and it was therefore impossible to reach consents.

7) The Yogev Letter and correspondence regarding the structural change

On September 8, 2014, the Company received a copy of the letter of Mr. Uri Yogev, addressed to Mr. Avi Nisenkorn, Chairman of the New National Labor Federation, regarding "The State's Position with Respect to the Israel Electric Corporation Ltd." (hereinafter: the "Yogev Letter"). A summary of the final proposal for the structural change of the Company, acceptable to the Minister of Finance and the Minister of National Infrastructures, Energy and Water, was attached to the Yogev Letter. Furthermore, it was noted that what is stated in the letter regarding the structure of the Electric Company and regarding changes in the electricity sector partially requires primary legislation amendments and partially requires other regulation. According to the letter, the letter is valid for 30 days.

On September 11, 2014, a copy of the letter of Mr. Uri Yogev and Mr. Kobi Amsalem, the Commissioner of Wages and Labor Agreements of the Ministry of Finance, addressed to Mr. Avi Nisenkorn, regarding the "Position of the State regarding the Israel Electric Company Ltd. as of September 8, 2014", was sent to the Company. It was clarified in the letter that the Yogev Letter presents the position of the State both as regards the required changes in the electricity sector and the required changes in the Electric Company, as well as the proposed economic changes with respect to the implications of the changes in the Company on the employees. The authors of the letter note in the letter that, for the avoidance of doubt, a reaction is required from the New National Labor Federation to what is detailed in the Yogev Letter regarding the economic considerations that will be paid with respect to the implications of the planned changes in the Electric Company for the employees and the changes that will be required for the existing collective agreements and existing collective arrangements.

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**NOTE 1:- GENERAL (continued)**

**e. Structural Change (continued)**

7) The Yogev Letter and correspondence regarding the structural change (continued)

The Yogev letter included reference to each of the following issues:

- (a) Implications of the structural change on the rights of the employees, including increasing efficiency, remuneration with respect to structural change, managerial flexibility.
- (b) The structural change in the electricity sector - including removal of the system management from the Company, assets and sale of power stations, reducing emissions; smart metering, business entrepreneurship, operation in separate profit centers, financial strength, competition in the distribution and supply segments.

The position of the Company regarding the issues detailed in the Yogev Letter with respect to the structural change and that were discussed in the Recommendations Draft of the Steering Team is according to the position of the Company with respect to the recommendations that were included in the Recommendations Draft of the Steering Team.

On September 15, 2014, a copy of the letter of Mr. Avi Nisenkorn, addressed to Mr. Uri Yogev, whose heading is "Negotiation impasse and unilateral proceedings", was received by the Company. According to the letter, in view of the "unilateral position", as defined, which was presented in the Yogev Letter, and in view of the negotiations reaching an impasse, the National Labor Federation and employees' organization do not intend to stand aside and plan to take all measures in this matter.

At present there are material differences between the State's position and the position of the National Labor Federation, particularly with regard to employee rights relating to the structural change. The position of the Company is that the negotiations between the parties should be continued and the reform in the electricity sector should be promoted.

The issues included in the Recommendations Draft of the Steering Team and the Yogev Letter may be of great importance to the Company, its financial position and the continued functioning of the Company as an essential service provider, but to the best of the Company's knowledge, as of the date of the report, the final report of the Steering Team has not been published, and the Company does not know if and when a final report as stated is intended to be published, and the Company also does not know if and when any structural change based on the Yogev letter will be implemented.

The Recommendations Draft of the Steering Team and the Yogev Letter have not yet been examined by all the authorized government entities and have not yet been approved by them, and they are not in line with the provisions of the Electricity Sector Law. Implementing a structural change in the electricity sector in accordance with the Recommendations Draft of the Steering Team and the Yogev Letter, if and insofar as it will be decided on their implementation and an agreement will be reached regarding their implementation, fully or partially, and making the Recommendations Draft of the Steering Team or the Yogev Letter legally binding, will require approval of all the authorized entities in the State, including the approval of the government, execution of required legislation amendments, and execution of additional actions, none of which have been agreed upon or adopted as of the date of this report and it is not known if they will take place. As of the date of the report, there is uncertainty if and when the Recommendations Draft of the Steering Team or the Yogev Letter will be implemented, if at all, and if the Recommendations Draft of the Steering Team or the Yogev Letter will eventually be implemented, and it will be according to the discretion of the authorized entities and subject to the law. If all of these will not take place, then it is possible that the Company will be required to implement the structural change as it is outlined in the Electricity Sector Law, either in the manner in which the Company understands that the Electricity Sector Law can be implemented, as described in this Note, or in any other outline.

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**NOTE 1:- GENERAL (continued)**

**e. Structural Change (continued)**

8) Estimated cost of the structural change

The implementation of the structural change is expected to have material implications on the financial position of the Company and its results, in the short, medium and long term, in accordance with the structural change outline that will be ultimately adopted. The Company estimates that the costs of the structural change, insofar as will be implemented according to the outline set in the Yogev Letter, can be divided into three major categories: (1) compensation for employees with respect to the implications of the structural change on their rights, (2) financial implications related to the arrangement of assets, and (3) residual costs related to the implementation of the structural change.

Nonetheless, since there is no certainty, as of the date of the report, regarding the manner of implementation of the structural change and its date, and there is no certainty to what extent (if at all) the structural change will be based on the outline set in the Yogev Letter, the Company cannot reliably estimate the possible implications of the structural change on the financial position of the Company and its results.

9) Continued negotiations to promote the reform

During November 2015, the ministers assigned the Director General of the Ministry of Energy and the Director General of the Ministry of Finance with the task of starting a process to formulate the government's position and to renew negotiations and talks for implementation of the reform in the electricity sector, with the participation of the relevant government entities, the Company and the employees' representatives. Several meetings were held between the parties during the past 3 months, but an agreed outline has not yet been formulated and the Company does not yet know if and how the aforesaid outline which will be finally formulated will be different from the Draft Recommendations of the Steering Team.

For details regarding the decision of the National Court of Labor, pursuant to which by April 30, 2016, the reform outline will be promoted in the Company, and at the same time there will be intensive negotiations between the State, the Company and the National Labor Federation, regarding all the issues related to implementation of the reform and its implications on the working conditions of the employees and their occupational security, see Note 35.c.7) below.

10) Resolutions of governmental bodies with respect to the structural change in the last three years

Over the course of the years since the date of the enactment of the Electricity Sector Law, the Government of Israel and the governmental bodies adopted a number of resolutions with respect to the structural change, some of which have been adopted as amendments to the Electricity Sector Law while others have not been adopted into the Law and have not even been implemented.

For details of the letter received by the Company from the Antitrust Authority, under which the General Director of the Israel Antitrust Authority is considering to use the authority vested in him and instruct the Company to refrain from increasing its electricity production capacity, and the Company actions in this matter, see Note 34.b.9.b) below.

Independently of this letter, in July, 2013, the General Director of the Israel Antitrust Authority presented the Ministers with the position of the Antitrust Authority with respect to the Structural Change, according to which, inter alia, the parallel activities of the Company of generating electricity, transmitting it, distributing it and supplying it to the consumers prevent the development of competition in electricity production, and the dominant position of the Company in each of the activity segments creates an inherent apprehension to operating a market force in a segment in which it is a single supplier, while forcing out competitors and reducing the competition in another segment, where it is exposed to attempts by others to compete with it.

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**NOTE 1:- GENERAL (continued)**

**e. Structural Change (continued)**

11) The position of the Company with respect to the structural change

The Company regards the implementation of the structural change as a milestone in establishing and reinforcing the financial strength of the Company.

However, in the opinion of the Board of Directors and the Management of the Company, the Electricity Sector Law, in its current version, does not deal with all of the issues that the Structural Change causes to the Company, and does not regulate in detail the manner of its execution, as well as the ways to establish and reinforce the financial strength of the Company. In the opinion of the Company, a real structural change in the Company is vital to its ability to fulfill the functions that are imposed upon it by the Electricity Sector Law and it intends to continue to operate, to the extent possible, to advance a structural change in the real outline, with the consent of the Employees' Organization and the relevant State entities.

12) The impact of the structural change on the creditors of the Company

In a letter to the Chairman of the Board of Directors of the Company, of February 28, 2007, regarding the legislation of amendment 5 to the Electricity Sector Law, the General Manager of the Companies Authority clarified that implementation of the reform in the Company in accordance with the Electricity Sector Law, including amendment 5 of the same date, will be executed while examining, inter alia, the implications of the structural change on the liabilities of the Company, in a manner, inter alia, that will not prevent repayment of loans taken by the Company.

Furthermore, in the opinion of the Board of Directors and the Management of the Company, executing and implementing the structural change in the Company (in any format) and/or executing the assets' arrangement as detailed in Note 1f, involve addressing issues that pertain to creditors of the Company, in view of agreements with some of them, if they will be affected by the execution of the structural change and/or the assets' arrangement, subject to the law. For details regarding restrictions applying to the Company by virtue of the loans taken see Note 20 e below.

As of the date of this report, the Company and the State have not yet completed dealing with the stated issues.

13) Labor Disputes

For details regarding the decisions and proceedings of the Courts of Labor concerning labor disputes and sanctions taken with regard to the structural change, see Note 35 c 7) below.

It is noted that as of the date of this report, the actual implementation of the structural change has not yet began, in any outline, and despite the publication of the draft of recommendations of the Steering Team and following the Yogev Letter, and the continued discussions on this issue, there is still material uncertainty as to the final format of the structural change, the date of its implementation or its implications for the Company, its business and results, but implementation of the structural change is expected to have a material impact on the Company, its business, operations and financial results.



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**NOTE 1:- GENERAL (continued)**

**f. Assets Arrangement**

**1) Electricity Sector Law Stipulations**

Section 62 of the Electricity Sector Law prescribes different directives with respect to certain rights and assets, which were held by the Company on the expiration date of the concessions granted to the Company by force of the Electricity Concession Ordinance (March 4, 1996), despite the provisions of section 46 of part a of the amendment to the Electricity Concession Ordinance ("section 46 to the concession").

According to section 46 of the Concession, at the end of the Concession period, the plant (as defined in the concession) with all its fixed facilities, instruments and materials was intended to be transferred to the holdings of the State (the High Commissioner at the time), free of charge, provided that the State will be appropriately compensated for the fuels, mechanisms, meters and instruments, either stored at the warehouse or transported to the Company or were ordered by the Company, which belong to the Company and for which the Company paid.

Section 62 of the Electricity Sector Law states the following:

- a) Despite the provisions of section 46 of the Concession, the liabilities of the Company, as well as the rights and assets which it held at the time that the concession expired, and for which it is entitled to compensation from the State pursuant to the aforesaid section, will remain with the Company (i.e., will not be transferred to the State) and no compensation will be paid for them ("Compensable Assets").
- b) The rights and assets for which the Company is not entitled to compensation, as stated above in sub-section (a), and which are used or were designated to be used, whether directly or indirectly, for its operations pursuant to the Electricity Sector law, will be purchased by the Company according to their value on the date the rights and assets were acquired, in accordance with an arrangement to be signed between the State and the Company ("The Assets Arrangement"); in this section "are used" or "were designated to be used", as will be determined by the Ministers ("Non-Compensable Assets in Use").

The Electricity Sector Law also states that until the assets arrangement referred to above in sub-section (b) is carried out, the assets and rights, as to which the arrangement is being prepared, will remain with the Company, as they were at the time that the concession expired. According to the Electricity Sector Law, in view of the fact that the parties did not arrive at an arrangement in this matter by March 1997, the Ministers will have to determine provisions as to the acquisition of the aforesaid rights and assets.

Moreover, similar to the Electricity Concessions Ordinance, the Electricity Sector Law does not specify which assets and rights are compensable assets with respect to which the Company is not required to pay the State, and also does not specify which assets and rights are assets in use that are non-compensable, for which an assets arrangement should be drawn. Moreover, the Electricity Sector Law does not define the manner and method for calculating the value of the assets and rights that will serve as the basis for determining the acquisition cost of these assets under the assets arrangement. Therefore, and in view of the time that elapsed, the Company cannot estimate when, if at all the ministers will issue instructions on the arrangement and its implementation.

Section 62(d) of the Electricity Sector Law also obliges the Company to indemnify the State with respect to any payment paid by the State for any of the Company's liabilities in force at the concession expiration date, arising from its expiration or from implementing the provisions specified in sub-sections (a) and (b) above.

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**NOTE 1:- GENERAL (continued)**

**f. Assets Arrangement (continued)**

**2) The Position of the Company Regarding the Assets and Rights Classification**

Based on the opinion of its legal advisors, the Company classified the rights and the assets into three groups: (a) rights and assets that are compensable assets, to which the assets arrangement will not apply; (b) rights and assets that are assets in use that are non-compensable to which the assets arrangement will apply; and (c) Non-compensable assets (attributed to the first group of assets) and are also not assets in use which are non-compensable (attributed to the second group of assets) for which section 62 of the Electricity Sector Law does not prescribe any arrangement, however, in the absence of use or designated use by the Company, they are not considered as assets in use that are non-compensable and therefore, the Company believes, based on the opinion of its legal advisers, that these assets were not intended to be transferred to the State at the end of the concession and would have remained the property of the Company, which the Company does not need to buy from the State ("Unused Non-Compensable Assets").

It should be noted that in the opinion of the State in 2000 ("the State's Opinion"), the State believes that the assets in this third category were transferred to the ownership of the State at the end of the concession. According to the opinion of the State, "all the remaining non compensable rights and assets, which were not expected to be bought from the State, are actually held by the State, from the effective date of the Electricity Sector Law and all the resulting implications".

**3) The Opinion of the State**

In February 2000, the Company received a letter from the Deputy Commissioner of Budgets at the Ministry of Finance in which he indicates that as part of the activities of the Governmental team that was appointed to deal with the issue, an economic, accounting and legal State opinion was prepared (and was attached to the letter to the Company), regarding the assets arrangement. The letter also stated, that according to the contents of the opinion of the State, it seems that implementation of the assets arrangement in accordance with the Electricity Sector Law might have a material effect on the Company.

According to the State's Opinion and in reference to the provisions of sections 44(c) and 46 to the concession, the Company is not entitled to compensation for investments already refunded through provisions for depreciation (namely, these assets are not included in the compensable assets group). Notwithstanding, based on the assets classification in the opinion of its legal advisers, the Company believes that the majority of its assets on the Concession expiration date (both fully depreciated depreciable assets on the concession expiration date and depreciable assets that were not fully depreciated on the concession expiration date, except assets in a marginal volume) are compensable assets.

The State's opinion included in its definition of the non-compensable assets to which the assets arrangement is supposed to apply, the assets (some of which could be defined as being "used" or "intended to be used" and some as "not used" or "not intended to be used") (the description of the assets is quoted from the economic opinion, written for the Chairman of the Governmental team for returning the assets of the Company arrangement): which at the time the Concession expired were fully depreciated, or partially depreciated, in the amount of what was depreciated (namely, with respect to each compensable facility, installation or repair, the compensation will be paid only with respect to the non-depreciated balance) and non-depreciable assets and rights of the Company, including land and companies held by the Company, except cash money and securities to money. The State also includes in its opinion as non-compensable assets, installations installed and repairs performed by the Company, if these were financed by share capital (profits that were not distributed, deriving from dividend and profits to which the "owners" were entitled according to section 34 to the supplement to the Electricity Concessions Ordinance) or by payment of a party interested in a connection (payment/ deposit paid by whoever requested the Company to connect any site to the electricity supply system, by building an electricity grid, including a load increment).

The economic opinion of the State includes a wider specification of the non-compensable assets to which the assets arrangement should apply and also of compensable assets. It also sets criteria and an economic model (including calculation formulas) for attributing and classifying these assets.

The cost of the fully depreciated assets, as detailed above, which appeared in the Company's Financial Statements as of March 31, 1996, is as of today approximately NIS 7.4 billion (adjusted to the CPI until January 1, 2014). The Company estimates that these assets include mainly power stations, transmission and distribution facilities, real estate properties and various assets such as equipment, machinery and various buildings.

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**NOTE 1:- GENERAL (continued)**

**f. Assets Arrangement (continued)**

**3) The Opinion of the State (continued)**

The net depreciated cost in the Company's books, of the partially depreciated assets, to the extent of the depreciated balance, net of the liabilities according to a certain rate, which depends on their financing sources (estimated by the Company to primarily include power plants, transmission and distribution facilities, certain real estate and additional equipment) and non-depreciable assets of the Company, estimated by the Company to include primarily intangible assets and shares of investee companies, but not cash and inventory, as aforementioned, as appeared in the Financial Statements of the Company as of March 31, 1996, amount to approximately NIS 7.4 billion (adjusted to the CPI until January 1, 2014).

The aforementioned data are data as of March 31, 1996, yet the determining date is the end of the concession date, namely, March 4, 1996.

As calculated by the Company in accordance with the State's opinion, the cost in the books of non-compensable assets for which the assets arrangement will be applied, and for which the Company will be required to pay consideration to the State is approximately NIS 7.4 billion.

Despite the abovementioned, most of the balance of the stated assets has been depreciated in the Company books since March 31, 1996.

In addition, the majority of Company lands, that were purchased before March 31, 1996, were depreciated in full until that date and their cost as of December 31, 2015 (before depreciation) is approximately NIS 576 million.

In the Company's opinion, one should not infer the economic value of the assets from the amounts indicated above on the assets costs in the Company's books, where pursuant to this economic value, the amount which the Company is liable to be requested to pay will be determined according to the assets arrangement, even if the position presented in the State's Opinion is accepted and the value may be lower or higher.

In March 2000, just after the State's Opinion was received, the Director of the Electricity Authority in the Ministry of National Infrastructures, Energy and Water (The Ministry of National Infrastructures, Energy and Water 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 National Infrastructures, Energy and Water. Therefore, the Company did not respond at the time to the aforesaid communication of the Ministry of Finance. To the best knowledge of the Company, the subject was discussed in the past by a Government team, but no progress was made since then. The Company was notified that the need to address the issue of the assets arrangement was mentioned in the past, in discussions of different Government entities. Furthermore, in November, 2011, the Company received a draft of an interim report of recommendations by a team of regulators that was established in May 2009, by virtue of a Government Resolution, with the participation of the Director General of the Ministry of National Infrastructures, Energy and Water, the Budgets Commissioner of the Ministry of Finance, the Director General of the Government Companies Authority, the Manager of the Electricity Administration in the Ministry of National Infrastructures, Energy and Water, the Commissioner of Wages and Labor Agreements and the Comptroller General, or their representatives, under which, inter alia, it is proposed to reexamine the implications of the assets arrangement, according to section 62 to the Electricity Sector Law, 1996, including in view of the legal and economic opinions existing in this matter and its implications at the time of implementation of the structural change.

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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
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**NOTE 1:- GENERAL (continued)**

**f. Assets Arrangement (continued)**

4) The Opinion of the Company

The opinion of the State does not match the opinion of the legal advisors of the Company. Based on the opinion of its legal advisors (in the absence of a specification regarding classification of the assets in section 62(a) of the Electricity Sector Law and in the absence of a ruling on the subject, and based on the purpose of the law and the intention of the legislator, as expressed in discussions held on the eve of legislating the Electricity Sector Law), the interpretation that all the assets which are depreciable, even if fully depreciated on the expiration date of the concession, should be included in the compensable assets group should be preferred over the interpretation of the State in its opinion, which states that all the assets of the Company which were fully depreciated on the concession expiration date and were recognized in the rate through a provision for depreciation constitute non compensable assets, whereas assets that were not fully depreciated constitute non compensable at the rate of the amount depreciated, net of a certain rate of the liabilities.

Based on the opinion of its legal advisors on the appropriate interpretation of the assets arrangement, including the classification of the assets to which it will apply, and taking into consideration the provisions of the Electricity Sector Law (including those mentioned above) and section 46 of the Concession, the Company classifies the majority of the assets it held on the Concession expiration date (both fully depreciated depreciable assets and depreciable assets which were not fully depreciated at the time the concession expired, and excluding assets in a marginal amount), are compensable assets, and as such, assets that will remain the property of the Company, for which no compensation will be paid by the State and will not be included in the assets arrangement, therefore, the Company will not be required to pay consideration to the State with respect to these assets. In the opinion of the Company, the assets arrangement will therefore apply to non-compensable assets in use only, which did not constitute the majority of the Company's assets on the Concession expiration date. Therefore, the Company estimates, that the implementation of the assets arrangement should not have and does not have a material effect on the Company or its financial results or financial position.

However, the matter is to be decided by the Ministers. As far as the Company knows, as of the date of the report, the Ministers did not conclude any recommendations on the subject of the assets arrangement as yet. Therefore, the Company cannot estimate the actual conclusions regarding the assets arrangement, its implications (if any) on the Company and there is no certainty that the implementation of the assets arrangement will not have a material effect on its financial condition.

Moreover, the Company is of the opinion, based on the opinion of its legal advisors, that the interpretation of section 62 to the Electricity Sector Law in a manner which will obligate the Company for the payment of the above amounts or any similar amount, in order to purchase the assets from the State, will be contrary to the declared purposes and objectives of the Electricity Sector Law, contrary to the principles of the correct and appropriate interpretation and will constitute an impairment of the proprietary rights of the Company. According to the legal opinion of the Company's legal advisors, the interpretations of section 62(a) to the Electricity Sector Law should be preferred so there is no significant impact on the Company's capital and its financial strength by the possible positioning of the loans taken by the Company (including debentures issued by the Company) for an early payoff and will cast a doubt as to its ability to repay its liabilities and to continue operating as a going concern, while the explicit intention of the legislator was that the Company will exist and fulfill the functions it was assigned and the tasks imposed upon it in the Electricity Sector Law and in the licenses granted to it by virtue of it.

Without derogating the position of the Company regarding the interpretation of section 62 to the Electricity Sector Law, based on the legal opinion it received, the Company will have a good argument, that the acquisition cost of the assets and rights applied to the Company, if and provided it will be obligated to pay for them according to the assets arrangement, should be recognized as part of the costs in the electricity rate, and therefore, accepting the opinion of the State means that the electricity consumers will be obliged to pay for the assets once again, after the acquisition by the Company was already paid for in the past by the consumers by means of the electricity rate. The opinion was also prepared on the basis of the assumption that the Electricity Authority will be reluctant to approve these costs through the rate (again), due to public reasons. The opinion of the State did not relate to this argument and did not confront it. The opinion of the State does not relate to the recognition of the assets and rights purchase cost within the framework of determining electricity rates by the Electricity Authority.

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**NOTE 1:- GENERAL (continued)**

**f. Assets Arrangement (continued)**

5) The draft of recommendations of the Steering Team

As detailed in section e above, on March 23, 2014, the draft of recommendations of the Steering Team was published for comments by the public, and it included, inter alia, detailed recommendations by the team relating to the issue of the assets arrangement, including: the Company will submit a complete list of all the assets in its possession (hereinafter: the "Assets List") to the Director General of the Government Companies Authority. Regarding assets that are serving the Company in the electricity chain - the ownership or lease arrangements in effect to date will be continued. The manner of determining the list of assets which are essential to the Company for future development of its operating segments or for populating units (such as office buildings which are required by the Company), and their handling. Assets that are not used by the Company and not required by it to develop the electricity chain in accordance with the Assets List or in accordance with the determination of a committee headed by the Director General of the Companies Authority, Ministry of National Infrastructures, Energy and Water, Ministry of Finance, Companies Authority, and the Company (hereinafter: the "Reserves Committee") will be sold by the Company to the State, free of nuisances, soil pollution, etc, according to rules that will be determined by the Reserves Committee. Provisions were also determined in the Draft of Recommendations of the Steering Team regarding payment for the purchase of the power stations, system management assets, land and structures which will be purchased from the Company by the State or by the system management company by offsetting the Company's debt to the State in accordance with principles which were set in the Draft of Recommendations. An agreement between the Israel Land Authority and the Company which was supposed to regulate all the engagements between the parties and provisions regarding the State and the Company's examination of the various taxation aspects of the aforesaid steps and which was not signed as of the date of the report. And that the Company will undertake not to claim ownership of rights to land and other assets which are not included in the Assets List, and the State will be permitted to receive these assets without consideration. It was further determined in the Draft of Recommendations of the Steering Team that implementation of all the assets arrangements detailed in the Draft of Recommendations of the Steering Team by the State is conditional on full implementation of the issues requiring arrangement, as detailed above, by the Company, and that every sale or transfer of assets or liability by the Company, including to a subsidiary, will be executed subject to the law and taking into account the restrictions included in the debt raising documents of the Company.

On May 7, 2014, the Company presented the Steering Team with its initial reaction and position with regard to all the recommendations Draft of the Steering Team. As part of this, the Company had reservations from part of the Team's draft of recommendations regarding the assets arrangement.

6) The Yogev Letter

On September 8, 2014, the Company received the Yogev Letter. Following is the referral to the issue of the assets arrangement in the stated letter:

- Real estate assets which serve the Company and are expected to serve the Company in future will remain under the present arrangement.
- Removing the system management from the Company and operating it as a separate Government Company in the first year of the agreement.
- Real estate assets that are unnecessary to the current operation of the Company will be transferred to the State according to an arrangement that will be determined.
- The Company will sell the Ramat Hovav stations, the land at Alon Tavor and the land at Eshkol C-D. Private electricity producers will construct power stations in accordance with the needs of the sector instead of the Eshkol C-D stations which will be scrapped. A station will be constructed at Alon Tavor in accordance with the needs of the sector. Haifa C station will be scrapped.
- The State will pay for the power stations, system management assets and land and structures that the State or the system management company will purchase from the Company, by offsetting the Electric Company's debt to the State.

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**NOTE 1:- GENERAL (continued)**

**f. Assets Arrangement (continued)**

7) The position of the Company regarding breakdown of the assets in accordance with the assets' arrangement outline as it is detailed in the Yogev Letter:

Following is a breakdown of the Company's assets according to their classification under the assets' arrangement outline as it was detailed in the Yogev Letter, all on the basis of the Company's understanding and position:

- a) Assets, which according to the Company's understanding, the assets' arrangement pursuant to the Yogev Letter does not apply to, or that will remain in the Company's possession pursuant to the ownership arrangements existing at present. Their impaired cost as of December 31, 2015 is approximately NIS 61.3 billion. These assets are operating assets which serve the current operation of the Company.
- b) Operating assets which, pursuant to the State's position, as it arises from the Yogev Letter in accordance with the Company's understanding, are expected to be all or partially sold to the State or to the system management company as the case may be. Their impaired cost as of December 31, 2015 is approximately NIS 2.4 billion. In accordance with the Company's understanding, pursuant to the Yogev Letter, the existing stations at the Eshkol C and Eshkol D sites, at a scope of 912 MW, will be scrapped, and the relevant land will be sold in full to private producers.

It is noted that it is the Company's opinion that one cannot conclude, from the amounts mentioned above regarding the assets' cost in the Company books, the consideration which will be received from the sale of the stated assets.

Additionally it is noted that the Company had material reservations concerning that stated in the Yogev Letter with respect to the sale of the additional assets to the State, including with respect to the intention that the payment with respect to the additional assets will be conducted by way of offsetting against a debt.

- c) Assets which are not expected to serve the Company in future and, pursuant to the State's position, as it arises, in accordance with the understanding of the Company, from the Yogev Letter, are all or partially expected to be transferred to the State under an arrangement which will be determined. These assets (including fixtures to these lands, insofar as were built), were fully impaired as of December 31, 2015. The Company delivered to the State a list of several assets which according to its position fulfill this definition.

Regarding this, it is noted that the Company has reservations with respect to that stated in the Yogev Letter pertaining to this issue that complete uncertainty does not exist with respect to the list of assets that will be transferred or sold, with respect to the final value of those assets, and with respect to the issue of if and how will the Company be compensated with respect to the transfer of these assets to the State.

This breakdown is according to the Company's opinion and there is no certainty that the State entities will accept it. That which is stated in this section is based on the Company's position alone pertaining to interpretation of that stated in the Yogev Letter and its implementation. It is clarified that the State has not yet classified and estimated the Company's assets in accordance with the Yogev Letter.

It is further noted that the Yogev Letter, the Draft of Recommendations of the Steering Team and the letter of the Comptroller General and the Director of the Companies Authority (as detailed below) included general principles with respect to the assets arrangement outline and the manner of its implementation, some of which were not fully explained or detailed within the Draft of Recommendations of the Steering Team, Yogev Letter or the letter of the Comptroller General and the Director of the Companies Authority, and therefore it is not possible to accurately estimate the implications of the assets arrangement, insofar as will be implemented and pursuant to which of these documents, on the Company.

It is emphasized that in accordance with the Yogev Letter, the validity of the offer detailed in it was 30 days after its delivery to the employees, namely until October 8, 2014.

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**NOTE 1:- GENERAL (continued)**

**f. Assets Arrangement (continued)**

**8) Letter of the Comptroller General and the Director of the Government Companies Authority**

On May 18, 2015, the letter by Comptroller General of the Ministry of Finance and the Director of the Companies Authority was sent to the Chairman of the Securities Authority, Mr. Shmuel Hauzer.

In the letter from the Comptroller General and the Director of the Companies Authority it was clarified, following the Yogev Letter and discussions and meetings held regarding the issue of negotiable debentures by the Company, that for several months the Division of the Comptroller General and the Companies Authority are striving to formulate an outline for the arrangement of the assets of the Electric Company, including with the aid of external consultants, since the assets arrangement is part of a comprehensive outline of structural change in the Electric Company, and the approval of the Ministers to advance an assets arrangement in this outline separately from a comprehensive structural change has not yet been received, and since insofar as this approval will be received, they intend to act with the relevant State entities to promote the matter, in order to recommend an outline for assets arrangement for the Electric Company, including legislation amendments as will be required, to the Minister of Finance and the Minister of National Infrastructures, Energy and Water.

The Comptroller General and the Director of the Companies Authority clarified that it is not their intention, within the assets arrangement outline which will be proposed by them to the Ministers, to impair the book value of the assets of the Company according to the audited statements, and that the arrangement which will be offered to the Company will include the transfer of assets to the State in accordance with their value in the audited statements. The Comptroller General and the Director of the Companies Authority clarified that the arrangement may include, inter alia, transfer of assets whose market value exceeds their value in the Company's books in consideration for their book value alone. The payment, in full or in part, may be by way of offsetting the perpetual debenture balance of the Company to the State. It was further clarified that they do not intend, within the arrangement which will be proposed, to affect the Company's ability to operate the assets that will remain in its possession after the arrangement, and which will be required for the execution of its operations in accordance with the licenses it holds, as will change from time to time.

It was clarified in the letter of the Comptroller General and the Director of the Companies Authority that all that it includes is their position alone, it has not yet been examined or approved by all the relevant entities in the State, and they are subject to the examination and approval of the Ministers.

It is noted that according to the position of the Company, the assets arrangement should be executed in collaboration with the Company and the details of the assets over which the assets arrangement will apply should be arranged in collaboration with the Company.

It is noted that the letter of the Comptroller General and the Director of the Companies Authority is not acceptable to the Company which has reservations about its contents, including that according to the position of the Company, the assets should be transferred against their market value, as will be determined, and not less than their book value.

**9) Additional Talks regarding the Assets Arrangement**

As of the date of publication of the report, there are continued talks between the Company and State entities regarding the Assets Arrangement, but the parties have not yet reached consents and decisions have not been reached on the issue.

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**NOTE 1:- GENERAL (continued)**

**f. Assets Arrangement (continued)**

**10) Assets Arrangements - Summary**

Implementing a structural change in the electricity sector and/or implementing the assets arrangement in accordance with the Draft of the Recommendations of the Steering Team, the Yogev Letter or the letter of the Comptroller General and the Director of the Companies Authority, if and insofar as an agreement will be reached regarding their implementation, in full or in part, and making the Draft of Recommendations of the Steering Team, the Yogev Letter or the letter of the Comptroller General and the Director of the Companies Authority legally binding, will require approval of the authorized entities in the State, including the approval of the government, execution of required legislation amendments, and execution of additional actions, none of which have been agreed upon or adopted as of the date of this report and it is not known if they will take place.

As of the date of the report, there is uncertainty if and when the Draft of the Recommendations of the Steering Team, the Yogev Letter or the letter of the Comptroller General, and the Director of the Companies Authority, or any other outline of the assets arrangement will be implemented, if at all, and it will be according to the discretion of the authorized entities and subject to the law.

The Company estimates that as of the date of this report, the assets arrangement does not have a material impact on the Company or its financial results or its financial position. However, the Company cannot estimate what the actual conclusion will be with regard to the assets arrangement, what its implications (if any) will be for the Company, and it has no certainty that a future implementation of the assets arrangement will not materially impact its financial position.

For details regarding the Company's position in relation to the issues related to the Company's creditors regarding the structural change and/or the assets arrangement, see Note 1.e.12 above.



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**NOTE 1:- GENERAL (continued)**

**g. Environmental Protection Laws**

- 1) The Company's activities are subject to different environmental protection laws and regulations on different issues, e.g., emission of pollutants into the air, soil and water pollution, noise abatement, non-ionizing radiation, storage and use of hazardous materials and fuels, asbestos and more. The Company believes that as on the date of this report it is in material compliance with the directives of the laws on environmental protection. The Company holds the environmental licenses required for its activity and acts to obtain any missing licenses. Non fulfillment of the environmental provisions of the law and the conditions of the licenses granted to the Company by virtue of them may impose a criminal and administrative exposure on the Company, including fines and sanctions and shut down injunctions for installations, and exposure to expenses of cleaning and rehabilitating environmental damage.
- 2) Terms regarding airborne emissions from the Company's facilities are imposed on the Company, inter alia, within in personam orders by virtue of the Abatement of Nuisances Law (which were granted before the Clean Air Law entered into effect), and within the terms of a business license. Among others, an in personam lateral order signed in December 2010 applies to the Company, and it applies to all the power stations of the Company ("Lateral Order").

Within the Lateral Order the Company is required, inter alia, to act to reduce airborne emissions at the coal powered power stations of the Company. These projects are extremely complex and complicated in planning and engineering, and are executed and are planned to be executed in active, crowded generation sites abundant with active infrastructures.

Advancing the emission reduction project has encountered difficulties and obstacles due to events not under the control of the Company, including unexpected difficulties with the various work contractors of the project, the "Zuk Eitan" Operation and restrictions from the field of labor laws.

Further to extensive correspondence on the issue, in December 2015, the Company received an additional amendment to the business license terms of the Orot Rabin site which anchors, inter alia, the framework for the continued implementation of the emission reduction project at the site, subject to execution of a plan for reducing surplus emission from the site ("Site Bubble Plan"). In addition to this directive, in January, 2016, after the financial statements date, the Company received the directive of the Minister of National Infrastructures, Energy and Water under section 10 (c) of the licenses of the coal powered generation units at the Maor David (Orot Rabin) power station and at the Rutenberg power station for reducing the pollutant emissions and maintaining the energy security in the operation of the coal powered units (hereinafter: the "Minister's Directive").

The Minister's Directive determines that the coal powered generation units will be operated such that the electricity generation rate in these units will be reduced by 15% in an annual calculation relative to the electricity generation in these units in 2015.

Pursuant to the Minister's Directive, the reduction will be executed according to the terms of operation detailed in it, including that operation of all the coal powered units will be the minimum required, and that in the event that the Minister declares a special situation in the electricity sector, the restriction will be lifted until the end of the special situation.

It was further written that the Electricity Authority will be instructed to assimilate the surplus cost with respect to this directive in the electricity rates.

The Company applied to the Ministers of Environmental Protection and National Infrastructures, requesting that they work in coordination when determining the provisions regarding the manner and extent of reducing the electricity generation at the coal powered units. The Company added that the existing situation, according to which two sets of provisions on the same subject which are incompatible with each other are imposed on the Company, is an unreasonable situation which may not be operationally feasible and may result in unnecessary financial expenses.

In February, 2016, the Company received letters from the Ministry of Environmental Protection, pertaining to completion of documents for the applications for emission permits at the Rutenberg and Orot Rabin power stations.

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**NOTE 1:- GENERAL (continued)**

**g. Environmental Protection Laws (continued)**

Within the letters, the Company was required, inter alia, to submit a plan for the manner of meeting the emission values at units 1-4 of the Orot Rabin site; a plan for reducing surplus emission which will be caused as a result of the updated schedules for implementing the emission reduction project at the generation units at Orot Rabin 1-4 and at Rutenberg, as well as detailed milestones for the installation of means for emission reduction. The Company submitted the required information and is in contact with the Ministry of Environmental Protection regarding this matter.

Regarding the future of units 1-4 at the Orot Rabin site, the Company applied to the Director General of the Ministry of National Infrastructures, Energy and Water, requesting a coordinated decision by all the relevant Government Ministries regarding the future of these units and the need for a surplus emission reduction plan in view of its possible implications.

Insofar as the Company's plan and schedules proposed by it will not be accepted, operating the coal powered generation units without means to reduce emission reduction after the dates set will constitute breach of some of the environmental laws which apply to the Company. Insofar as the Company will choose to cease the operation of the generation units, in order to avoid this breach, this may materially affect the stability of the transmission system, the Company's fuels mix and costs and even the reliability of the electricity supply.

- 3) As at the date of signing the financial statements, several proposed environmental bills and regulations are in various stages of enactment, including the Draft of the Non-Ionizing Radiation Regulations (Amendment), which became known to the Company through a petition submitted to the High Court of Justice against the Minister of Environmental Protection, Minister of National Infrastructures, Energy and Water and the Minister of Finance, regarding their duty to regulate regulations under the Non-Ionizing Radiation Law. The Regulations Draft seeks to set permitted maximum exposure levels regarding radiation in the electricity grid's frequencies. If the threshold values included in the Regulations Draft delivered to the Company will become obligatory values, it may have material implications for the Company.
- 4) During recent years an increase has occurred in the environmental demands that apply (or that are undergoing legislation procedures) to the operation of the Company and in the supervision and enforcement of these demands. The Company is studying the material economic, legal, operational and technical implications for its activity which may arise from the directives, laws, regulations and environmental bills. The Company allocates funds in its budgets to fulfill the directives of the laws applied to it and those expected to be applied. As on the date of this report, and based on the directives of the Electricity Sector Law, the Company estimates that the material costs which will be applied as a result of new regulatory requirements related to environmental protection will be covered within the framework of the electricity rate. The decision on recognizing the costs is given to the Electricity Authority.

For additional information regarding the rate recognition for the emission reduction project see Note 3.

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**NOTE 1:- GENERAL (continued)**

**h. The Restrictive Trade Practices Law, 1988:**

- 1) On February 2, 2016, the Company received a letter from the Antitrust Authority, within which it was claimed that the Company abused its status as a monopoly and damaged the service received by large business customers who transferred to purchase electricity from private electricity producers, by stopping the service of customer portfolio managers which was provided to these customers before the transfer to private electricity producers. In the aforesaid letter, the General Director of the Antitrust Authority ("Director") notified that he is considering to use the authority vested in him by the Restrictive Trade Practices Law, and determine that the Company abused its status as a monopoly in the transmission of electricity and its distribution, and impose a financial fine on the Company in the amount of NIS 13 million, with respect to alleged violations of the Restrictive Trade Practices Law, as stated.  
It was further written that the Director is considering imposing a financial fine on a number of past and present senior office holders of the Company.  
The Company is studying the details of the letter, and intends to make use of right to be heard given to it, and to respond to the claims arising from this letter in accordance with the provisions of the law.
  
- 2) Following that stated in Note 1a.1) above, regarding the Company being declared as a monopoly by the General Director of the Antitrust Authority, on December 8, 2015, the Company applied to the General Director of the Antitrust Authority, requesting to cancel the declaration of the Company as a monopoly and alternatively that the declaration will be changed and reduced, so that it will be clarified that it does not apply to the sale of electricity to large electricity consumers (in ultra and high voltage) (the "Company's Application"). Following the Company's Application, and additional correspondence, a meeting regarding this issue was held between the Company and the General Director of the Antitrust Authority. As of the date of publication of the report, the response of the Antitrust Authority to this issue has not yet been received.

**i. Definitions**

<b>Related Parties</b>	–	As defined under International Accounting Standard 24
<b>Dollar</b>	–	US dollar.
<b>Subsidiary Company</b>	–	Company 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.
<b>Held Companies</b>	–	Subsidiary companies and investee companies.
<b>Associate Company</b>	–	Company in which the Company has material influence.
<b>Total Electricity Consumers</b>	-	All the electricity consumers in Israel that are customers of the Company and that are customers of private producers.
<b>IFRS</b>	-	International Financial Reporting Standards which also include International Accounting Standards (IAS) and clarifications determined by the Committee for Interpretation of International Financial Reporting Standards (IFRIC) or by the Committee for Interpretations of International Accounting Standards (SIC) which preceded it.
<b>IAS</b>	-	International Accounting Standards

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**NOTE 2:- REPORTING RULES AND ACCOUNTING POLICIES**

**a. 1) Declaration of Compliance with International Financial Reporting Standards:**

In light of the termination of validity 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 of January 1, 2015, the Consolidated Financial Statements of the Company are prepared in accordance with International Financial Reporting Standards (hereinafter: "IFRS Standards") and their interpretations which were published by the International Accounting Standards Board (IASB) and the Securities Regulations (Annual Financial Statements), 2010 (hereinafter: the "Financial Statements Regulations"). The main points of the accounting policies detailed below were consistently implemented with respect to all the reporting periods presented in these Consolidated Financial Statements, except for changes in accounting policies which derived from implementation of Standards which are not in effect and which were adopted by the Company by way of early adoption as detailed in section y below.

In accordance with the reply of the Securities Authority (to a preliminary application by the Company regarding the manner of transition to International Standards), the date of transition to IFRS was set to January 1, 2014. The comparative figures were restated in order to retrospectively reflect in them the adoption of the IFRS Standards as of the transition date.

See Note 37 below with respect to the material differences between a report pursuant to the IFRS and a report pursuant to the Government Companies Regulations.

**2) Operating cycle period**

The Company's regular operating cycle period is 12 months.

**b. Functional Currency and Foreign Currency**

**1) Functional Currency**

The Financial Statements of the Company and the consolidated company are prepared in New Israeli Shekel which is the currency of the primary economic environment in which they operate ("the functional currency").

**2) Translation of Transactions in Currencies other than the Functional Currency**

In preparing the financial statements of the Company and the consolidated company, transactions in currencies other than the Company's functional currency ("foreign currency") are recorded at the rates of exchange prevailing at the dates of the transactions. At each statement of financial position date, monetary items denominated in a foreign currency are translated at the rates published by the Bank of Israel and were valid at that date. Non-monetary items carried at fair value that are denominated in a foreign currency are translated at rates prevailing at the date that the fair value was determined. Non-monetary items that are measured in terms of historical cost are translated at exchange rates in effect on the transaction date, as they relate to the non-monetary item.

**3) Method of Recording Exchange Rate Differences**

Exchange rate differences are recognized in operations in the period in which these arise, except for the cases detailed below:

- Exchange differences with respect to transactions intended to hedge certain foreign currency risks (regarding the accounting policy of the Company on hedging transactions, see section o below).
- Exchange differences which relate to assets under construction for future use in production are included in costs of those assets, when they are regarded as an adjustment to interest costs on foreign currency borrowings (regarding the accounting policy of the Company on capitalization of borrowing costs, see section (i) below).
- Exchange differences recognized in the electricity rates and expected to be collected for periods following the statement of financial position date (see Note 15 e).

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**NOTE 2:- REPORTING RULES AND ACCOUNTING POLICIES (continued)**

**c. Consolidated Financial Statements**

The consolidated financial statements of the Company incorporate the financial statements of the Company and a subsidiary (the National Coal Supply Corporation, hereinafter: the "Coal Company").

Financial statements of the subsidiary are prepared in accordance with the accounting policies of the Company. In the consolidated financial statements, 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.

**f. Investments in Associate**

An associate company is an entity in which the Company has significant influence alone, without control. The significant 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 the accounting policies of the Company. 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 profit/loss of the associate and in its comprehensive profit/loss.

The value of the Company's holdings in an associate company as of its date of incorporation is recognized as deferred income within other liabilities, and recognized as income over a period of service provision under the agreement, by the straight line method.

Profit or losses which were created from transactions executed between the Company and an associate of the Company were cancelled in accordance with the Company's share in the rights of the associate.

For details see Note 10b below.

**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.

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**NOTE 2:- REPORTING RULES AND ACCOUNTING POLICIES (continued)**

**h. Fixed Assets**

- The Company presents its fixed asset items in accordance with the cost model. In the cost model, fixed asset items are presented in the statement of financial position at cost, net of accumulated depreciation and net of a provision 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 credit 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.
- 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. 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:**

	<u>Useful life (years)</u>	<u>Depreciation rates (%)</u>
Power stations.....	30 - 50 (mainly 30 years)	2-3.33
Industrial gas turbines.....	25	4
Jet gas turbines.....	15	6.67
Transmission system .....	30	3.33
Distribution system .....	20 - 30 (mainly 30 years)	3.33-5
Meters .....	9-14 (mainly 14 years)	7.1-11.1
Inventories (including office equipment), mobile mechanical equipment and telecommunications .....	10	10
Computers and auxiliary equipment.....	3-5	20-33.33
Motor vehicles.....	5-7	14.3-20
Buildings.....	30	3.33

The residual values, depreciation method and useful life of the asset are reviewed by the Management of the Company at the end of every fiscal year. Changes are handled as a change of estimate in a prospective manner. Gains or loss incurred by sale or withdrawal from service of a fixed asset is determined in accordance with the difference between the proceeds from its sale and its carrying amount at the date of sale or withdrawal from service, and is recognized in the statement of operations.

On December 8, 2015, the Electricity Authority published, among others, its decision pertaining to the recognition of costs of emissions reducing facilities at the generation units, and determining the life of the facilities, and determination of the life of the coal fired units to which the facilities will be attached (hereinafter the "Decision"). The Company studied the decision regarding the aforesaid and had significant reservations about it. It therefore submitted a petition on this issue to the High Court of Justice.

After the date of the statement of financial position, a notice was received from the Electricity Authority regarding a secondary hearing following the Authority's decision in the matter (see Note 3.f below).

So long as the issue of extending the life of the stations and the cash flow deriving from this extension has not been finally clarified, in a regulatory manner, the Company has not changed the depreciation period of the coal fired power stations in its Financial Statements.

From time to time, the Company examines the useful life of the stations in accordance with the physical, regulatory and economic life, and in accordance with the regulatory decision which will be reached, the Company will reexamine the depreciation period of the coal fired power stations.

**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 Company, and amortized according to the straight line method throughout the useful lifespan of the principal cost item.

Current maintenance costs are charged to the statement of operations and comprehensive income when incurred.

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**NOTE 2:- REPORTING RULES AND ACCOUNTING POLICIES (continued)**

**h. Fixed Assets (continued)**

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, or capitalized to the asset's cost.

**i. Credit Costs which are directly Attributable to Purchase, Construction or Production of a Qualifying Asset**

Costs with respect to specific and general credit which are directly attributable to purchase, construction or production of an asset requiring a substantial period of time to prepare it for its designated function or sale (hereinafter: "Qualifying Asset"), are capitalized as part of the asset's cost, during the period starting from the date on which all the following terms are fulfilled for the first time: (a) expenditures with respect to the asset are incurred for the Company; (b) credit costs are incurred for the Company; and (c) the Company executes activities which are required for preparing the asset for its designated use.

The capitalization of the credit costs as stated ends when, materially, all the activities required for preparing the asset for its designated use are completed.

The Company suspends capitalization of credit costs during prolonged periods in which it suspends the active development of a qualifying asset.

The credit costs which are directly attributable to purchase, construction or production of a qualifying asset are the same credit costs that would have been prevented if the expenditure with respect to the qualifying asset would not have been executed.

Cash flow with respect to interest capitalized to assets

In the statement of cash flow, the Company classifies cash flow with respect to interest payments that are capitalized to qualifying assets in investment operations together with the other investments in assets.

**j. Intangible Assets**

1) Intangible assets

Identifiable non-monetary assets, 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:

	<b>Useful life (years)</b>	<b>Amortization rates (%)</b>
Software .....	5-15	6.67-20

Intangible assets purchased separately are presented at cost less amortization and accumulated impairment losses. The estimation of useful life and amortization methods are reviewed at the end of each annual reporting period, In case of changes in estimates, the effect is handled as a change in estimate presented in a prospective manner.

The useful life of the software that was defined as strategic projects of the Company was set to 15 years.

2) Intangible assets created internally - research costs

Costs with respect to research activities are charged to profit or loss on the date of their creation.

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**NOTE 2:- REPORTING RULES AND ACCOUNTING POLICIES (continued)**

**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 for 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.

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 profit.

**l. Inventory - Fuel**

Fuels inventory is an inventory of materials consumed in the electricity generation process.

Inventory costs include all of the purchase costs, direct labor costs, fixed and variable overhead expenses and also other costs incurred to bring the inventory to the current location and condition. The cost of inventory is measured in accordance with the weighted average method. The inventory is stated at the lower of cost and net realizable value. The fuels inventory that is held for use in the electricity generation process is not written down if electricity sales equal the cost or exceed cost. Inventory designated for sale is stated according to net realizable value (see Note 8 below).

When inventories are purchased under borrowing terms whereby the arrangement involves a financing element, the inventories are stated at cost reflecting the purchase cost at usual borrowing terms. The difference between the actual purchase price and the purchase cost at usual borrowing terms is recognized as interest expense over the period of the financing.

**Inventory - Fuel – Non Current Assets**

The policy of the Company, of maintaining fuels inventory is mainly for backup and availability needs of the electricity system in case of mishap in the supply of gas, and for times of emergency. Inventory that the Company anticipates will be used it during a period exceeding a year is presented within the section of Inventory fuels - Non-Current Assets.



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**NOTE 2:- REPORTING RULES AND ACCOUNTING POLICIES (continued)**

**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 profit or loss, the accompanying purchase costs are recorded to the statement of profit or loss.

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 profit or loss;
- Loans and receivables.

**2) Financial Asset at Fair Value through profit or loss**

A financial asset is classified as "financial assets at fair value through profit or loss" when those assets are held for trading or designated at the initial recognition stage as financial assets at fair value through profit or loss, including those originating from changes in exchange rates. The change is recognized in operations in the period in which it occurred.

The financial assets of the Company that are included in this category include: swap transactions and forward transactions. See section o below.

**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 for debts identified as delinquent debts (see Note 6 below).

**4) Impairment of Loans and Receivables**

Financial assets, other than those classified as financial assets at fair value through profit or loss, 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 flow 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 measured 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 flow, discounted at their original effective interest rate.

If the amount of loss due to impairment of value of a financial asset decreased in the following period and that decrease is objectively related to an event that occurred after the impairment in value was recognized, then in this case, the loss from impairment of value recognized in the past is fully or partially cancelled through profit or loss. 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 profit or loss.

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**NOTE 2:- REPORTING RULES AND ACCOUNTING POLICIES (continued)**

**n. Financial Liabilities and Financial Instruments Issued by the Company**

**Classification as a Financial Liability**

Non-derivative financial instruments are classified as a financial liability, according to the essence of the underlying contractual arrangements.

Financial liabilities are presented and measured according to the following classification:

- Financial liabilities at fair value through profit or loss.
- Other financial liabilities.

**1) Financial Liabilities at Fair Value through Operations**

A financial liability is classified at fair value through profit or loss if it is held for trading purposes, or were designated at the initial recognition stage as financial liabilities at fair value through profit or loss including those originating from exchange rates. The change is recognized in the profit or loss in the period in which it occurred. Financial liabilities of the Company, included in this category, include swap transactions and forward transactions. See also section o below.

**2) Other Financial Liabilities**

Other financial liabilities (mainly including debentures and liabilities to banks), are initially measured at fair value net of transaction costs. Subsequent to the date of initial recognition, other financial liabilities are measured at amortized cost, using the effective interest rate method.

The effective interest method is a method of calculating the amortized cost of a financial liability and of allocating interest expense over the relevant period. The effective interest rate is the rate that accurately discounts the forecasted stream of the estimated future cash flow through the expected life of the financial liability to its book value or a shorter period, where appropriate.

**3) Financial Liabilities Linked to the Consumers Price Index**

The Company has financial liabilities that are linked to the Consumers Price Index which are not measured at fair value through profit or loss. The Company determines the effective interest rate for these liabilities as a real rate plus linkage differentials according to the actual changes to the index which occurred until the end of the reporting period.

**4) Reduction of Financial Liabilities**

A financial liability is removed when and only when it is cleared, namely, when the liability that is defined in the contract was paid-up, canceled or expired.

**o. Derivative Financial Instruments**

- 1) The Company enters into a variety of derivative financial instruments to manage its exposure to interest rate and foreign currency rate risks, including currency swaps, interest swaps, and combined interest swaps and currency swaps transactions, and foreign exchange forward contracts. Further details on the derivative financial instruments used by the Company are presented in Note 27 below.

Derivative financial instruments are initially recognized at fair value on the date that a derivative contract is entered into and are subsequently at their fair value at each statement of financial position date. As a rule, changes in fair value of derivative financial instruments are recognized in profit or loss.

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 3 a below.

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**NOTE 2:- REPORTING RULES AND ACCOUNTING POLICIES (continued)**

**o. Derivative Financial Instruments (continued)**

- 2) Hedge accounting - the Company designates hedging of derivative financial instruments. The hedged items are designated as hedged cash flow.

The hedging relationship is documented by the Company on the date of the contractual engagement of the hedge transaction. As part of the documentation, the hedged instrument, the hedged item, the hedged risk and the implemented hedging strategy are identified, and the degree of suitability of the strategy to the overall policy of the Company is examined. Additionally, from the beginning of the hedging relationship and throughout their period, the Company documents the degree in which the hedging instrument is effective, offsetting the exposure to changes in the cash flow with respect to the hedged risk in the hedged item.

The balance sheet classification of hedging instruments is determined according to the remainder of the period of the hedging relationship at the end of the reporting period. If the remainder of the hedging relationship period exceeds 12 months at the end of the reporting period, the hedging instrument is classified in the statement of financial position as a non-current asset or liability. If the remainder of the hedging relationship period does not exceed 12 months at the end of the reporting period, the hedging instrument is classified in the statement of financial position as a current asset or liability.

The Company applies cash flow hedge accounting with respect to fixed interest bearing loans, for which the Company has engaged in currency exchange contracts.

The effective part of the changes in value of the financial instruments that are designated for cash flow hedging is recognized in other comprehensive income in the "Income (loss) with respect to cash flow hedging" item and the part that is not effective is immediately recognized in the profit or loss.

Cash flow hedge accounting is terminated when the hedging instrument lapses, is sold or realized or when the hedging relationship no longer meets the threshold conditions for hedging. In this matter, changing the counterparty to the hedging instrument as a result of legal or regulatory requirements, in a manner that does include additional changes to the conditions of the hedging instrument beyond the changes necessary as a result of changing the counterparty, does not constitute lapse or realization. After the hedge accounting is ended, the amounts attributed to the other comprehensive income are classified to profit or loss.

For additional details regarding financial instruments see Note 27 below.

**p. Revenue Recognition**

Revenue is measured at the fair value of the consideration received or the consideration which the Company is entitled to receive as revenue from sale of electricity and provision of services in the ordinary course of business. The revenue is presented less estimated discounts, granted according to regulatory conditions applied to the Company.

**1) Revenue from Sale of Electricity**

- a) Revenues from sale of electricity are recognized upon consumption of electricity by customers, according to meter readings. Revenues for the quantity consumed during the period between the last meter reading and the statement of financial position date are included according to estimates.
- b) The Company examines the compliance with conditions for recognition of income from sale of electricity. If it is not possible to determine that it is expected that the economic benefits attributed to the transaction will flow to the Company, the Company recognizes income from sale of electricity in accordance with the amount it expects to collect.

**2) Revenues from Interest**

- a) Interest revenue from deposits is accrued on a time basis, by reference to the principal outstanding and at by use of the effective interest method.
- b) Interest income with respect to electricity customers is recognized at the time of collecting the debt with respect to which it was accrued.

**3) Revenues from Dividends**

Revenues from dividends with respect to investments are recognized on the date on which the entitlement to receive the dividend was created.

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**NOTE 2:- REPORTING RULES AND ACCOUNTING POLICIES (continued)**

**q. Works according to an Implementation Contract**

Where the outcome of material works according to an implementation contract can be reliably estimated, 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 profit or loss.

**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.

**Operating Leases**

Rental income from operating leases is recognized on a straight line basis over the lease term. With regard to operating lease arrangements in which at the inception of the lease period, no lease fees are received, or reduced lease fees are received, and also when additional benefits are granted to the lessee, the Company recognizes revenue on the straight line basis, over the lease term.

**3) Asset Leasing**

**Financial Leasing**

Under financing lease transactions in which the Company leases assets from another entity, the Company, on the date of inception of the lease, recognizes the asset at fair value, or if lower, at the present value of the minimum lease payments. The liability for the transfer of the minimal lease payments to the lesser is included in the statement of financial position as a finance lease obligation. In subsequent periods, current payments with respect to the finance lease are apportioned between the financing component and the liability component so as to achieve a constant rate of interest that is allocated on the balance of the liability.

The portion attributed to the financing element is charged to operations, other than instances in which the leased asset is a qualifying asset, where borrowing costs are capitalized (Regarding capitalizing borrowing costs, see section i above).

Land leases from the Israel Lands Administration are classified as a financial lease. Deferred leasing payments paid at the inception date of the lease are presented in the statement of financial position in the fixed assets section, amortized over the leasing term.

**Operating Lease**

Lease expenses related to operating leases are recognized on a straight-line basis over the lease term. In lease arrangements, where no leasing fees are paid at the beginning of the lease period, or reduced fees are paid and also when the lesser grants additional benefits, the Company recognizes the expenses on the straight line basis, over the lease term.

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**NOTE 2:- REPORTING RULES AND ACCOUNTING POLICIES (continued)**

**s. Provisions**

Provisions are recognized when the Company has a legal obligation or constructive obligation as a result of a past event, as to which the utilization of economic resources is probable to liquidate the obligation and they can be reliably estimated.

The amount recognized as a provision reflects the best estimate of the management of the consideration required to settle the present obligation as of the statement of financial position date, taking into account the risks and uncertainties surrounding the obligation. Where the provision is measured by using the cash flow estimated to settle the obligation, the book value of the provision is the present value of those anticipated cash flow. Changes with respect to the time value are charged to profit or 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 and income represents the sum of the total change in balances of deferred taxes.

**2) Deferred Taxes**

The Company creates deferred taxes for temporary differences between the value for tax purposes of assets and liabilities and their value in the financial statements. Balances of deferred taxes (asset or liability) are computed according to tax rates and tax laws enacted or substantially enacted by the statement of financial position date. Deferred tax liabilities are usually recognized for taxable temporary differences between the value for tax purposes of assets and liabilities and their value in the Financial Statements. Deferred tax assets are recognized for all temporary differences that may be deducted up to the amount of anticipated taxable income, against which the deductible temporary difference may be utilized.

In the calculation of the deferred taxes, the deferred taxes on distribution of earnings in held companies are not taken into account since the dividends are not taxable.

Assets and liabilities for deferred taxes are presented on an offset basis, when an entity has a legally enforceable right to set off current tax assets against current tax liabilities and when they relate to taxes on income levied by the same tax authority and the Company intends to settle its current tax assets and the liabilities on a net basis.

**u. Benefits to Employees**

**1) Post-Employment Benefits (see Note 11 below)**

Post-employment benefits of the Company include: pension and grants. Post-employment benefits of the Company are partly defined contribution plans and partly defined benefits plans.

Expenses for the liability of the Company to deposit funds in a defined contribution plan (cumulative pension fund see Note 11 e below) are charged to profit or loss, or capitalized to the cost of assets, at the time that the labor services, as to which the Company is obligated to make the deposit, are supplied. The difference between the deposit amount payable and the total deposits paid is presented in the statement of financial position in the payables item.

Expenses for a defined benefit plan (the Company's pension fund see Note 11 d below) are charged to profit or loss, or capitalized to the cost of the asset according to the projected unit credit method, while utilizing actuarial valuations carried out at the end of every reporting period. The current value of the liability of the Company with respect to a plan for a benefit defined for December 31, 2015 is determined by capitalization of the expected future cash flow with respect to the plan. According to the International Accounting Standard 19 (IAS 19), the rate used for capitalization of liabilities with respect to post-employment benefits will be determined by using the market yields at the end of the reporting period for the high quality corporate debentures.

According to the IAS 19 Amendment "Employee Benefits", employee deposits relating to the employee's service will be treated as a decrease of the service cost. The amendment enables a practical way, in a case in which the sum of deposits is not dependent on the number of years of service, to decrease the cost of the current service in a period during which the related service was provided.

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**NOTE 2:- REPORTING RULES AND ACCOUNTING POLICIES (continued)**

**u. Benefits to Employees (continued)**

**1) Post-Employment Benefits (see Note 11 below) (continued)**

According to the Authority's staff position of November 2014, the Company capitalizes the liabilities with respect to benefits to employees, as of the 2014 Financial Statements, in accordance with the market yields for Corporate Debentures.

According to the accounting policies of the Company, the plan assets are measured at fair value. Interest income on the plan assets and the funds in trust are set on the basis of the rate of capitalization of the liability for the beginning of the year and are recorded to the statement of operations or capitalized to the cost of assets. The difference between the interest income for the plan assets and funds in trust and the comprehensive yield of the plan assets and funds in trust is recorded to remeasurements of the liability (the asset), net, with respect to a defined benefit (hereinafter "remeasurements") in other comprehensive income and will not be reclassified to profit or loss at a later date.

When the total deposits paid exceeds the deposit required with respect to the service that was provided up to the date of the statements of financial position, and this surplus will lead to decrease of the future deposits, or a monetary repayment, the group recognizes the asset.

Actuarial gains and losses derive primarily from the difference between the actuarial assumptions, that are long-term assumptions, and the behavior of those variables during the reporting year (such as the expected rate of increase in salaries, the capitalization interest rate, the rates of early retirement and mortality and from the difference between the actual return on the funded amounts during the reporting year, and the expected return as of the beginning of the year) and from the changes in the actuarial assumptions themselves. Actuarial gains and losses are recorded to the other comprehensive income on the date of their creation, or capitalized to the asset cost. Actuarial gains and losses that were recorded to remeasurements in other comprehensive income will not be reclassified to income or loss at a later date.

Past service cost is recognized immediately in the statement of operations during the period in which the plan was changed.

The liability of the Company for a defined benefit plan, recognized in the statement of financial position, represents the present value of the defined benefit obligation less fair value of the assets of the plan. A net asset, created by this calculation, is limited to the amount of the future economic benefits available in the form of refunds from the plan or in the form of a reduction in future deposits in the plan ("cap amount").

Pension liability is assigned to service periods of the employees according to the rights accumulation rate in the pension plan.

**2) 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.

**THE ISRAEL ELECTRIC CORPORATION LIMITED**  
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**NOTE 2:- REPORTING RULES AND ACCOUNTING POLICIES (continued)**

**u. Benefits to Employees (continued)**

**3) 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 profit or loss 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 flow for the plan at market yields of high quality Corporate Debentures (see Note 11 h below).

Actuarial gains and losses are charged to the statement of profit and loss upon their creation. Past service cost is recognized immediately in the statement of profit and loss in the period in which the plan was changed.

**4) Benefits for Dismissal**

Benefits for dismissal are benefits due to be paid as a result of the Company's decision to dismiss employees prior to the usual retirement age or as a result of the employee's decision to agree to voluntary retirement in return for these benefits.

The liability of the Company for an early retirement plan is charged to operations, where the Company is liable under a formal severance plan, that includes, at least, the location, position and estimated number of dismissed employees, the benefits to which the dismissed employees are entitled and the plan implementation date. Also the period of time for completing the implementation will be such that will not reasonably allow material changes in the plan.

**5) Funds in Trust**

Funds held in trust are recorded in their fair value in accordance with the IFRS standard 13.

**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, which 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 36 below).

**x. Classification of interest paid, dividends paid and interest and dividends received in the cash flow statement**

The Company classifies cash flow with respect to interest and dividends received as cash flow from investing operations, and cash flow with respect to interest paid as cash flow that were used for financing operations. Cash flow with respect to taxes on income are in general classified as cash flow that served current operations, except for those that can be easily identified with cash flow that were used for investment or financing activities.

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**NOTE 2:- REPORTING RULES AND ACCOUNTING POLICIES (continued)**

**y. New Standards and Clarifications which were adopted by the Company by Early Adoption, which have an Effect on the Current Year:**

**IFRS 14 - Regulatory Deferral Accounts**

In January 2014, the International Financial Reporting Standard number 14 (hereinafter: IFRS 14") was published. IFRS 14 was published as an intermediate standard to be implemented as of 2016, and its purpose to permit, as a possible alternative, continued implementation of the previous accepted accounting principles and the accounting policy for recognition, measurement, impairment, and removal of regulatory deferral accounts in the financial statements of regulated companies during the initial transition to implementation of the IFRS standards.

The standard enables the Company, which conducts operations that are subject to rate regulation, to implement the practice existing on the subject of recognition of regulatory deferral accounts, in the reports prepared according to the IFRS standards, as the Company has implemented in its financial statements pursuant to the previous accepted accounting principles.

Pursuant to the financial reporting principles of the Company which were implemented until December 31, 2014 in accordance with the Government Companies Regulations as described in Note 36 below, the Company implemented accounting treatment with regard to the timing of charging expenses and income to the profit and loss statement for the purpose of reflecting and creating an adequate matching between the expenses and the income which will be created for the Company according to the dates of their recognition in the electricity rate, by creating regulatory deferral accounts.

The accounting treatment is implemented when all the three following conditions are fulfilled:

- 1) Rate regulation - rates with respect to regulated services or products are determined by a regulator which is an independent third party, or by a committee with authorization, or are subject to their approval, in accordance with the law or a contract which determines rates for debiting the consumers.
- 2) Specific cover of costs - regulated rates are constructed so as to cover the specific costs (included required return on capital) pertaining to the supply of the regulated service or product.
- 3) Competition and possibility of collecting from customers - in light of the demand for a regulated service or product and the level of direct and indirect competition, it is likely that the rates determined so as to cover the costs can be debited and collected from the consumers.

These conditions can also be implemented on separate parts of activities such as electricity generation or transmission, or on a specific sector of customers.

Should a conclusion be reached that the Company no longer fulfills the abovementioned conditions, the regulatory deferral accounts should be deleted. A company fulfilling the above detailed conditions will create regulatory deferral accounts when there is an expense the Company has met in the past but has not yet been received in the rate, as well during postponement of income, when it is returned to the consumers in future.

A regulated entity should reevaluate the likelihood of coverage of the regulatory deferral accounts on every date of publication of financial statements.

Should a conclusion be reached that the Company no longer fulfills the conditions detailed above, and not all of the regulatory deferral accounts are not covered by the rates, then they should be deleted, or part of them, from the statement of financial position.

The IFRS 14 details, inter alia, various presentation requirements in comparison with the manner of presentation of regulatory deferral accounts in financial statements until the transition date. See Note 15 below.

In accordance with IFRS 14, presentation of regulatory deferral accounts and changes in them is different in the financial statements under the IFRS, compared to the manner of their presentation until the transition date. The regulatory assets which were pursuant to the Government Companies Regulations are defined, as of the transition date, as "regulatory deferral accounts". The total regulatory deferral accounts in debit and the total regulatory deferral accounts in credit are presented as separate items in the statement of financial position and are separated as a separate category. Regulatory assets/liabilities were presented in the past both for short term and for long term.



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**NOTE 2:- REPORTING RULES AND ACCOUNTING POLICIES (continued)**

**y. New Standards and Clarifications which were adopted by the Company by Early Adoption, which have an Effect on the Current Year: (continued)**

**IFRS 14 - Regulatory Deferral Accounts (continued)**

The change in regulatory asset/liability, net of tax, was presented until the transition in the statement of profit and loss as a decrease in revenues or decrease in the operating or financing expenses. The net change in regulatory deferral accounts as of the transition date and onward is presented in the financial statements in a separate section in the statement of comprehensive income (see Note 37.c.3 below).

**z. New Standards and Clarifications Published which are effective and were not Adopted by the Company in Early Adoption**

**1) IFRS 15 - Income with respect to contracts with customers**

The new standard determines a comprehensive and uniform mechanism that regulates the accounting treatment of revenues deriving from contracts with customers. The standard cancels IAS 18 "revenues" and IAS 11 "Construction contracts" and the interpretations accompanying them. The central principal of the standard is that the revenue recognition will reflect the transfer of the goods or the services to customers in an amount that represents the economic benefits that the Company is expecting to receive in consideration for them. For this purpose, the standard determines that the recognition of revenue will exist when the Company transfers to the customer the goods and/or services designated in the contract with him in such a manner that the customer gains control over those goods or services.

The standard determines a five stage model for implementing this principle:

- Identifying the contract (or contracts) with the customer.
- Identifying the performance obligations of the contract.
- Determining the transaction price.
- Allocating the transaction price to the performance obligations.
- Recognizing the income when the Company completes the performance obligations.

Implementing the model depends on facts and circumstances specific to the contract and sometimes requires extensive exercise of discretion.

Furthermore, the standard determines extensive disclosure obligations regarding contracts with customers, the significant assessments and amendments to them that were used when implementing the instructions of the standard, in order to enable the users of the financial statements to understand the nature, quantity, timing and reliability of the revenues and cash flow deriving from the contracts with the customers.

The standard shall enter into a binding effect regarding annual reporting periods commencing from January 1, 2018. Early implementation is possible. In general, the standard will be retrospectively implemented, but entities will be permitted to choose certain adjustments within the framework of the standard's transitional provisions regarding its implementation for prior reporting periods. The FASB and IASB are considering an amendment to the standard in order to clarify the basic principles on which they were based.

At this stage, the Company is studying the effect of the implementation of the standard's provisions on the contracts with its customers and manner of recognition of the revenue from them. This examination has not yet ended.

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**NOTE 2:- REPORTING RULES AND ACCOUNTING POLICIES (continued)**

**z. New Standards and Clarifications Published which are effective and were not Adopted by the Company in Early Adoption (continued)**

**2) IFRS 9 (2014) "Financial Instruments"**

The International Financial Reporting Standard (2014) IFRS 9 "Financial Instruments" (hereinafter: the "Standard") is the final Standard of the financial instruments project. The Standard cancels the previous stages of the IFRS 9 that were published in 2009, 2010 and 2013. The final Standard includes classification and measurement provisions for financial assets that were amended with respect to those published in the first stage in 2009, and also includes the classification and measurement provisions for financial liabilities as published in the second stage in 2010, offers a more updated model based on principles regarding hedging accounting, and presents a new model for examining forecasted loss from impairment, as detailed below. Additionally, the Standard cancels the interpretation IFRIC 9 "Reexamination of Embedded Derivatives".

Financial assets:

The standard determines that all the financial assets are to be treated as follows:

- Debt instruments will be classified and measured subsequent to initial recognition at amortized cost or at fair value through profit or loss, or fair value through other comprehensive income. The measurement model will be determined based on the Company's business model for managing financial assets and in accordance with the characteristics of the contractual cash flows deriving from such financial assets.
- A debt instrument which, according to the criteria, is measured at amortized cost or fair value through other comprehensive income, may only be designated at fair value through profit or loss if such designation eliminates inconsistencies in the recognition and measurement that would have arisen had the asset been measured at amortized cost or fair value through other comprehensive income.
- Equity instruments will be measured at fair value through profit or loss.
- Equity instruments may be designated at fair value through other comprehensive income upon initial recognition. Instruments that have been designated as aforesaid will cease to be tested for impairment and any related gain or loss will not be recognized in profit or loss, including in the event of disposal.
- Embedded derivatives will not be separated from a host contract that falls within the scope of the standard. Instead, hybrid contracts will be measured as a whole at amortized cost or at fair value, in accordance with the business model and the contractual cash flows criteria.
- Debt instruments will be reclassified only if the Company changes its business model for managing financial assets.
- Investments in equity instruments that are not quoted on an active market, including derivatives on such assets, will be measured solely at fair value. The alternative measurement at cost under certain circumstances has been eliminated. Nevertheless, the Standard determines that, under limited circumstances, cost may be an appropriate estimate of fair value.

Financial Liabilities

The standard also prescribes the following provisions with respect to financial liabilities:

- The change in the fair value of a financial liability that is designated to fair value through profit or loss upon initial recognition, and which is attributed to changes in the credit risk of the liability, is recognized directly in other comprehensive income, unless such recognition gives rise to or increases an accounting mismatch.
- Upon the repayment or settlement of a financial liability, the amount of the fair value recognized in other comprehensive income will not be classified to profit or loss.
- All derivatives, whether assets or liabilities, will be measured at fair value, through comprehensive income, including a derivative financial instrument that constitutes a liability, which is related to an unquoted equity instrument for which a fair value cannot be determined reliably.

Hedging

The Standard sets new hedging provisions and provides an option to choose an accounting policy of implementing the new hedging provisions that will be detailed below in brief or, alternatively, those existing under IAS 39. When the hedging project will be completed in the future, the IASB will again examine the possibility of choosing the stated policy.

Within the standard, the three types of hedge accounting remained unchanged: hedging of cash flows, fair value and net investment in foreign operations. However, material changes were made with regard to the transactions qualifying for hedge accounting, especially expansion of the risks eligible for hedge accounting of non-financial items. Additionally, changes have occurred in the manner in which forward contracts and derivative options will be treated when they constitute hedging instruments.

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**NOTE 2:- REPORTING RULES AND ACCOUNTING POLICIES (continued)**

**z. New Standards and Clarifications Published which are effective and were not Adopted by the Company in Early Adoption (continued)**

**2) IFRS 9 (2014) "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 ratios". Retrospective estimation of the effectiveness of hedging will no longer be required. The disclosure requirements regarding the risk management activities of the Company have been expanded within the new standard.

Impairment

The new impairment model that is based on expected credit losses will be applied to debt instruments that are measured according to amortized cost or fair value through other comprehensive income, receivables with respect to leases, contract assets recognized under IFRS 15 and written obligations for granting loans and financial guarantee contracts.

Provision for impairment will be for forecasted losses according to probability of insolvency during the next 12 months (in the coming year), or according to probability of insolvency for the lifetime of the instrument. An examination throughout the lifetime of the instrument is required if the credit risk has risen significantly from the date of initial recognition of the asset. Another approach applies if the financial instrument is created or purchased when it is credit-impaired.

The standard adds instructions for presentation and disclosure concerning impairments of financial instruments

Date of commencement and possibilities of early adoption

The standard will become obligatory for annual reporting periods starting from January 1, 2018 or later.

As a rule, the provisions of the standard with respect to assets and financial liabilities were implemented retrospectively, except for certain exceptions determined in the transitional provisions of the standard. It was further determined that despite the retrospective implementation, companies implementing the standard for the first time will not be obliged to amend their comparative figures for previous periods. Moreover, comparative figures will be able to be amended only when their amendment as stated does not use hindsight. Provisions relating to hedging will be implemented, in general, in a prospective manner with limited retrospective implementation.

At this stage, the Company's Management is unable to assess the effect of the adoption of the standard on its financial position and operating results.

**3) IFRS 16 - Leasing**

The new standard was published in January, 2016, and cancels IAS 17 "Leases" and the interpretations accompanying it, and determines the principles for recognition, measurement, presentation and disclosure of leasing with respect to both parties to the transaction, namely the client (lessee) and the supplier (lessor).

The new standard cancels the distinction existing at present regarding a lessee, between financial leases and operating leases and determines a uniform accounting model regarding all types of leasing. Pursuant to the new model, the lessee is required, with respect to each leased asset, to recognize the asset with respect to the right of use on the one hand, and the financial liability with respect to the lease fees on the other hand.

The provisions of recognizing the asset and liability as aforesaid will not apply to assets leased for a period of up to 12 months only and regarding the lease of low value assets (such as personal computers).

The standard does not change the present accounting treatment in the lessor's books.

The standard will enter into binding effect regarding annual reporting periods which commence on January 1, 2019, or later. Early implementation is possible, provided that IFRS 15 "Income with respect to contracts with customers" is also implemented. In general, the standard will be retrospectively implemented, but entities will be permitted to choose certain adjustments within the transition provisions of the standard regarding its implementation on previous reporting periods.

The Company has not yet examined the impact of the standard's provisions on the contracts for leasing assets it owns.

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**NOTE 2:- REPORTING RULES AND ACCOUNTING POLICIES (continued)**

**aa. Principal Factors of Uncertainty in Estimates and Accounting Considerations in Applying Accounting Policies**

**1) General**

In application of the accounting policies of the Company described in sections a-z, the management of the Company is required, in certain cases, to exercise extensive accounting judgment with regard to assessments and assumptions concerning the book value of assets and liabilities that are not necessarily available from other sources. The assessments and related assumptions are based on past experience and other factors that are deemed relevant. The results in practice may be different from these assessments.

The assessments and the assumptions on which they are based are continuously examined by the management. Changes of the accounting assessments are only recognized for the period in which an assessment change was executed if the change only affects that period, or recognized for that period and future periods if the change affects the present period and the future periods.

**2) Considerations in implementation of accounting policies**

The following relates to critical considerations, except for those involving estimates (see section 3 below), carried out by the Company in the process of implementing the accounting policy of the Company, and which have a significant impact on the sums recognized in the Financial Statements.

Income Recognition

The Company recognizes income when it is probable that the financial benefits deriving from the transactions will flow to the Company, when this cannot be determined, due to uncertainty as to the ability to collect from the customer, the income is recognized only when the uncertainty is lifted, namely when there is high certainty as to the ability to collect or when the sum is received.

**3) Principal Factors of Uncertainty in Estimates**

a) Fair value of financial instruments

The management of the Company exercises judgment in selecting appropriate estimation techniques for financial instruments that do not have a quoted market price in an active market. The estimation techniques used by the management of the Company are like those applied by market participants. The fair value of other financial instruments is determined on the basis of the capitalization of their forecasted cash flow, based on assumptions supported by observed market prices and rates. The assessment of the fair value of financial instruments that are not listed for trading in an active market includes several assumptions that are not supported by observed market prices and rates. The book value of the financial instruments that are estimated through estimation techniques as of December 31, 2015 adds up to approximately NIS 1,144 million (as of December 31, 2014, approximately NIS 1,394 million).

b) Provision for legal proceedings

Legal claims, including class actions, are pending against the Company. See Note 35 b 1) below.

The management of the Company relies on the opinion of legal and professional advisors in order to examine the legal relevancy of these claims, as well as to determine the probability that they will be realized to its detriment. After the advisors of the Company formulate their legal position and the prospects of the Company regarding the claim, whether the Company will have to bear the consequences or whether it can reject it, the management of the Company assesses the sum that should be recorded in the financial statements, if any. An interpretation to an existing legal situation that is different from that of the legal advisors of the Company, a different comprehension by the management of the Company regarding contractual engagements and changes that originate from relevant case law, or addition of new facts, can affect the value of the total provision with respect to the legal proceedings pending against the Company and thus materially affect the financial position and results of the operation of the Company.

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**NOTE 2:- REPORTING RULES AND ACCOUNTING POLICIES (continued)**

**aa. Principal Factors of Uncertainty Estimates and Accounting Considerations in Applying an Accounting Policy (continued)**

**3) Principal Factors of Uncertainty in Estimates (continued)**

c) Provision for municipal taxes (rates), fees and levies

The Company receives demands with respect to municipal taxes for periods that preceded the report date. These demands mainly derive from a change in classification of the areas held by the Company, a demand to increase charged areas and a demand with respect to municipal tax rates. Additionally, from time to time, the Company receives demands to pay retroactive development levies with respect to the Company sites, with respect to levies that were not demanded by the authorities in the past and/or demands to pay levies for infrastructure works that are currently executed by the authorities.

The Company executes an estimation every cut-off period, including with the assistance of external lawyers and/or receiving external advice from consultants in the field, for the purpose of examining the payment demands versus facts, documents and data held by the Company, and examining the reasonability of the payment demands. Changes that occur in the legal environment, case law and addition of new facts may affect the value of the provision in the books, and thus affect the financial position and the outcome of the operations of the Company (see Note 35 b 7).

d) Employee benefits

The present value of the Company's liability for payment to pension plan and bonuses and to severance pay to its employees is based on a large number of data that are determined on the basis of an actuarial evaluation, while using a large number of assumptions, including the capitalization rate (also see Note 11 h). The Company assesses the capitalization rate once a quarter, and from December 31, 2014, the capitalization rate is based on the high quality Corporate Debentures return rate.

Other key assumptions are determined on the basis of the conditions of the market and the experience accumulated by the Company. For additional details regarding the assumptions used by the Company see Note 11 below.

Changes in the actuarial evaluations may significantly affect the book value of the liabilities of the Company and payment of pension payments and bonuses and severance pay.

e) Assessment of life span of fixed assets and intangible assets

As stated in section h above, the management of the Company examines the useful life span assessment of fixed assets and intangible asset items every reporting year.

f) Regulatory deferral accounts (IFRS14)

The Company applies IFRS 14 to regulatory deferral accounts, the standard requires a regulated body to reassess the likelihood of covering the regulatory assets at every date of publication of financial statements. Additionally, within the framework of the estimates formulated for the purpose of calculating regulatory assets, the Company is assisted by assessments and there is no certainty that the Electricity Authority (the public body regulating the electricity rates) will approve them in the future.

If a conclusion is reached that the Company no longer meets the above mentioned conditions for implementing the standard, and not all of the regulated assets are covered by the rates, or if it turns out that the actual rate update is different from the assessment used in the calculation of regulatory assets, or determination of a new rate in matters for which the Electricity Authority has reached a fundamental decision, then the regulatory assets, or some of them, have to be deleted from the statement of financial position.

g) Classifying fuels inventory in the statements

Based on its forecasts, the Company estimates the expected use of the liquid fuels inventory in its possession. According to these forecasts, the liquid fuels inventory is presented in current assets. Liquid fuels inventory, whose use is expected to occur after a year, is presented in non-current assets.

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**NOTE 2:- REPORTING RULES AND ACCOUNTING POLICIES (continued)**

**aa. Principal Factors of Uncertainty Estimates and Accounting Considerations in Applying an Accounting Policy (continued)**

**3) Principal Factors of Uncertainty in Estimates (continued)**

h) Tangible and intangible asset impairment

The Company examines the need of a provision for the impairment of its assets under IAS 36. Changes in assumptions and assessments are able to affect the forecasts of the results of the operation of the Company, and the need of provision for asset impairment.

i) Accounts receivable

The Company estimates, under statistical models, the revenue from electricity sales during the report period with respect to the relative part of the revenue included in invoices issued after the date of the Statement of Financial Position, which include charges with respect to the report period. The statistical models are based on a statistical simulation that creates several scenarios that are built, inter alia, on electricity generation in practice by the Company and by private producers, losses rate assessment, and the average price estimate.

The estimate of accounts receivable in the Company's books as of December 31, 2015 adds up to approximately NIS 1,627 million (as of December 31, 2014 approximately NIS 2,618 million).

j) Provision for doubtful debts

The Company examines the need of a provision for the impairment of its accounts receivables in accordance with the provisions of IAS 39, which instructs examining the need for a provision for impairment of financial assets.

For this purpose, the Company examines signs of impairment in the period based on past experience, financial difficulties of its customers, not meeting payments, and more. A provision for impairment, i.e. provision for doubtful debts, is determined in accordance with the estimate of the Company that is based on the above mentioned. Actual collection may eventually be different from the assumptions of the Company if the conditions taken into account are changed.

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**NOTE 3:- THE ELECTRICITY RATE**

**a. General**

**1) The Manner of Determining the Charge Rate**

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

- The charge rates shall be determined based on the principle of cost, considering, inter alia, the type and standard of services. Each price shall reflect the cost of the particular service, without any price decreasing at the expense of increasing another. If a subsidy is set in the State budget for the purpose of decreasing a service price, the subsidy amount will be decreased from the cost of that service.
- With respect to the cost, an adequate return on capital rate shall be taken into account, considering the rights and duties of an essential service supplier license holder. The law does not define what an adequate return on capital rate is.
- For the purpose of setting the charge rates, the Electricity Authority shall perform cost control actions for the essential service supplier license holder, and it is entitled not to include expenses which in its opinion are not required for fulfillment of the duties of the essential service supplier license holder.
- When determining the rates of all the consumers, the Electricity Authority will take into account the costs that were not taken into account as a result of the decreased prices.

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

A "rate base" is determined every few years. When determining a "rate base", the Authority determines the manner of its update. A separate "rate base" is determined for every activity segment.

The bases of the transmission and distribution rates came into effect in July 2002 for the years 2002-2005 and have not yet been updated. Until the updating of the rates, which according to the decision of the Electricity Authority will retrospectively apply from April 1, 2012, the Company is receiving payments of advances for these segments (see section c below).

The generation rate came into effect, as stated, in February 2010 for the years 2010-2014 and has not yet been updated (see section b below).

**a) Manner of calculating the costs**

Fuels costs:

The fuels basket is composed of:

- Approved normative fuels quantities are based on running a model which simulates the generation system and includes all the expected unit characteristics and demand. The fuels basket recognized in the rate for a certain year is calculated twice - the fuels basket is calculated on the date of the annual update for the current year on the basis of demand forecasts and on the following annual update date it is recalculated retroactively in accordance with demand that materialized in practice.
- Recognized fuels prices are based on costs, in current prices.

**Operating and maintenance costs**

The recognized sum is determined on the basis of the reporting in the Company books, with the execution of adjustments.

- In the generation segment - according to the average of the years 2002 - 2006
- In the transmission and distribution segments - according to the data of a representative test year - the year 2000

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**NOTE 3:- THE ELECTRICITY RATE (continued)**

**a. General (continued)**

**1) The Manner of Determining the Charge Rate (continued)**

**a) Manner of calculating the costs (continued)**

Capital costs:

The recognized capital costs are determined on the basis of the recognized active assets.

The major capital cost components:

- Depreciation
- Return on equity
- Return on foreign capital

**b) Manner of determining the recognized assets:**

- In the transmission and distribution segment - the recognized assets were determined on the basis of the book costs in 2000 with the execution of adjustments
- In the generation segment, the recognized assets were determined on the basis of the Company's active generation units pursuant to a future outline:  
For the rate recognition, the generation units were divided into two groups:  
"Old units" - units which were activated before December 31, 2002 and the recognition of costs with respect to them is based on the costs in the Company books.  
"New units" - units which were activated after this date and the recognition of costs with respect to them is normative.

**c) Depreciation**

The recognition of the depreciation costs in the various segments is according to the recognition of assets:

- In the transmission and distribution segments - on the basis of the book costs in 2000
- In the generation segment - by division between "old units" and "new units", the recognition of the costs of the new units is pursuant to an outline for the recognized cost of each unit is determined in advance according to its normative activation date.

**d) Return on equity and return on foreign capital:**

Return on equity and return on foreign capital were determined normatively. Within this framework, a normative financial leverage was determined, according to which 1/3 of the assets are financed by equity and 2/3 by foreign capital.

- Return on equity:  
The recognized rates of return on equity, net:  
Generation segment - 7.62%  
Transmission segment - 5.5%  
Distribution segment - 6.2%
- Return on foreign capital:  
There is a normative division of the financing basket of the foreign capital according to the following components:  
NIS (linked) financing basket  
Increased interest NIS financing basket  
Hedged financing basket



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**NOTE 3:- THE ELECTRICITY RATE (continued)**

**a. General (continued)**

**1) The Manner of Determining the Charge Rate (continued)**

**d) Return on equity and return on foreign capital: (continued)**

Following is a table describing the normative financing composition and the cost of foreign capital as of 2015:

	<b>Financing basket composition</b>	<b>Cost of capital</b>
NIS financing basket	70%	4.13%
Increased interest NIS financing basket	21%	5.29%
Hedged financing basket	9%	4.13%

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 rate can be updated due to an annual update or an ongoing update, as follows:

- a) Annual Update – Every year, the Electricity Authority is supposed 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. The components the Electricity Authority is required to update are: capital costs of recognized assets in generation, rates of return, composition of the financing basket, fuels mix, fuels cost update, electricity purchases, incentives, consumption distribution update, etc.  
 On May 25, 2015, the decision of the Authority was published, pursuant to which the annual rate update date will be in the month of July of each year.
- 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 the average wage of a salaried position in the economy.
  - All other components are linked to the CPI.

The current update is executed twice a month.

In the Authority's decision of January 21, 2015, the Authority determined that an actual rate update will be conducted when the one of the following conditions is fulfilled, according to the earliest among them:

- (1) A change in the recognized cost of the input basket of the whole system of at least 3.5%, provided that four months have passed since the last update.
- (2) The date of the annual update, as of 2016.

Since the consumer rate, as stated, is not updated as a result of every change in the input basket, there is a "fund" named "Compensation with respect to delay in update" into which the gap between the recognized input basket and the actual income is accumulated.

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**NOTE 3:- THE ELECTRICITY RATE (continued)**

**a. General (continued)**

**3) 2015 Annual Update**

On September 7, 2015, the Authority published a decision pertaining to the 2015 annual update (hereinafter: the "Decision").

Following are the principal points of the Decision:

- a) Rate update - there was an average decrease in the electricity rate of 5.89% as of September 13, 2015, compared with the rate that entered into effect on February 1, 2015, where approximately 1.5% of this decrease derives from the determination of a system rate.
- b) System costs (system management rate) - it was determined that the costs defined by the Authority as "system management services" will apply to all the electricity producers and not only to the consumers of the Company as was the case so far. For additional details see section e below.
- c) Recognized costs with respect to fuels - the final fuels basket for 2014 and the forecasted fuels basket for 2015 were calculated on the basis of a market model.
- d) A supplement to the recognized cost with respect to new rate bases in the grid's segments - there is no change in the sum of the advance given to the Company in 2015 regarding the update of the rate base in the transmission and distribution segments and it stands at approximately NIS 700 million. For additional details see section g below.  
The Authority decided that the advance given to the Company as a supplement to the recognized costs for the various grid segments will be deposited in a dedicated account as of the annual update date and until determination of a new rate base for the grid's segments. These sums will be released for investment purposes in the grid segments according to a mechanism which was determined (see also section g below).
- e) Supplements to the operating costs recognized in the generation segment - as of January 1, 2015, the amortization factor which was imposed on the operating costs in the generation segment at a rate of 2% per year was suspended, until determination of a new rate base for the generation segment. The efficiency rate accumulated until December 31, 2014 will continue to be included in the recognized cost of the operating costs in the generation segment.
- f) Capital services costs in the generation segment -
  - It was determined that capital services with respect to the full costs of conversion to gas, piping, and connection fees for the Ramat Hovav site will be recognized for the Company.
  - A decision regarding recognition of the full costs of conversion at the Haifa site has not yet been determined.
  - The supplement with respect to the additional beyond normative construction costs of the Haifa combined cycles (units 3 and 4) was decreased.
  - The Company's request for recognition of additional costs beyond normative costs with respect to Gezer 3 and 4 combined cycle and the Alon Tavor steam addition was rejected definitively.
  - A costs supplement with respect to interest costs during construction of the Hagit combined cycle has been recognized.
  - A costs supplement with respect to interest costs during construction of the shared assets which served to construct the new generation units of the Company has been recognized.

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**NOTE 3:- THE ELECTRICITY RATE (continued)**

**a. General (continued)**

**3) 2015 Annual Update (continued)**

- g) Costs with respect to arrangements for managing shortage and with respect to electricity purchases - the Authority notified that as the Company did not properly report with respect to the arrangements, the Authority could not perform costs control of this arrangement, and so the Authority only recognized 80% of the costs of arrangements of initiated divesting through operation of independent generators, voluntary divesting and frequency divesting for 2014. The Company estimates with high likelihood that these costs will be recognized for it within the coming annual update.
- h) Hedge mechanism - the hedged capital amount will remain in effect until application of a new rate base for the generation segment.
- i) The decision of the annual update for 2015 entered into effect on September 13, 2015.

**4) Regulated Mechanism for Ruling and Rate Recognition**

The Company has been operating for a long time to establish a regulated mechanism for pre-ruling that will provide the Company with, inter alia, evaluation of certainty regarding the expected rate coverage, before entering execution of major and material projects. Furthermore, the Company is operating to establish a mechanism for recognition of exogenous costs which are not included in the rate base, which it is obliged to bear by virtue of the law.

**b. The Generation Segment Rate**

- 1) The rate base for the generation segment was determined for the years 2010-2014. Pursuant to the Authority's requirement, the Company will deliver data and material required for the purpose of determining a new rate base for the generation segment.
- 2) Following the Company's request to retrospectively apply the new generation rate base from January 2015, the Authority clarified to the Company that as long as a new rate base has not been determined and a new decision has not been reached, the rate determined in the rate base book for 2010 is valid.

**c. The Transmission and Distribution Segments**

The update of the rate base in the transmission and distribution segments was determined by the Electricity Authority in 2002, on the basis of data which was correct in 2000. The Authority determined in its decision of 2002 that these rate bases will be in effect until 2005. However, since then, the Authority has not determined a new, appropriate and updated rate base for these segments, despite repeated applications by the Company.

On November 30 2015, the Company filed a petition with the Supreme Court in Jerusalem, sitting as the High Court of Justice, to grant orders nisi against the Electricity Authority. Within this petition, the Court was requested to issue an order nisi directed towards the Electricity Authority, instructing it:

- (a) to publish within 45 days a document for a hearing for public comment on the issue of a new rate base in the electricity transmission, distribution and supply segments.
- (b) to reach a decision within 60 days from the date of publication of the document for the public hearing on the basis of the new rates for these segments.
- (c) to refrain from any reduction in the electricity rates, until the entry into effect of the new rate base.

The Court was requested to issue orders nisi as stated, and after a hearing to instruct on converting them to absolute.

According to the decisions of the Electricity Authority, as of April, 2012 the Company is receiving advances as an addition to the recognized cost for the transmission and distribution rates. Additionally, the amortization factors applicable to these segments were suspended. The rate of the advances was an annual amount of approximately NIS 300 million as of April 2012, and as of April 2013 in an annual amount of approximately NIS 400 million. In the decision of the Authority regarding the 2014 annual update, the Authority increased the amount of the advances for 2015 by approximately NIS 300 million such that the total advance amounted to approximately NIS 700 million.

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**NOTE 3:- THE ELECTRICITY RATE (continued)**

**c. The Transmission and Distribution Segments (continued)**

As of 2012, all the advances received on account of the recognized cost addition for the transmission and distribution rates and suspension of the amortization factors were charged in the Company books as income and not as advances in light of the lack of cover which exists in the transmission and distribution sectors. Reinforcement for this position was received in February 2015, in light of the Authority's demands to allocate the advances to investment needs in the grid's segments.

In October, 2015, the Company received a report prepared by the consulting company on behalf of the Electricity Authority (hereinafter: "Navigant") regarding the updating of the rate bases for transmission and distribution, before the Electricity Authority's plenum formulated its position in preparation for a hearing for the grid's rates' base. The draft report adopted the methodology proposed by the Company, according to which its income recognized in the rate will be based on investment and operating forecasts in the segments of the grid. A retrospective update mechanism of the recognized income will apply, based on the Company's performance in practice, with the Authority executing thorough control and requiring detailed reports. Additionally, Navigant accepted the Company's request to increase the net recognized yield rate to equity to approximately 7.7%. Furthermore, Navigant recommended to transfer to a nominal rate. However, the findings of the draft report pointed to high salaries of the employees of the Electric Company compared to the average salary of the market, compared to the U.S.A. In view of this, the recommendation of the draft report was not to recognize in the rate approximately 34% of the salary costs of the Company. The Company appealed this recommendation.

The Company is of the opinion that the recommendations of the report do not indicate as to the final decision that will be made by the Electricity Authority. Regarding this, the Authority noted that a sub-committee on its behalf is examining the findings of the report in preparation for a public hearing and is not obliged to accept this report. Notwithstanding, if the recommendations of the report are fully accepted by the Electricity Authority, it will have a material impact on the financial results of the Company, both in terms of expected growth in income and possibility of provision for impairment of assets.

**d. Adjustment of the Rate to the Implications of the Adoption of International Financial Reporting Standards**

As of January 1, 2015, the Company has transitioned to full implementation of the International Financial Reporting Standards (IFRS) in the Financial Statements of the Company (see Note 2 a 1 above).

On December 14, 2015, the Authority published its decision regarding the rate approach to the transition to nominal financial reporting. This decision enables the Company to record, as of January 1, 2016, part of the linkage differences balance as regulatory accounts.

This decision by the Authority does not affect the sum of the electricity rate.

The Company is of the opinion that transition to full implementation of IFRS, as stated, should be accompanied by a suitable rate or accounting solution, in order to reflect the nominal financing costs and ensure the adequate return on equity as well as execution of rate updates, so that significant arrears will not be created between the sums due to the Company or the electricity consumers and the date of their collection, in order to prevent serious damage in future that will result in erosion of the Company's equity and make it harder to raise funds.

In light of this, the Company is of the opinion that the transition to reporting under the IFRS standards and the accompanying partial solution in the decision of the Electricity Authority, as detailed above, constitute a partial accounting solution which will enable the nominal financing costs to be reflected, but does not fully solve the erosion of the Company's equity.

The Company is of the opinion that the Authority must set a mechanism which will provide a complete solution to the transition to nominal reporting in the long term, through rate cover by the method of nominal reimbursement.

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**NOTE 3:- THE ELECTRICITY RATE (continued)**

**e. Determining a Rate for the System Management Service (System Costs)**

On August 6, 2015, after a long period during which cross subsidization existed between consumers of the Company and consumers from private producers and a public hearing of almost one year, the Electricity Authority published a decision according to which the system management rate will be imposed on all the electricity sector's consumers.

These rates will apply as of September 13, 2015. This rate is not supposed to change the total revenues of the Company, but is rather intended to cause a more equal allocation of the burden of costs among the various electricity producers in the sector. This rate includes administrative system management costs, system balancing services costs, costs with respect to backup services and auxiliary arrangements. The administrative costs as determined in the decision are temporary until determination of the transmission and distribution rate base.

The total Company's current costs with respect to 2015 from this rate are estimated at approximately NIS 3.2 billion (approximately 5.4 Agorot per kWh). Of this, approximately NIS 1 billion was deducted from the recognized costs in the generation segment including fuel (approximately 1.7 Agorot per kWh). The remaining costs, except for the administrative system management costs, do not actually constitute part of the cost recognized for the Company with respect to its operation and it only serves as conduit for money transfer of these costs.

The recognized costs of all the system management services for the current year will be updated once a year on the basis of forecasts, and on the annual update date, these costs will be updated according to actual data.

Accounting will be made between the forecasted costs and the actual costs in the previous year and payment with respect to the gap will be returned through the Compensation with Respect to Non-consecutive Rate Update mechanism.

As a condition for recognition of the system management costs, the Company will be required to report the system management services revenues and expenses in a separate special report which will be published in the Electricity Authority's website.

On September 13, 2015, an updated decision by the Electricity Authority was reached regarding the system rates. Within the decision, the accrued debt of the private producers and independent producers with respect to system management rates for the period between June 1, 2013 and June 30, 2015 was updated to NIS 465 million instead of NIS 360 million in the original decision of August 10, 2015. However, the final calculation of the debt will be for the period between June 1, 2013 until September 13, 2015, and interest and linkage will be added to it. This sum will be returned to the Company's consumers through the electricity rate.

On December 23, 2015, the Company submitted a petition against the Electricity Authority pertaining to the determination of a rate for the system management services (system rates).

Within this petition, the Court was requested to instruct the Electricity Authority to recognize the Company's complete system costs, and not to only partially recognize these costs, as it decided with respect to various components which are included in the system rate and detailed in the petition; to determine that the determination of the Electricity Authority, which was given within the decision, that it will execute a reduction of 10% of the system rate regarding past debts accumulated by private electricity producers with respect to the electricity system management services, which they benefited from in the period between June 1, 2013 until the date the decision was reached, is void, and alternatively, is voidable and it is reasonable and just to cancel it; and to instruct the Electricity Authority to refrain from making use of discriminating and arbitrary methodologies when determining the system costs, as detailed in the petition.

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**NOTE 3:- THE ELECTRICITY RATE (continued)**

**e. Determining a Rate for the System Management Service (System Costs) (continued)**

In relation to the Electricity Authority's decision which was published on August 10, 2015, regarding the determination of a rate for system management services (system rates), pursuant to which, inter alia, the system management rate will be imposed on all the electricity consumers in the sector, a number of petitions were submitted against the Electricity Authority and the Company by private electricity producers:

- On September 10, 2015, the Ashdod Refinery Paz Company Ltd. submitted a petition against the Electricity Authority and the Company to the High Court of Justice with respect to the decision, as stated. The Company submitted its response to the petition which requested an interlocutory order. On December 27, 2015, the High Court of Justice rejected the application of Ashdod Refinery Paz to receive an interlocutory order ex parte, and determined that the petition for granting an interlocutory order will be determined by a panel of 3 judges.
- On November 19, 2015, the Hadera Paper Company Ltd. also submitted a petition to the High Court of Justice against the Electricity Authority and the Company pertaining to the stated decision. On November 26, 2015, the High Court of Justice granted an interim injunction ex parte, under which the Company is prevented from collecting a system management costs rate (from the Hadera Paper private electricity producer). The Company submitted a preliminary response to the petition and the application for an interlocutory order. On February 17, 2016, the High Court of Justice dismissed the Hadera paper's petition to grant an interlocutory order against the Electricity Authority and the Company regarding the system management costs rate, and even cancelled the interim injunction it had granted in this matter on November 26, 2015, as stated. The primary petition was set for a hearing in September 2016.
- On December 28, 2015, the Oil Refineries Ltd. submitted a petition against the Electricity Authority and the Company, requesting an order nisi and an interlocutory order regarding the system costs rate.
- On February 4, 2016, the Company was added as a respondent to the petition by the Israel Chemicals Ltd., Rotem Amfert Negev Ltd., and Hadera Paper Works Ltd. companies against the Electricity Authority, which includes an urgent application to grant an interlocutory order and an interim injunction, also with regard to system costs rate.

The Supreme Court rejected the application of the independent producers for interlocutory orders, submitted by the Oil Refineries Ltd., Paz Ashdod Refineries Ltd., Israel Chemicals Ltd., and Hadera Paper Works Ltd., pertaining to the decision of the Electricity Authority regarding the system rates. In addition, it was decided that there will be a consolidated hearing of all the petitions (including the Company's petition) regarding the system rates, and it was set for September 12, 2016.

Based on the opinion of the Company's legal advisors, the Company estimates that it will collect from the private suppliers and self-producers the income due to it with respect to the system costs rate.

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**NOTE 3:- THE ELECTRICITY RATE (continued)**

**f. Project to Reduce Emissions at the Coal-Powered Power Stations**

- For details of the Company's commitment to implement the project to reduce emissions at the coal-powered power stations, see Note 1 g above.
- On December 8, 2015, the Company learned of the Authority's decision regarding recognition of costs of installations for reducing emissions at the Orot Rabin 5-6 generation units and the Rutenberg 1-4 generation units (which bears the date of November 25, 2015). Pursuant to the decision, the Authority will recognize the costs of the emission reduction installations in accordance with the budget which was prepared and approved by the Company as of 2013. Interest costs during construction according to recognized yield and according to the date of activation and a normative construction period, as will be set by the Authority, will be added to these costs. The recognition of costs will apply from the activation date of each installation on the annual update date after activation of the installation. Recognition of the cost of shared installations will be divided among the units. The life of the installations will be 25 years from the date of activation of the installation. Additionally, the life of the coal units will be extended and will be 25 years from the date of return to operation of each coal unit.

The Company opposes the Authority's decision regarding the extension of life of the coal units, as aforesaid. Additionally, it should be noted that when taking into account, inter alia, the complexity of the project and the passage of time since the date the budget was prepared by the Company, there are at present additional costs in material amounts.

In addition, under the Authority's decision, the Company's request to recognize a supplement for the operating costs with respect to the project will be examined subject to delivery of detailed data of the operating costs (see Note 1.g.4 above). The Company intends to deliver detailed information to the Authority regarding the additional operating costs of the coal generation units, which derives from operating the emission reduction installations, in order to receive recognition with respect to them.

The Company has extremely significant objections both as regards the manner of the Authority's decision making (without executing a hearing proceeding, as required according to the Company's position), and regarding some of the determinations in the decision.

In view of this, on December 31, 2015, the Company submitted a petition to the High Court of Justice, requesting to grant orders nisi against the Electricity Authority regarding the above mentioned decision. Within this petition, the Company demanded to conduct a hearing regarding all the issues included in the above mentioned decision, and to reach an updated/amended decision on the basis of the material presented to it.

On March 10, 2016, the notice of the Electricity Authority was received, regarding a later hearing on the above mentioned Authority's decision. The Authority clarified that reaching the decision within a hearing will be executed after a plenum will be appointed for the Authority, with powers to determine rates in the electricity sector - and the Authority is supposed to submit its response to petition to the High Court of Justice on March 17, 2016. See Note 2.h above.

- On November 29, 2015, the Electricity Authority delivered to the Director General of the Ministry of National Infrastructures, Energy and Water its response to the alternatives for emission reduction at the Orot Rabin 1-4. The position of the Authority is that the alternative of installing installations for emission reduction (scrubbers) in the above mentioned units should be chosen.

**g. A Designated Account for Financing the Transmission and Distribution Projects**

In the Authority's decision of September 2015 on the issue of the 2015 annual update, the Authority determined that the amount of the annual advances will remain unchanged in relation to the 2014 annual update. The amount of the advances in current terms is NIS 700 million. In addition it was determined that the Company will deposit the full sum of the annual advance of approximately NIS 700 in the designated account in 12 equal monthly deposits commencing from the date of the annual update and until a new rate base for the grid's segments is determined. After talks conducted by the Company with the Electricity Authority and consents reached by the parties, after the statement of financial position date, the Company deposited and released funds in accordance with the mechanism agreed upon between it and the Electricity Authority.

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**NOTE 3:- THE ELECTRICITY RATE (continued)**

**h. Decision of the Authority Regarding Irregularities between the Costs Recognized in the Electricity Rates and the Company's Actual Costs**

On February 9, 2015, the Authority published a decision, under which the Company is required to annually report to the public about the differences between the actual costs in that year compared to the costs recognized in the electricity rate, according to activity segments, in accordance with the format presented in the decision. The decision entered into effect from the date of publication of the 2014 Financial Statements. Additionally, under the decision, these reports for the years 2010-2013 will be displayed retrospectively on the Company's website within three months from the date the decision was reached. In accordance with the consent with the Electricity Authority, the report for 2014 was reported within the 2014 Prospectus and Annual Financial Statements. Additionally, the Company has delivered a report for 2013 to the Authority for its response.

**i. Implementation of Reporting Obligations on the Company**

On January 15, 2015, the Authority published a decision on the implementation of reporting obligations on the Company, in which the Authority imposes on the Company regular annual, quarterly and monthly reporting obligations. The reporting dates the Company is required and will be required to meet are according to the decision.

The obligation to report is a requirement to receive, in a format and on fixed dates, quantitative, financial, technical and professional data relating to the Company's entire operations, and it is aimed at regulating and facilitating the interface between the Company and the Electricity Authority, to create a comprehensive reporting format for the Company, to spare detailed data demands from the Company from time to time and thus to increase efficiency of work processes with the Company and assist the Authority in determining and updating the rate and in ongoing follow-up of deviations from the framework of the rate. Most of the data is required to be reported on June 1 of each year, pertaining to the past year.

The Company applied to the Authority, requesting a solution for the Company's inability, at this stage, to comply with some of the data requirements in the required reporting format. The Company needs comprehensive preparation that will include development of supportive information systems and allocation of managerial resources in order to meet the requirements of the report. During 2015 and until February 2016, the Company delivered to the Authority a report regarding data it was required to report with respect to 2013-2014.

The Authority's decision regarding implementation of the reporting duties on the Company - system management segment as of October 26, 2015 included details of the reports required by the system management including instructions as to their submission with attachment of a declaration signed by the system management, details of the required dates in accordance with the frequency of the reports, details of the reports which will be published for the public and general instructions regarding details of the powers and sanctions held by the Authority in case of delay in the data submission. The reporting requirements include extensive chapters with data regarding generation and consumption, financial reporting and demand management. The company is required to report on June 1 of every year in relation to the previous year.

The Company applied to the Authority with a request to hold urgent discussions on the subject in order to clear all the open issues in regards to the implementation of the decision.

**j. Pension Costs**

The Authority has not yet completed its examination concerning the rate recognition of the pension costs of the Company. There is only partial recognition of the pension costs in the present rate.

From time to time, the Company delivers data in the matter, in accordance with the demand of the professional team of the Authority.

The Company estimates that at the end of the procedure, the Authority will approve the entire pension costs since these costs are an integral part of the wage components that are backed by various agreements and approved by the relevant regulators (subject to decisions by the Supervisor of Wages regarding wage deviations).

Regarding this issue, within a hearing of a class action against the Company with respect to the pension, the Court ruled that the Electricity Authority has to hold a discussion and reach a decision by April, 2016. (For additional details see Note 35b.2)a)(1) below).



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**NOTE 3:- THE ELECTRICITY RATE (continued)**

**k. Distribution and Electricity Supply Licenses**

The Electricity Authority is operating to provide electricity distribution licenses to additional entities besides the Company. The Company opposes this and will act with the means at its disposal against these decisions, insofar as will exist.

On January 15, 2015, the Electricity Authority reached a decision which ratified a previous decision of the Authority of June 25, 2012, for providing electricity distribution and supply licenses to the Shean (Electricity) Development Company Ltd. (hereinafter: the "Shean Development Company"), that were in force until January 1, 2015. The Shean Development Company supplies electricity to plants in the industrial area that is close to Beit Shean. The distribution license was granted for a period of one year that begins on the date that the permit is received. The supply license was granted until June 30, 2015. The licenses entered into force upon receiving the Minister's approval of March 1, 2015.

On September 24, 2015, the Company submitted a petition against the Electricity Authority, Sha'ar Hanegev Energy Supply and Tapugan Industries Ltd. In the petition, the Company requests the Court to cancel the Electricity Authority's demand so that the Company will not have to connect the Tapugan Industries' plant to the Company's electricity grid and to cease the activity of distribution services supply in the region of the Sha'ar Hanegev Industrial Area. The Company also requests that the Court will instruct the Electricity Authority to cease all activity, instruction or decision pertaining to the privatization of the electricity sector and electricity distribution in Israel, including with regard to determining reduced rates for entities engaging in electricity distribution or supply and/or providing permits and/or licenses to distribute or supply electricity, before the completion of the reform and structural change of the electricity sector.

Sha'ar Hanegev Energy Supply and Tapugan Industries Ltd. submitted their responses to the petition. According to the Court's decision, the Electricity Authority has to submit a response on its behalf by April 6, 2016.

On December 13, 2015, the Company received the decision of the Electricity Authority regarding the grant of distribution and supply licenses to distribution companies in the Kibbutzim connected to the distribution grid, as detailed in the decision. Within the decision the Authority decided, for the first time, to grant distribution licenses for a period of 20 years and to grant supply licenses until January 1, 2017, to dedicated distribution companies which were established by the Kibbutzim, in accordance with the outline to regulate the legal activity of historical electricity suppliers, under that determined in the Authority's decision of August 11, 2009. The stated licenses will enter into effect upon receiving the approval of the Minister of National Infrastructures, Energy and Water.

**l. Recognition of the Cost of Extending the Lease Period of the Gasification Ship by the Electric Company**

On June 22, 2015, the Company applied to the Authority, requesting to recognize cost with respect to extension of the lease period of the gasification ship for supply of LNG. On October 26, 2015, the Authority's decision was received, under which it was decided to recognize in principle the Company's cost with respect to extending the lease period of the gasification ship, which ends in October 2017, for two additional years, subject to the following conditions: recognition of the lease cost which will not exceed the present lease price and under conditions which will not be less than the present lease conditions. The Company has to examine the profitability of continuing the extension of the lease period beyond the two additional years and until the development of an additional gas reservoir for the sector, and present it to the Authority.

Recognition of the operating costs will be executed subject to delivery of a report by the Company and cost control. The lease and operating costs will be grossed up in the system management rates according to the methodology set in these rates.

On December 28, 2015, a letter was received from the Authority, under which according to the examination of the draft agreement for leasing the gasification ship which was transferred to the Authority, the professional team will recommend recognizing the costs of leasing the ship in the annual updates of each year.

During the new leasing period, the lease and operating costs will be grossed up in the system management rates in accordance with the methodology determined in these rates.

**m. Changes and Updates in Consumption Criteria**

On December 16, 2015, the Company received the decision of the Electricity Authority of November 25, 2015, regarding changes and updates in consumption criteria, in which the Authority added fines to the Company with respect to noncompliance with criteria which did not exist previously, and also increased the credit days of the consumers. The decision includes many implementation requirements from the Company within a short time frame. Noncompliance with the new criteria can create financial exposure for the Company. The Company is studying the implications of the decision.

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**NOTE 4:- CASH AND CASH EQUIVALENTS**

	<b>As of December 31</b>	
	<b>2015</b>	<b>2014</b>
	<b>NIS in millions</b>	
Cash and balances in banks .....	124	22
Short-term deposits* .....	2,400	4,482
<b>Total cash and cash equivalents .....</b>	<b>2,524</b>	<b>4,504</b>

\*As of the date of the Statement of Financial Position, there are Dollar and NIS deposits (see Note 27 f for currency spread)

The average interest for Dollar deposits ranges between 0.5%-0.85% (according to the deposit period).

The average interest for NIS deposits ranges between 0.08%-0.2% (according to the deposit period).

**NOTE 5:- SHORT TERM INVESTMENTS**

	<b>As of December 31</b>	
	<b>2015</b>	<b>2014</b>
	<b>NIS in millions</b>	
Designated account .....	-	85
Short-term deposits * .....	407	2,474
<b>Total short term investments .....</b>	<b>407</b>	<b>2,559</b>

\* Dollar and Euro deposits for a period exceeding three months. The average interest for these deposits ranges between 0.55% and 0.04%.

**THE ISRAEL ELECTRIC CORPORATION LIMITED**  
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**NOTE 6: TRADE RECEIVABLES FOR SALES OF ELECTRICITY**

**a. Composition**

	As of December 31	
	2015	2014
	NIS in millions	
Open debts (1) .....	4,037	3,270
Provision for doubtful debts .....	(550)	(561)
Unrecognized income (2) .....	(590)	(281)
	2,897	2,428
Income receivable (3) .....	1,627	2,618
<b>Total customer receivables with respect to electricity sales .....</b>	<b>4,524</b>	<b>5,046</b>
Stated in current assets .....	4,145	4,546
Stated in non-current assets .....	500	500
Stated in non-current liabilities .....	(121)	-
<b>Total customer debt with respect to electricity sales .....</b>	<b>4,524</b>	<b>5,046</b>

(1) Also includes balance with respect to the accumulated debt of the private suppliers and self-generators with respect to the system management rates for the period from June 1, 2013 to September 13, 2015, offset by balances with respect to liability to return sums to the Company's consumers with respect to these rates (also see Note 3 e above).

(2) The above mentioned relates to income from various customers throughout the Palestinian Authority (hereinafter: the "Palestinian Authority") and the East Jerusalem Electricity Company as detailed in section c below. Regarding the examination of the manner of recognizing the income see Note 2 p.1)b) above.

(3) Income with respect to the relative part of the electricity invoices issued after the date of the Statement of Financial Position, that according to an estimate relate to the relative reporting period.

The last date for paying electricity bills without charging interest is between 11 to 14 days from the date of preparation of the bills according to the type of customer as detailed in the criteria of the Electric Authority. After this period, customers are debited with an annual interest at a rate of approximately 8.1% with respect to the balance of their debt. Regarding the update of the consumption criteria which includes an update of the days of credit given to the Company's customers, see Note 3.m. above.

According to the accounting policies, interest revenue with respect to arrears from electricity customers are recorded at the time of collection of the debt with respect to which they were accrued.

**b. 1) Aging of all outstanding customer receivables before provision for doubtful debts on the report date:**

	As of December 31	
	2015	2014
	NIS in millions	
From 2 months to 3 months .....	517	524
From 3 months to 6 months .....	368	516
From 6 months to one year .....	346	458
From one year to two years .....	593	583
Over two years .....	379	124
<b>Total .....</b>	<b>2,203</b>	<b>2,205</b>

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**NOTE 6: TRADE RECEIVABLES FOR SALES OF ELECTRICITY**

- b. 2) Aging of all outstanding customer receivables which were provided for doubtful debts, except for the debts of the East Jerusalem Electricity Company and the Palestinian Authority (see section c below):

	As of December 31			As of December 31		
	2015			2014		
	(in NIS millions)			(in NIS millions)		
	Balance before provision for doubtful debts	Provision for doubtful debts	Balance after doubtful debts	Balance before provision for doubtful debts	Provision for doubtful debts	Balance after doubtful debts
From 2 months to 3 months.....	258	8	250	227	6	221
From 3 months to 6 months.....	124	13	111	162	15	147
From 6 months to one year.....	89	26	63	113	32	81
From one year to two years.....	63	25	38	69	32	37
Over two years.....	134	101	33	124	90	34
<b>Total .....</b>	<b>668</b>	<b>173</b>	<b>495</b>	<b>695</b>	<b>175</b>	<b>520</b>

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**NOTE 6: TRADE RECEIVABLES FOR SALES OF ELECTRICITY (continued)**

- c. 1) Below are details of the balances of the Palestinian Authority and the East Jerusalem Electricity Company after provision for doubtful debts and income that was not recognized from the customers' balance:

	<b>As of December 31</b>	
	<b>2015</b>	<b>2014</b>
	<b>NIS in millions</b>	
Issued invoices.....	1,684	1,701
Receivables.....	137	148
<b>Total debt</b> .....	<b>1,821</b>	<b>1,849</b>
<b>Less:</b>		
Provision for doubtful debts previous periods.....	(386)	(154)
Decrease (increase) in provision for doubtful debts in the period .....	8	(232)
Income not recognized previous periods .....	(281)	-
Income not recognized in the period .....	(309)	(281)
<b>Total debt with respect to sale of electricity</b>	<b>853</b>	<b>1,182</b>
Presented in current assets .....	353	682
Presented in non-current assets .....	500	500
<b>Total debt with respect to sale of electricity</b> .....	<b>853</b>	<b>1,182</b>

- (a) Of the total income not recognized in the year ended on December 31, 2015, approximately 82% is attributed to the East Jerusalem Electricity Company and approximately 18% is attributed to the Palestinian Authority. Of the total income not recognized in the year ended on December 31, 2014, approximately 64% is attributed to the East Jerusalem Electricity Company and approximately 36% is attributed to the Palestinian Authority.
- (b) Of the total net debt balance as of December 31, 2015, approximately 67% is attributed to the East Jerusalem Electricity Company and approximately 33% is attributed to the Palestinian Authority. Of the total net debt balance as of December 31, 2014, approximately 61% is attributed to the East Jerusalem Electricity Company and approximately 39% is attributed to the Palestinian Authority.
- (c) The exposure of the Company with respect to these debts is the total open debt less provisions and less V.A.T grossed in it. In light of the fact that pursuant to the V.A.T laws, if the debts become bad debts, the tax authorities will grant a tax refund for the V.A.T grossed in the debt. The total exposure of the Company is NIS 599 million, and NIS 923 million as of December 31, 2015, and December 31, 2014, respectively.
- 2) The payments of the Palestinian Authority and the East Jerusalem Electricity Company are executed both through transferring payments of the two and through transfers that the Company received from the Ministry of Finance, out of the sums held by the Ministry of Finance that are at the disposal of the Palestinian Authority. As the invoices are not paid in full, the management of the Company is acting to collect the debts both by way of collection operations (such as reducing the electricity supply) and by legal means as stated below. Additionally, the Company applies to the relevant State entities in order to bring about the collection of the stated debts.
- a) On May 8, 2014, the Company submitted an action to the Jerusalem District Court against the East Jerusalem Electricity Company in the amount of approximately NIS 531 million. In this action, the East Jerusalem Electricity Company is demanded to pay the Company the debt for electricity provided to it in the period of up to October 2013, which has not been paid up to the present.

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**NOTE 6: TRADE RECEIVABLES FOR SALES OF ELECTRICITY (continued)**

c. 2) a) (continued)

The Company is examining the possibility of also submitting an action with respect to the balance of the debt of the East Jerusalem Electricity Company for the period after October 2013.

At the Company's request, on May 15, 2014, the Jerusalem District Court gave its decision on the application submitted by the Company to impose a provisional attachment.

According to the decision, given the existence of allegedly reliable evidence for the existence of a cause of action, the Court granted the Company's application, imposing a provisional attachment order (by registry) in the amount of NIS 380 million over the office building of the East Jerusalem Electricity Company and all its assets that are held by banks and credit companies, except for current accounts insofar as they have a debit balance. So far, the Company has seized a few NIS millions through attachment orders.

The East Jerusalem Electricity Company claims that as of March 9, 2016, it has paid the debt with respect to the invoices which are the subject of the action. The Company disagrees with this claim. These claims are expected to be clarified during April 2016.

- b) On June 12, 2014, the Company submitted a petition to the High Court of Justice against the Minister of Finance, The Government of Israel, the Minister of Defense, The Minister of National Infrastructures, Energy and Water, and the Palestinian Authority, requesting the Minister of Finance to use his authority and offset the amount of the debt to the Company from the monies transferred to the Palestinian Authority, and alternatively to address the collection of the debt through the State's budget or by another manner.

On April 20, 2015, in the hearing of an application submitted by the Company as detailed above, the Company expunged the application while maintaining its full rights and other claims.

- c) On June 7, 2015, the East Jerusalem Electricity Company filed a claim against the Company in a total amount of NIS 1,247 million, but the claim was set at only NIS 500 million for purposes of the court fee.

Within its claim, the East Jerusalem Electricity Company raises claims pertaining to two issues it raised within the statement of defense it filed in response to the Company's claim. The first issue is that the Company did not attribute part of the tax money offset by the Ministry of Finance to the debts of the East Jerusalem Electricity Company except for once in December 2012 (the claim amount was estimated by the East Jerusalem Electricity Company at NIS 1.05 billion). The second issue is the entitlement of the East Jerusalem Electricity Company for reimbursement with respect to allegedly erroneous rates it was debited with between 2006-2012 (the claim amount was estimated by the East Jerusalem Electricity Company at NIS 124 million).

Furthermore, the East Jerusalem Electricity Company raised two new financial causes within its claim. The first cause is that the Company allegedly requires the East Jerusalem Electricity Company to pay its bills within 11 days from the issue of the invoices, instead of 20 days according to the criteria, which leads to excessive interest charges (the claim amount was estimated by the East Jerusalem Electricity Company at approximately NIS 53 million). The second cause is that the Company did not execute work to install and enlarge the connecting points of the East Jerusalem Electricity Company, despite allegedly collecting payment from it for this work (the claim amount was estimated by the East Jerusalem Electricity Company at approximately NIS 65 million).

Additionally, the East Jerusalem Electricity Company raises another claim in its statement of claim, according to which the Company invaded the exclusive license area of the East Jerusalem Electricity Company and allegedly took away its possibility to supply electricity in this area. With respect to that statement, the East Jerusalem Electricity Company requests declaratory relief under which the distribution area detailed in its distribution license belongs to it alone and the Company is prohibited from supplying electricity in this area.

The Company submitted an application for stay of proceedings because of the identity of the causes. A decision has not yet been reached in the matter. A statement of defense to the claim of the East Jerusalem Electricity Company was filed by the Company.

A hearing has been scheduled for April 17, 2016. The application for stay of proceedings will be discussed during the hearing.

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**NOTE 6: TRADE RECEIVABLES FOR SALES OF ELECTRICITY (continued)**

- c. 2) d) The Company is examining whether the recognition terms exist in its income from customers in general and from the East Jerusalem Electricity Company and the Palestinian Authority in particular, each one separately, pursuant to the provisions of International Standard no. 18 (see Note 2 p above). Additionally, every period, the Company examines whether there exists objective evidence which indicates that the debt value has been impaired, i.e. the need for provision for impairment of its customer's financial debt pursuant to the provisions of International Standard no. 39 (see Note 2 aa 3) j) above).

The stated examinations included, inter alia, an examination of the pace of the debt collection, various payments means available to the two entities, separately for each one as stated, negotiations with the State entities on this matter, the types of debits with respect to which the debt exists, and more. In accordance with this examination, the Company included adequate provisions.

- e) Talks have been renewed in May 2015 in an attempt to settle the debt with the representatives of the Palestinian Authority, under the auspices of the Ministry of Finance and with the involvement of the Coordinator of the Government Activities in the Territories, the Electricity Authority and other government ministries. These talks, as well as other talks being held regarding this issue, have not yet matured into an agreement.

The Company is examining the implications of the legal proceedings and sources for paying the debt and in accordance has included in the Financial Statements an appropriate provision.

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**NOTE 7:- OTHER CURRENT ASSETS**

	As of December 31	
	2015	2014
	NIS in millions	
<b>Receivables</b>		
Current maturities (loans to employees, chartering tug boats and currency exchange transactions) .....	253	131
Government institutions .....	20	37
Income receivable .....	98	113
Other receivables .....	183	152
	<b>554</b>	<b>433</b>
<b>Debit balance:</b>		
Prepaid expenses	85	58
Deposits for securing swap transactions	76	46
	161	104
	<b>715</b>	<b>537</b>

**NOTE 8:- INVENTORY - FUELS**

**a. Composition:**

	As of December 31	
	2015	2014
	NIS in millions	
Fuel oil(*) .....	417	522
Diesel oil .....	841	1,220
Liquid natural gas (hereinafter: "LNG") .....	22	47
Coal .....	365	479
Coal in transit .....	317	292
Methanol .....	1	2
<b>Total</b> .....	<b>1,963</b>	<b>2,562</b>
Presented in Current Assets .....	839	1,053
Presented in Non-Current Assets .....	1,124	1,509
<b>Total</b> .....	<b>1,963</b>	<b>2,562</b>

**b. Additional information: (\*)**

	2015	2014
Sum of fuel oil inventory recognized as expense during the period due to inventory impairment for the purpose of its sale in the markets .....	23	95
Sum of fuel oil inventory recognized as expense during the period due to decrease in price to net realizable value .....	27	-
	<b>50</b>	<b>95</b>



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**NOTE 9:- LONG-TERM RECEIVABLES**

	As of December 31	
	2015	2014
	NIS in millions	
Natural Gas Lines - gas transmission project (see Note 34b1)a) below) .....	653	709
Receivables for currency swap transactions .....	443	262
Customers with respect to electricity sales .....	500	500
Designated deposit .....	171	300
Other * .....	145	193
Total long-term receivables .....	<u>1,912</u>	<u>1,964</u>
Less – current maturities (see Note 7 above) .....	<u>253</u>	<u>131</u>
	<u><u>1,659</u></u>	<u><u>1,833</u></u>

\* Including mainly loans to employees and chartering tug boats. The majority of loans to employees were at a non-linked annual interest rate of approximately 0.89%. The interest with respect to chartering tug boats was in the annual interest range of 7.9%-8.4% per year, linked to the dollar.

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**NOTE 10:- INVESTMENT IN HELD COMPANIES**

**a. Held Companies:**

**1) Details of the Consolidated Companies of the Company:**

<u>Subsidiary Name</u>	<u>Company Operation</u>	<u>Place of Incorporation</u>	<u>Holding rate of capital rights as of December 31</u>	
			<u>2015</u>	<u>2014</u>
			%	%
National Coal Supply Corporation Ltd.	The company purchases coal for the coal power stations of the Electric Company	Israel	100	100

- a) The National Coal Supply Corporation Ltd. (hereinafter: the "Coal Company") is a company that was established under a decision by the Ministers for Economic Affairs and is subject to the Government Companies Law, and the provisions under it. The Company controls the Coal Company. The Coal Company deals mainly with the sale of coal it imports from abroad to the Company.
- b) On July 15, 2004, the Company signed an agreement with the National Coal Supply Corporation for the purchase and supply of coal for the Company's power stations that consume coal - Orot Rabin in Hadera and Rutenberg in Ashkelon. The agreement is in force from December 31, 2003 and will remain in force for as long as the Company shall have generation licenses for the aforesaid power stations. The Company reserves the right to cancel the agreement with one year's advance notice. The consideration that is paid is calculated based on cost in addition to an agreed upon profit and is subject to the coal price approved for the Company by the Electricity Authority. In 2011, an amendment to the agreement was entered, on the timing of transferring the ownership of coal shipments. According to the agreement prior to the amendment, the ownership was transferred to the Company at the shipping port, causing the outstanding balance owed by the Company to the Coal Company to include a charge for the "inventory on route". According to the amendment to the agreement, the ownership of and responsibility for the coal will be transferred to the Company at the deck of the ship that offloads the coal at the offloading port. The Coal Company will also be responsible for performing all the actions required to release the coal shipments and transfer the ownership to the Company upon offloading the coal from the ship, using the cranes on the quay, including payment of the charges, tolls and taxes.
- c) In the years 2015 and 2014, the Company acquired coal from the Coal Company at a cost of approximately NIS 3,384 million, and NIS 3,793 million respectively.
- d) The Company has financing expenses in 2014 with respect to a loan received from the Coal Company and repaid in 2014 in the amount of approximately NIS 12 million.
- e) Dividends from the Coal Company - In September, 2015, dividends in the amount of NIS 5 million were received from the Coal Company with respect to 2014. Dividends in the amount of NIS 7.5 million were proposed after the statement of financial position date with respect to 2015.
- f) Regarding the contractual engagements of the Coal Company, see Note 35 a 5) below.

**2) Details of Held Companies**

<u>Investee Company Name</u>	<u>Residence</u>	<u>Status</u>	<u>Holding rate of Ordinary Shares</u>	
			<u>December 31</u>	
			<u>2014</u>	<u>2013</u>
			%	%
PAMA Ltd.	Israel	Inactive since 2000	49.99	49.99
Migrashei Kablanim Ltd.	Israel	Inactive	76.00	76.00
Jordan Properties Company (*) Ltd.	Israel	Active	99.98	99.98

(\*) Jordan Properties Company Ltd. holds real estate, registered in its name in the lands register and used by the Company. Jordan Properties Ltd. has two wholly-owned inactive affiliated companies - Ma'abarot Hayarden Ltd. and the Palestine Construction Company Ltd.

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**NOTE 10:- INVESTMENT IN HELD COMPANIES (continued)**

**3) The Advanced Studies Fund of the Employees of the Israel Electric Corporation Ltd. ("Advanced Studies Fund")**

The Company holds 50% of the Management shares and of the rights to appoint Directors (without the right to share the profits) of the Advanced Studies Fund of Company employees. The Company deposits funds in the Advanced Studies Fund with respect to entitled employees, according to employment agreements.

The amounts deposited during the periods are as follows:

	<b>NIS Million</b>
For the year ended on December 31, 2015	80
For the Year ended on December 31, 2014	80

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") by a selection committee comprised of representatives of the state and representatives of the Company.

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.

On July 14, 2013, the Communications Company was incorporated under the name IBC Israel Broadband Company (2013) Ltd. (hereinafter: "IBC"). As stated, the Company holds IBC at a rate of 40% of the share capital and voting rights at a shareholders' meeting of IBC.

IBC is meant to provide fixed line 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, and the founders' agreement of the Communications Company between the Company and the Consortium and a representative of IBC was signed, under which, inter alia, the members of the consortium undertook to transfer loans to IBC, which as of the date of publication of the report have been transferred in full. IBC 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 the second part of the grant, in an amount of approximately NIS 75 million, was transferred to IBC in August 2015, according to consents between IBC and the State. Suppliers of IBC will be paid out of this sum, subject to compliance with the terms that will be determined between IBC and the State.

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**NOTE 10:- INVESTMENT IN HELD COMPANIES (continued)**

**b. Investment in Associate Company (continued)**

On July 16, 2013, five directors were appointed to the IBC Company (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 the IBC Company 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 reflected the fair value of 40% of the share capital of IBC as of the Transaction Date.
- 4) The Company and the employees' union conducted negotiations regarding the demands of the employees for their participation in the rights connected to the communications enterprise. The Companies Authority notified the Company of its objection to presenting the employees with shares, and that this form of remuneration is not acceptable to it. In light of that stated and following this, the Company and the employees' union reached consents pertaining to the remuneration of the Company employees' rights regarding the profit of the Electric Company from the communications enterprise (not by way of giving shares to the employees), subject to receiving all the approvals from the required entities. These consents required the approval of the Companies Authority and the Director of Wages in the Ministry of Finance. The Company submitted a request to receive the approval of the Companies Authority and the Director of Wages for these consents.

The Companies Authority has appointed a special examiner for reviewing the issue of granting rights to the employees with respect to the communications enterprise. The examination has not yet been completed. As of this date, the required approvals for the stated consents have not yet been received from the State entities, and an agreement as stated has not yet been signed.

- 5) According to the information delivered to the Company by the management of IBC, in January, 2016, the management of IBC presented the Board of Directors of IBC with a business plan within which it was made clear that it will not be able to be implemented without adequate funding (from the existing shareholders and/or addition of an external investor and/or financing from external sources). The stated business plan includes, inter alia, significant acceleration of the deployment. The plan was approved by the Board of Directors of IBC, subject to fulfillment of a number of material conditions which include, inter alia, removal of regulatory barriers and raising adequate financing to execute the plan. It was further determined that until the adequate financing is raised, the extent of the deployment will be small.

To the best of the Company's knowledge, as of the date of the report, there is no certainty as to the date of executing capital raising as stated.

- 6) The Company examined the transaction between the Company and the Consortium as detailed in section 2 above 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.
- 7) To the best of the Company's estimate, the IBC Company and its operation have no material impact on the business results of the Company.

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**NOTE 10:- INVESTMENT IN HELD COMPANIES (continued)**

**b. Investment in Associate Company (continued)**

Name of associate	Operation of the Company	Country of incorporation	Holding rate of rights in capital		Scope of investment in the associate (*)	
			As of December 31		As of December 31	
			2015	2014	2015	2014
			%	%	(in NIS millions)	
IBC company	Providing fixed line telecommunications services to communication operators and business customers through an optical fiber communications infrastructure	Israel	40	40	74	86

(\*) The scope of investment in IBC is the book value of the investment treated according to the equity method.

**Presentation in the Statement of Financial Position**

	As of December 31	
	2015	2014
	(in NIS millions)	
Investment in associate for January 1 .....	86	98
Company's share of the loss of IBC for the period.....	(12)	(12)
Total investment balance for December 31 .....	74	86

IBC prepares its financial statements in accordance with IFRS standards.

The financial statements of IBC were not attached to the reports of the Company, due to lack of materiality in relation to the reports of the Company according to regulation 23 (b) of the Securities Regulations.

**THE ISRAEL ELECTRIC CORPORATION LIMITED**  
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**NOTE 11:- POST EMPLOYMENT EMPLOYEE BENEFITS**

**a. Excess of amounts of pension plan assets over the pension obligation**

	<b>As of December 31</b>	
	<b>2015</b>	<b>2014</b>
	<b>NIS in millions</b>	
Fair value of plan assets (see section k) 2) below) .....	28,820	27,739
Present value of pension obligations (see section j) 1) below) .....	(23,192)	(23,352)
	<b>5,628</b>	<b>4,387</b>
Present value of pension obligations with respect to special agreements on early retirement (see section j) 3) below) .....	(342)	(77)
Excess of pension plan assets over pension obligations* .....	<b>5,286</b>	<b>4,310</b>

\* For additional details see and additional information see section j) 1) and section k)2) below.

**b. Funds in Trust**

	<b>As of December 31</b>	
	<b>2015</b>	<b>2014</b>
	<b>NIS in millions</b>	
Fair value of funds in trust .....	<b>1,921</b>	<b>1,909</b>

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 are invested in Government and corporate debentures (assets according to section 116 A of IAS 19 (2011) see section I below and note 12 below).

**c. Liabilities with respect to other post-employment benefits**

	<b>As of December 31</b>	
	<b>2015</b>	<b>2014</b>
	<b>NIS in millions</b>	
Present value of obligation with respect to other post-employment benefits (see section j) 2) below) .....	<b>2,732</b>	<b>2,930</b>

**Composition according to types of the other benefits:**

	<b>As of December 31</b>	
	<b>2015</b>	<b>2014</b>
	<b>NIS in millions</b>	
Discounted electricity .....	901	1,035
V.A.T. and grossed up tax with respect to discounted electricity .....	349	383
Retirement benefits .....	1,089	1,120
Welfare Fund for pensioners insured in the budgetary pension .....	47	47
Holiday gifts including grossed up tax .....	346	345
<b>Total</b> .....	<b>2,732</b>	<b>2,930</b>

**THE ISRAEL ELECTRIC CORPORATION LIMITED**  
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**NOTE 11:- POST EMPLOYMENT EMPLOYEE BENEFITS (continued)**

**d. The Pension Plan of the Company and Other Post-Employment Benefits**

- 1) The pension regulations from 1958 apply to all Company tenured employees and pensioners and their survivors who were admitted to work in the Company up to June 10, 1996 (inclusive) (hereinafter: "the Insured under the Budgetary Pension Arrangement"). The code of the central provident fund for pension to the Company's employees, pensioners and their survivors is based on the provisions of the aforesaid pension regulations and prescribes the entitlements of the Insured under the Budgetary Pension Arrangement (see also section k 1) below).

On March 5, 2012, the "Change of Method of Updating the Budgetary Pension, 2012 Law" was published in the Official Gazette. This law changed the mechanism of updating the pension of the Insured under the Budgetary Pension Arrangement to linkage to the Consumer Price Index.

Following is a summary of the budgetary pension arrangement under the by-laws of the central provident fund for pension:

The entitlement for pension is created with the existence of one of the following conditions:

- a) At the mandatory retirement date (for a woman - from the retirement age date) which is determined under the Retirement Age Law.
- b) Early retirement after a minimum of 30 years of work in the Company, provided that the employee has reached the age of 55 for men and age 50 for women (provided that the Company desires his retirement and with the approval of the employee union).
- c) An employee aged 40 years or over who has been working in the Company at least 10 years and is dismissed.
- d) Retirement due to disability.
- e) Special retirement - if and insofar as will be carried out according to a specific arrangement that was prepared and approved by the authorized authorities according to law, and according to rules that will be approved.

The survivors of an employee/a pensioner are entitled to a pension in accordance with the pension rates that are set out in the pension code.

Rates of pension:

- Upon reaching retirement age (mandatory), dismissal, early retirement— the pension rate shall not fall below 25% and shall not exceed 70% of the determining salary of the employee for the calculation of pension and its amount will be calculated based on the number of years of employment in the Company, in accordance with the principles set out below:
- After first 10 years of work— 25% of the employee's determining salary for pension.
- For every additional year of employment, up to 30 years of work— an additional 2% for every full year of work in excess of the first 10 years of work (up to a maximum of 65%).
- For every additional year of work in excess of 30 years and up to 35 years of work — an additional 1% for every work year or a part thereof in excess of the first 30 years of work (up to a maximum of 70%).
- In the event of the retirement of a permanent employee due to disability, the pension rates are determined in accordance with the Pension Regulations.

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**NOTE 11:- POST EMPLOYMENT EMPLOYEE BENEFITS (continued)**

**d. The Pension Plan of the Company and Other Post-Employment Benefits (continued)**

1) (continued)

Rates of pension: (continued)

The actuarial liability with respect to employees and pensioners/ survivors who are insured under the Budgetary Pension Arrangement includes, in addition to the pension that is payable after the termination of employment, the following entitling components:

- "Excess employment grant" (over 35 years of work). The eligibility is conditional upon retirement after the age of 60 for men or 55 for women. For fractional years, the relative share of the grant will be paid. The grant is also paid for survivors in the event of death of an employee, upon the fulfillment of the entitling criteria.
  - "Up to 35 years grant" that is paid upon retirement and to survivors in the event of the death of an employee. This grant will not be paid to employees with a seniority of less than 10 years and in respect of years for which another compensation is payable.
  - Grant upon retirement due to disability (an employee who is eligible for this grant will not receive in addition the "up to 35 years grant").
  - Grant for the non-utilization of sick days.
  - Reduced electricity price benefit for pensioners/ survivors (including grossing up for tax and VAT).
  - Holiday gifts for pensioners/ survivors (including grossing up for tax).
  - Grant to employees completing 20 years of work in the Company.
  - The Company has a (perpetual) liability under a collective agreement to bear the costs of welfare activities in an amount that is equal to 0.49% of the salary of every employee and of the pension and grants to which every pensioner/survivor is entitled (this liability is not calculated with respect to the components that are not regular salary or those that are not affected by an hourly price: convalescence, electricity, gift, house duty by roster and Arava).
  - Starting January 2012, as part of the change of the updating mechanism of the pension of those insured by the budgetary pension arrangement to linkage to the CPI, a welfare fund was established for pensioners who are entitled to budgetary pension, similarly to the fund that was established under the Civil Service.
  - The Company insures its employees and pensioners with collective life insurance. A third of the premium is paid by the employee and the rest by the Company.
  - The Company retirees/survivors possess a basket of benefits and additional rights that are not included in the actuarial liability due to their being non material.
- 2) The estimated financial liability for pensions and grants for termination of employee-employer relations is based on actuarial calculations by an external actuary. The liability is calculated in accordance with rights and assumptions of the Company most of which were determined in consultation with the Company actuary, and in his opinion they are reasonable. The discount rates used for calculating the actuarial liability fit the market yields for the high quality corporate debentures as of December 31, 2015. See Note 2 u 1 above.



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**NOTE 11:- POST EMPLOYMENT EMPLOYEE BENEFITS (continued)**

**e. Pension to Employees who are not Included in the Pension Plan**

The remaining permanent employees of the Company (hereinafter: "Generation C Employees") who started working on June 11, 1996 and thereafter and are not included under the budgetary pension plan, as described in section d. above are insured by default under a comprehensive paying pension fund (an external long-standing or new cumulative pension fund, or under another pension insurance policy at the personal choice of the employee). The Company makes deposits on a regular basis in respect of its liabilities to these employees, excluding the severance pay supplement at the rate of 2.33% of the determining salary for severance pay.

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 stated, the actuarial liability with respect to Generation C Employees includes, subject to the fulfillment of criteria:

- Severance pay supplement (2.33%) on regular salary and 13<sup>th</sup> salary (for those employees who started working in the Company before January 1, 2004 and are entitled to a 14<sup>th</sup> 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.

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**NOTE 11:- POST EMPLOYMENT EMPLOYEE BENEFITS (continued)**

**f. Collective Agreements and Consents**

- 1) On February 25, 2015, a special collective agreement was signed between the Company and the New National Labor Federation and the Employee union (hereinafter: the "Collective Agreement"). It was agreed in the agreement, inter alia, on early retirement of 440 permanent employees in 2015, granting tenure and conditions for erasing permanent positions, extending employment of temporary employees employed in projects, deducting salary due to participation of employees in sanctions and strike, industrial peace and exhausting claims in issues arranged in the agreement (hereinafter: "Special Retirement Plan").

On May 27, 2015, the Commissioner of Wages of the Ministry of Finance and the Companies Authority approved the stated Collective Agreement.

The provision cost that was included in the report period with respect to the early retirement of 440 retirees is approximately NIS 569 million before tax effect (approximately NIS 418 million after tax effect), of which approximately NIS 227 million before tax effect is with respect to the compensation (approximately NIS 167 million after tax effect).

On September 24, 2015, an addendum to the special collective agreement, which was signed between the Company and the New National Labor Federation and the employees' union, was signed, according to which the Company will increase the number of retirees by early retirement by 20, and an appropriate update will apply to the permanency quotas and permanent positions' suspension which were determined in the collective agreement. On October 14, 2015, the authorized authorities approved the addendum to the agreement.

The cost of the retirement which was included in the report period with respect to realizing the addendum to the agreement with respect to early retirements of approximately 20 retirees which was included in the Statements is approximately NIS 33 million before tax effect (approximately NIS 24 million after tax effect), of which approximately NIS 14 million before tax effect with respect to the compensation (approximately NIS 10 million after tax effect).

- 2) On July 18, 2013, a collective (salary agreement) agreement was signed between the Company and the employee organization and the New National Employee Labor Federation (hereinafter: the "July 2013 Agreement"). This salary agreement was based on the salary agreement signed by the civil service in May, 2013, and entered into effect with the legislation of the law for "participation of employees, officers and other officials in the public service in measures to stabilize the fiscal situation in the country during the years 2013 and 2014 (Temporary Order) - 2013" (hereinafter: the "Fiscal Stability Law").

The agreement of July 2013 exhausts the employees' claims regarding the salary increments for a period up to December 31, 2012, moreover a commitment to industrial peace in this matter was determined in the agreement up to December 31, 2014.

Under the stated Fiscal Stability Law, during 2015, the Company transferred to the Treasury an amount of approximately NIS 41 million which constitutes the sum saved as a result of postponement of the date of payment of the salary increment of 1%, pursuant to the provisions of the Minister of Finance.

- 3) On December 23, 2015, the Ministry of Finance and the New National Labor Federation agreed on a wage supplement in the public sector at a rate of 7.5% for the period 2013-2017. This supplement will be paid to all the employees as follows:

3.75% as a uniform percentage and the remaining 3.75% as a uniform NIS supplement to all the employees.

As of the date of this report, this agreement has not yet been signed in the public sector and there is no certainty that it will also be fully or partially implemented in the Company after it is signed in the public sector, as its implementation for the Company's employees requires the approval of the authorized entities. The Company has examined the possible implication of the wage agreement in the public sector, insofar as will be implemented on the Company's employees, on the Company's actuarial liability, within a study executed by the Company actuary in this report period. See section h below.

The agreed upon supplement mentioned above included, inter alia, a single grant of NIS 2,000 to be distributed to each employee (including the employees of the cleaning and security contractors employed in the public sector) in two phases, as follows: NIS 1,000 per employee will be paid in the salary of January 2016, and an additional NIS 1,000 per employee will be paid in the salary of January 2017.

On January 14, 2016, the Director of Wages and Labor Agreements of the Ministry of Finance published criteria and guidelines for executing the first payment (which will be paid in 2016) in the amount of NIS 1,000 for employees in the public sector, and the Companies Authority executed a similar publication regarding this issue.

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**NOTE 11:- POST EMPLOYMENT EMPLOYEE BENEFITS (continued)**

**f. Collective Agreements and Consents (continued)**

On March 3, 2016, the Company's Board of Directors approved payment of the single grant of NIS 1,000 to the Company's employees and to the employees of the cleaning and security contractors, subject to various consents with the employees' union.

The payment related to the Company's employees was approved by the Director of Wages and Labor Agreements of the Ministry of Finance and the Companies Authority on March 9, 2016, and March 15, 2016, respectively.

4) Assessment of expected wage increase

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 (see also section 3 above) with respect to future labor agreements and cost of living allowance at a nominal rate of approximately 1.24% per year for the period from January 1, 2013, and until December 31, 2017, and at the rate of the actual increase of the index less 0.5% (erosion of 0.5% in real terms) per year from 2018 onwards. This assessment was determined considering past experience, in a study performed by the Company actuary in this report period. See section h below.

5) Expected termination of the labor code

Pursuant to the provisions of the labor code for the employees of the Electric Company of March 25, 2002, which is a collective agreement, the contractual validity of the code is until December 31, 2015. A change of the labor code will be executed after exhaustion of negotiations with the employees' union and the National Labor Federation. The Company is formulating a proposal for a new labor agreement and advancing negotiations with the employees' union and the National Labor Federation in order to reach consents in this issue.

**g. Examinations by the Supervisor of Wages**

On October 10, 2013, the Company received a letter from the Supervisor of Wages, including decisions regarding wage deviations in the following issues:

- 1) Payment for overtime not according to actual performance – the Supervisor of Wages instructs the Company to integrate external employees in accordance with the work requirements of the Company, and not to operate according to the Company Management's memorandum of 1990, under which a work day of external employees is 10 hours long. Overtime payment will only be paid subject to report of actual performance and subject to the existence of an arrangement that enables a stricter supervision of the work hours of the external employees. He intends to bring his decision to the attention of the Board of Directors so that it will supervise their execution and the allocation of the additional hours of the external employees.
- 2) Board and lodging payments – the Supervisor of Wages determines that Company payments for board and lodging deviate from that which is customary in the Civil Service, are contrary to section 29 of the Foundations of Budget Law and are therefore not valid. The Supervisor of Wages instructed the Company to adjust these payments to those customary in the Civil Service. The Supervisor of Wages intends to consider demanding return of payments from employees who received this benefit and were paid these payments in excess as of October 1, 2010, subject to the employees' right to a hearing within 60 days.
- 3) Command increment – the command increment is paid to various groups of employees of command level at different rates. According to the letter of the Supervisor of Wages, command increment should only be paid in accordance with a collective agreement of 1994. Additionally, according to the letter of the Supervisor of Wages, command increment is not to be paid to managers of deputy division/district manager level and upwards. The Supervisor of Wages intends to consider demanding a return of the payments paid to employees in excess as of October 1, 2010, and to pensioners as of October 1, 2011, subject to the employees' and pensioners' right to a hearing within 60 days.
- 4) Global pension overtime – members of the management of the Company (at a level of division/district managers and upwards) receive wages structured as "total pay", which are composed of a rank value and a global overtime value, and are not entitled to a separate payment for overtime. The Supervisor of Wages is instructing not to include the global overtime component in the calculation of the pension determining salary of management members who were appointed after 1996. Additionally, the Supervisor of Wages instructs that as of the salary of October 2013, the global overtime will not be taken into account as a determining

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**NOTE 11:- POST EMPLOYMENT EMPLOYEE BENEFITS (continued)**

**g. Examinations by the Supervisor of Wages (continued)**

component of the pension salary, with all that it entails (including their inclusion as a basis for calculating salary components that are paid based on the pension salary) for anyone who is not of A rank (anyone appointed as a member of management after the A rank was blocked in 1996. The Supervisor of Wages intends to consider demanding a return of the payments paid to management members in excess as of October 1, 2010, and pensioned management members as of October 1, 2011, subject to the these employees' and pensioners' right to a hearing within 60 days.

Additionally, the Supervisor of Wages announced his intention to conduct an examination of the terms of the wages, work and pension paid to the Company employees and pensioners. Within this the validity of the Company wage components will be examined. In the first stage of the inspection, the Supervisor of Wages will use the information that will be delivered/was delivered by the Company to the team of regulators that was established in order to increase the coordination and more efficient supervision of the Company.

According to the position of the Supervisor of Wages, as arises from the State's response which was submitted to the Haifa Regional Labor Court within a legal proceeding that is being conducted following the decision of the Supervisor of Wages (see also Note 35 c 5 below). The possible effect of the Supervisor of Wages' decision on the current salary cost of the Company employees as was estimated on the date of the letter is a decrease in the salary cost of approximately NIS 150 million per year, and a one-time decrease of approximately NIS 450 million in the actuarial obligation of the Company.

The Company disagrees, as aforesaid, with the determination of the Supervisor of Wages that this concerns wage deviations. The position of the Company, which is based, inter alia, on legal opinions it has received, is that the four stated wage components are paid by it in accordance with the law and the Company has a valid obligation to continue to pay them to the employees, and accordingly the Company also disagrees with the scope of the possible effect (decrease) of the decision on the current expenses of wage costs and the stated change (decrease) in the actuarial liability.

- 5) In accordance with the decisions of the Regional Court of Labor, the stated decision of the Supervisor of Wages will not enter into effect until a decision is reached in the main case in this matter, and on the other hand the employees' representatives will not take organizational steps. On August 20, 2014, a partial ruling was passed in the proceeding, addressing the issue of the casing of the considerations of the decision (as opposed to the decision itself), under which there was no legal flaw and flawed considerations were considered in the casing of the decision of the Supervisor, except for the issue of exhausting the right to a hearing. Afterwards, the hearing proceeding by the Supervisor of Wages was completed, and following the hearing, the Supervisor of Wages published an updated decision on December 11, 2014. In his updated decision, the Supervisor of Wages repeated all the determinations that were included in his original decision as detailed above, except for the following changes: approval to pay a command increment of 2.5% to employees meeting the criteria detailed in the Company's response and approval to pay a command increment of 12.5% to division managers and Senior Vice Presidents.

The proceeding is still pending at court.

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 arbitration, 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.

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**NOTE 11:- POST EMPLOYMENT EMPLOYEE BENEFITS (continued)**

**h. Changes in the Actuarial Assumptions during the Report period**

- 1) Following the formulating wage agreement for the State employees and past experience that wage agreements for State employees also apply to the Company, and a lower than expected inflationary environment, an updated wage study was performed by the Company actuary; the result of the study for the years 2013-2017 was nominal increase of 1.24% a year (real 1%), and from 2018 onward, a real wage erosion of 0.5% a year. Impact of the change of assumption is increase of the actuarial liabilities as of December 31, 2015 by approximately NIS 616 million.
- 2) The test of the mortality assumptions was executed by testing the mortality experience in the Company relative to the existing tables of the Ministry of Finance. The major change is in the mortality rates of women pensioners and women survivors. The impact of the change in the assumption is an increase in the liabilities as of December 31, 2015 by approximately NIS 160 million.
- 3) An update was executed in the work assumptions which were used to calculate the forecasted electricity rate estimate, which constitutes part of the estimate of the liability with respect to the reduced electricity rate benefit. This update decreased the actuarial liability as of December 31, 2015 by approximately NIS 120 million.

- i. The aforementioned reserve sections, with respect to post-employment employee benefits according to the calculations of the Company as of December 31, 2015 and December 31, 2014, amount to a total of NIS 26,266 million, NIS 26,359 million respectively.

**j. Reserves**

1) Changes in the present value of the obligation for pensions

	<b>For the Year ended December 31</b>	
	<b>2015</b>	<b>2014</b>
	<b>NIS in millions</b>	
Present value of the obligation for pensions as of the beginning of the year .....	23,352	22,900
Cost of interest .....	1,110	1,122
Current service cost .....	294	299
Benefits paid .....	(718)	(692)
	<b>24,038</b>	<b>23,629</b>
 <u>Losses (gains) with respect to remeasurement:</u>		
Actuarial losses (gains) deriving from changes in financial assumptions(*) .....	(583)	25
Actuarial losses deriving from changes in demographical assumptions	160	-
Impact of differences between the previous actuarial assumptions and that which occurred in practice (hereinafter: "Adjustments based on past experience") .....	(423)	(302)
	(846)	(277)
Present value of the obligation for pensions as of the end of the period ....	<b>23,192</b>	<b>23,352</b>

(\*) Mainly change in discount which served for calculating the liability.

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**NOTE 11:- POST EMPLOYMENT EMPLOYEE BENEFITS (continued)**

**j. Reserves (continued)**

2) Changes in the present value of the obligation for other post-employment benefits

	<b>For the Year ended December 31</b>	
	<b>2015</b>	<b>2014</b>
	<b>NIS in millions</b>	
Present value of the obligation for other post-employment benefits as of the beginning of the year.....	2,930	2,920
Cost of interest .....	139	146
Current service cost .....	61	61
Decrease in benefits due to their replacement by retirement benefits within a Special Retirement Plan (see section f above) .....	(36)	-
Additional provision with respect to employee retirement within Special Retirement Plan .....	21	-
Benefits paid .....	(122)	(95)
	<u>2,993</u>	<u>3,032</u>
<u>Losses (gains) with respect to remeasurement:</u>		
Actuarial gains deriving from changes in financial assumptions .....	(263)	(111)
Adjustments based on past experience .....	2	9
	<u>(261)</u>	<u>(102)</u>
Present value of the obligation for other post-employment benefits as of the end of the period .....	<u><b>2,732</b></u>	<u><b>2,930</b></u>

3) Changes in present value of the obligation with respect to special agreements on early retirement

	<b>For the Year ended December 31</b>	
	<b>2015</b>	<b>2014</b>
	<b>NIS in millions</b>	
Present value of the obligation as of the beginning of the year .....	77	119
Cost of interest .....	12	4
Additional provision with respect to employee retirement within Special Retirement Plan .....	340	2
Benefits paid .....	(72)	(48)
Actuarial income with respect to the obligation charged to the Profit and Loss.....	(15)	-
Present value of the obligation as of the period end .....	<u><b>342</b></u>	<u><b>77</b></u>

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**NOTE 11:- POST EMPLOYMENT EMPLOYEE BENEFITS (continued)**

**k. Funds**

1) Central Pension Fund

- a) From March 8, 2005, the Company deposits funds in the Central Pension Fund (hereinafter: the "Fund") to cover pension liabilities for pension for its employees entitled by the budgetary pension arrangements.

The Pension Fund acts by force of the Control of Financial Services (Provident Funds) (Rules for Management of a Central Provident Fund) Regulations – 2012. The fund was managed by the managing company accordingly. As of May 1, 2010, Infinity – Administrating the Main Pension Fund Ltd. manages the fund.

- b) According to the Financial Statements of the Fund, the actuarial liability as of December 31, 2015 is NIS 30,941 million and the debt of the Company on that date is approximately NIS 2,121 million. According to the Financial Statements of the Company, its actuarial liability for the pension obligations as of December 31, 2015 is NIS 23,534 million, and therefore there is surplus of NIS 5,286 million.

- c) The difference between the actuarial liability in the financial statements of the Fund as of December 31, 2015, and the actuarial liability in the financial statements of the Company as of December 31, 2015, mainly derives from a difference in calculation methodology between the bodies, which partly derives from different professional approaches, according to the rules that oblige each of the bodies: the Company calculates the actuarial liability in accordance with the accounting rules applied to the Company (in accordance with the International Financial Reporting Standards, including IAS 19 and the directives of the Securities Authority), while the Fund acts in accordance with the instructions of the Capital Market, Insurance and Savings Division Officer, where the Actuary of the Fund noted that the assumptions used to prepare the statement of financial position comply with the instructions of the Capital Market, Insurance and Savings Division Officer for preparing actuarial statements of financial position.

The main difference between the assumptions derives from the discount rate, used to calculate the actuarial liability, i.e. the Fund capitalizes the actuarial liability according to the discount rate of government debentures and the Company according to corporate debentures, see Note 2 u 1 above, and the assumption of the real increase in salary assumption, rate of employee promotion, seniority increment, labor agreements, salary erosion, etc. The difference in these assumptions causes a difference of approximately NIS 7.4 billion.

- d) Following the decision of the Board of Directors to examine the gap between the actuarial calculations of the Company and the Fund and in response to the Company's application to the Fund's management on this issue, on October 22, 2013, the Company received the Fund management's response to the issue of the gap between the actuarial calculations. Within this, the Fund's explanations of its choice of the calculating method of the actuarial obligation performed by the Fund's actuary were detailed. The Fund also noted that in the past, the calculation method of the Fund was examined by the Commissioner of the Capital Market, Insurance and Savings Division, who determined that he has no objection to the assumptions used by the actuary of the Fund. Following this, the Company applied to the Commissioner of the Capital Market, Insurance and Savings Division, requesting to accept his response and to settle the manner of handling the subject.

On December 4, 2013, the response of the Commissioner of the Capital Market, Insurance and Savings in the Ministry of Finance was received, stating, among others, that the calculation of the actuarial liability in the financial statements of the Fund was carried out according to accepted actuary principles.

Additionally, an ongoing dialogue and examinations of the differences in the actuarial assumptions between the Fund management and the Company management are maintained, so that the actuarial assumptions will be as similar as possible in accordance with all the above mentioned.

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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
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**NOTE 11:- POST EMPLOYMENT EMPLOYEE BENEFITS (continued)**

**k. Funds (continued)**

**1) Central Pension Fund (continued)**

e) On June 1, 2015, the Companies Authority notified the Company that it is conducting an examination of all the issues connected to the calculation of the actuarial liability in the Company including the methodologies implemented by the Company and the Fund for calculating the actuarial liability, implementation of the directives of the Commissioner of the Capital Market with respect to the calculation of the actuarial liability and with respect to the funds deposited in the Fund, deposit regulations according to the terms of the Fund, etc. On October 20, 2015 and after the statement of financial position date on January 3, 2016, the Companies Authority approached the Company and demanded that the management of the Company carry out an examination regarding the actuarial liability of the Company, especially with respect to the gap in the actuarial liability as it is calculated at the Company and as it is calculated by the Pension Fund, and formulate recommendations as to the optimal way it should operate in order to balance between maintaining the pension rights of its employees and maintaining its financial strength. The Company is preparing to execute the demands appearing in the above approaches of the Companies Authority.

f) On December 2, 2012, the Control of Financial Services (Provident Funds) (Rules for Management of a Central Provident Fund) Regulations – 2012 were published. At the same time, the circular “Instructions for Management of a Central Provident Fund” was published by the Commissioner of the Capital Market, Insurance and Saving. The circular enables, inter alia, to spread payments to the fund by the Company. This circular benefits the Company, mainly regarding the manner of spreading the payment with respect to debt to entitled pensioners.

The mentioned regulations and circular entered into effect on January 1, 2013. A parallel change to the articles of the fund was executed and approved by the Board of Directors of the Company on October 10, 2013. The approval of the Capital Market, Insurance and Savings Division of the Ministry of Finance was received on March 31, 2014.

In accordance with the aforesaid change, as of March 31, 2014, the manner of spreading the payments to the Fund with respect to the actuarial liability is detailed below:

Growth - as defined in the new regulations deriving from seniority supplement, the complete amount will be deposited during the year following the financial year in equal semiannual payments (at the end of the half and at the end of the year).

(1) With respect to active employees:

Other growth - the higher of the following sums will be deposited in the year following the financial year in two equal payments:

- (a) 10% of the lacking sum due to the employees.
- (b) A sum equal to 0.5% of the total actuarial liability with respect to the employees.

(2) With respect to pension receivers:

The higher of the following sums will be deposited in the year following the financial year, in two equal payments (at the end of the half and at the end of the year):

- (a) Half of the lacking sum due to the pension receivers.
- (b) A sum equal to 2% of the total actuarial liability with respect to pension receivers.

(3) With respect to entitling events - retirement or passing away of an entitled employee as defined in the instructions for managing a central pension fund:

At an expected retirement - the actuarial debt, if exists, will be completed a month before payment of the first pension.

At an unexpected passing away / retirement - the actuarial debt will be completed within a month from the date of demand which will be delivered a month from the first payment.



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**NOTE 11:- POST EMPLOYMENT EMPLOYEE BENEFITS (continued)**

**k. Funds (continued)**

**1) Central Pension Fund (continued)**

(4) Ongoing transfer:

A sum of not be less than NIS 50 million will be transferred every month (linked to the known CPI of the end of the year), provided that there is an actuarial deficit in the fund (until balanced).

The fund will pay a member the sum accumulated in the fund that exceeds the maximum sum in it, not later than 30 days from the date it submitted the fund's actuarial balance for a certain fiscal year. The maximum sum, as defined in the regulations, accrued actuarial obligation of the member plus 25%.

(5) With respect to special retirement operation - an increase has occurred in the accumulated actuarial liability due to employees or pension receivers as a result of change in the labor agreement, including early retirement agreement, a member will deposit into the employees' account or the pension receivers' account, as applicable, and not later than one year from the date of change in the labor agreement, and subject to regulation 2(f) of the regulations, the lower of the following:

- (a) The sum of the increase in the accumulated actuarial liability deriving from the stated change.
- (b) The amount required to equalize the total assets in the account to the total accumulated actuarial liability.

Regarding this, regulation 2 (f) - a member of a central pension fund will deposit sums required to complete the entire actuarial liability due to retirement of an entitled employee or due to his passing away, on a date and at a rate as the Supervisor will instruct, provided that the above mentioned date for completing the entire actuarial liability will not be later than two months from the first pension payment date.

- g) The Company deposited in the pension fund, including due to the early retirement campaign, NIS 1,280 million during the period ended on December 31, 2015.
- h) The Fund approved its financial statements as of December 31, 2015, on March 16, 2016.
- i) The Fund presents the value of its assets at fair value according to international financial standard principles (IFRS).
- j) According to the forecast of the Company, according to the articles in effect (starting from March 31, 2014), the expected transfers to the Central Pension Fund (Infinity) from the statement of financial position date until the end of 2016 will amount to approximately NIS 773 million.

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**NOTE 11:- POST EMPLOYMENT EMPLOYEE BENEFITS (continued)**

**k. Funds (continued)**

2) Changes in the fair value of the assets of the plan

	<b>For the Year ended December 31</b>	
	<b>2015</b>	<b>2014</b>
	<b>NIS in millions</b>	
Fair value of plan assets as of the beginning of the year .....	27,739	25,038
Interest income on plan assets .....	1,327	1,227
Deposits.....	1,280	600
Benefits paid .....	(761)	(706)
Gains (losses) with respect to remeasurements of plan assets:		
Yield on plan assets (except for sums included in the net interest cost) .	(765)	1,580
Fair value of plan assets as of the period end.....	<b>28,820</b>	<b>27,739</b>

	<b>For the Year ended December 31</b>	
	<b>2015</b>	<b>2014</b>
	<b>NIS in millions</b>	
Interest income on plan assets .....	1,327	1,227
Gains (losses) with respect to remeasurements of plan assets .....	(765)	1,580
Actual yield on plan assets .....	<b>562</b>	<b>2,807</b>

	<b>For the Year ended December 31</b>	
	<b>2015</b>	<b>2014</b>
	<b>NIS in millions</b>	
Employees participation in the plan .....	<b>27</b>	<b>28</b>

3) Composition of the asset portfolio of the funds of those insured by the Fund:

	<b>For the year ended December 31</b>			
	<b>2015</b>		<b>2014</b>	
	<b>(in NIS million)</b>			
	<b>Quoted in active market</b>	<b>Not quoted in active market</b>	<b>Quoted in active market</b>	<b>Not quoted in active market</b>
Negotiable government debentures .....	17,110	-	15,805	-
Corporate, negotiable debentures .....	952	-	1,215	-
Deposits and loans .....	-	3,634	-	4,516
Shares .....	4,646	-	4,754	-
Other investments.....	-	855	-	622
Cash .....	-	1,623	-	827
	<b>22,708</b>	<b>6,112</b>	<b>21,774</b>	<b>5,965</b>

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**NOTE 11:- POST EMPLOYMENT EMPLOYEE BENEFITS (continued)**

**I. Funds in Trust**

1) Funds in trust are designated to cover actuarial liabilities to employees and liabilities as related to the termination of employer/employee relationships and are invested in Government and corporate bonds.

a) The Company has a dedicated trust account for covering its actuarial liabilities (non-budgeted pension components) which exists in accordance with the agreement entered into on March 23, 2000, between the Company and the Trust Company of the United Mizrahi Bank Ltd, ("The Trust Account"). See also Note 12 below.

b) On May 20, 2013, the Company filed an application with the Center District Court, for implementing the decision of the plenum of the Board of Directors of March 21, 2013, under which the Company will approach the Trustee and instruct him to transfer the funds in the Trust Account to cover the deficit in the Fund, and/or to execute a reimbursement to the Company (subject to the application to the Court).

On November 5, 2015, the aforesaid Lod District Court gave its ruling, within which the Court partially consented to the Company's request to use the money in the trust account, see also Note 12 below.

c) For additional information regarding the Company's continued handling of the issue following the judgment see Note 12 below.

2) Changes in fair value of funds in trust designated to cover actuarial liabilities (assets according to section 116 A):

	<b>For the Year ended December 31</b>	
	<b>2015</b>	<b>2014</b>
	<b>NIS in millions</b>	
Fair value of funds in trust as of the beginning of the year.....	1,909	1,728
Interest income from funds in trust .....	91	85
<u>Gains (losses) with respect to remeasurement:</u>		
Yield on plan assets (except for sums included in the net interest cost) ...	(79)	96
Fair value of funds in trust as of the period end .....	<b>1,921</b>	<b>1,909</b>

3) Yield of funds in trust:

	<b>For the Year ended December 31</b>	
	<b>2015</b>	<b>2014</b>
	<b>NIS in millions</b>	
Interest income from funds in trust .....	91	85
Gains (losses) with respect to remeasurement of funds in trust .....	(79)	96
Actual yield on funds in trust .....	<b>12</b>	<b>181</b>
<b>Anticipated nominal yield rate of funds in trust as of the beginning of the period .....</b>	<b>4.77%</b>	<b>4.91%</b>

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NOTE 11:- POST EMPLOYMENT EMPLOYEE BENEFITS (continued)

**m. Capital Reserves With Respect to Remeasurements of the Liability (asset), net (Before Tax Effect)**

	For the Year ended December 31	
	2015	2014
NIS in millions		
Balance as of the beginning of the year .....	(191)	1,365
Yield on the plan assets less sums included in the net interest cost* .....	(179)	(1,556)
Balance as of the end of the period .....	<b>(370)</b>	<b>(191)</b>

\* Less reserve administration fees.

**n. Amounts Presented in Cost of Salaries and in Expenses with respect to Liabilities to Pensioners and in fixed assets**

	For the Year ended December 31	
	2015	2014
NIS in millions		
<b><u>Cost of Salaries and Expenses with respect to Liabilities to Pensioners</u></b>		
Current service cost after deducting employees participation in the pension plan.....	328	332
Cost of interest.....	1,249	1,268
Interest revenues (*) .....	(1,418)	(1,312)
Costs due to early retirement .....	604	8
Total cost recognized in salaries cost and expenses with respect to liabilities to pensioners .....	<b>763</b>	<b>296</b>

(\*) With respect to the plan's assets and funds in trust

**o. Remeasurements that were capitalized to assets cost (fixed assets):**

	As of December 31	As of December 31
	2015	2014
Decrease in fixed assets .....	<b>(66)</b>	<b>(482)</b>

**THE ISRAEL ELECTRIC CORPORATION LIMITED**  
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**NOTE 11:- POST EMPLOYMENT EMPLOYEE BENEFITS (continued)**

**p. Main Actuarial Assumptions Applied to the Actuarial Liability and Plan Assets**

	<b>For the year ended on December 31</b>	
	<b>2015</b>	<b>2014</b>
Weighted annual real interest rate grossed in the present value of the obligation at the end of the year*	2.85%	2.56%
Nominal rate of return used to calculate the interest cost	4.77%	4.91%
Anticipated annual nominal rate of return grossed in the fair value of plan assets	4.77%	4.91%
Average liability lifetime	16.2 years	16.5 years
Real update of salaries during the work period	- individual salary development model of the active employees (according to salary table + ranks promotion according to work agreements +tenure promotion + individual advancement evaluation in addition to the assumption that the salary table will increase at a nominal rate of 1.24% per year for 2013-2017 and will erode at a real rate of 0.5% per year from 2018 onwards compared to the CPI).	
Real update of pension amounts after employment termination	- Pension development model - from January 2012 the pensions are linked to the CPI and the actual linking of the pensions to the CPI began in January 2013 (according to the annual change in the CPI in 2012), and thus in future.	
Pensioners and next of kin mortality, including updated mortality data	- According to the Ministry of Finance draft circular dated July 11, 2012, and mortality study regarding employees, pensioners and survivors.	

**q. Analysis of sensitivity of main actuarial assumptions as of December 31, 2015:**

<b>Actuarial assumptions</b>	<b>Change %</b>	<b>Increase in liability</b>	<b>Change %</b>	<b>Decrease in liability</b>
Rate of interest for capitalization	(0.1)	413	0.1	416
Future salary increase rate with respect to general salary agreements and cost of living increment less the CPI (real increase)	0.5	668	(0.5)	626

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.

- r. The funds for pensions cover all the liabilities of the Company to employees included in the pension plan, assuming that the employees will retire in accordance with the accepted actuarial estimates. In the event that all employees included in the pension plan are discharged immediately, the liability amount for these employees is significantly higher than the liability amount presented in the Financial Statements. The Management of the Company estimates that such an event is not expected.

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**NOTE 12:- FUNDS IN TRUST**

- a. The Company holds funds in a trust account for several years, for the purpose of paying pension liabilities of the Company with respect to non-budgetary pension salary components. The trust account was opened in March 2000, after entering into a trust agreement with the Trust Company of Bank Hamizrachi Hameuchad Ltd. In accordance with the agreement, funds will be deposited in the trust account for the sole purpose of using these funds only for paying pensions to employees defined as "generation A" and "generation B" in the aforesaid arrangement with the Government on June 10, 1996 (hereinafter: "96 agreement) and not for any other purpose. The trust agreement stipulated that the trust will only act for the benefit of the entitled employees and the Company will not have any right to withdraw and/or use the funds in any way and/or instruct the trustee on using the fund, except one of the following three possibilities: instruct the trustee to transfer the funds to a pension fund, once it is established, a special payment order to pay entitled employees on account of pensions, instruct the trustee to pay the Company funds out of the trust funds, if the Company will prove that it actually paid entitled employees amounts that should have been paid to these employees by the trustee out of the trust account, had the Company not paid them.
- After the Central Provident Fund for Pension was founded, the funds accrued in the trust account up to that date and reflecting the actuarial liability of the Company (as of the founding date of the Central Fund), related pension payments, were transferred to the fund. When the Central provident Fund was founded in 2005, it transpired that it was not possible to transfer all the funds deposited in the trust account: amounts related to payment of different bonuses to employees on the termination of employee - employer relations were not transferred to the Fund, since these are not pensions. Therefore, according to the amendment to the income tax regulations (rules for approving and managing pension funds) - 1964, these funds cannot be transferred to the Pension Fund. In addition, according to the amendment to the pension funds regulations and according to the interpretation of the Capital Market, Insurance and Saving Department in the Ministry of Finance, funds with respect to an actuarial liability deriving from non-budget rights, granted to pensioners (e.g., electricity charge rate benefit, holiday gifts) could not be transferred to the Fund. As of the date of the report, sums are deposited in the trust account to cover the Company's liability to pay the following components: holiday gifts (including grossing up), disability benefit, grossing up charging of the tax benefit with respect to the "discounted electricity" component, grant for unused sick leave, grant for 35 years of employment, grant for employment of up to 35 years, welfare activity fund, and grant to survivors of deceased employees.
- b. On March 20, 2012, an outline of principles was concluded, with the consent of the Company and the Ministry of Finance, aimed at providing a solution to a cash flow problem that was occurred to the Company following the crisis of gas supply from Egypt. In light of that stated, the Company's Board of Directors decided on March 22, 2012, to adopt the concluded principles outline, which states, inter alia, that the Company will act to release surplus funds held in the dedicated trust account for covering the non-budgetary pension components.
- Following this decision, and after several legal proceedings that were conducted in the Labor Court following sanctions taken in this matter, and a hearing which was conducted in the District Court, and as part of which the parties agreed to the Court's proposal on June 21, 2012, which received the validity of a court's decisions, pursuant to which the Court instructed the trustee to transfer to the fund amounts according to the instructions of the Electric Company, provided that the total amounts or assets transferred will not exceed NIS 600 million, and within which the Company undertook not to give the trustee instructions to transfer additional amounts from the trust account, as long as a legal proceeding is being conducted in court, during 2012-2013, the Company transferred NIS 600 million every month, from the trust account to the Central Pension Fund.
- c. On March 26, 2012, the Company received the recommendations of the regulators team on the subject of releasing funds from the dedicated trust account (hereinafter: the "Recommendations Document"). according to which the deposits deposited by the Company with respect to components for generation A employees, which are not listed in the Annex to the agreement of '96, with respect to generation A employees, and also each deposit with respect to components to generation B employees and also deposits with respect to components to generation C employees are deposits for which no obligation to deposit was found.
- The Conclusions chapter in the Recommendations Document of the regulators team states that the Company should do everything necessary, including before the Trustee and the beneficiaries under the Trust Agreement, and by law, to release money deposited in the Trust Account, which the Company is not required to deposit. The decision of the Board of Directors of the Company of March 22, 2012, concerning the release of NIS 600 million, constituted, in the opinion of the regulators team, a "first step for the execution of the foregoing". At the same time, the regulators team believes that the Company's Board of Directors should continue to make the suitable decisions and act accordingly concerning the balance of the funds in this account, to implement the aforementioned principles. The regulators team also believes that the Company should consider acting, at the first stage and immediately to exercise the stipulations of the trust agreement in a way that will use the trust account funds for its purpose according to the trust agreement.

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**NOTE 12:- FUNDS IN TRUST (continued)**

c. (continued)

In practice, it is the opinion of the regulators team that the Company should consider exercising its authority, as determined by the trust agreement, to instruct the trustee for the purpose of receiving refunds from the trust account with respect to payments it paid out of its coffers.

It is also stated that as the founder of the trust account, the Company should also reconsider the range of means at its disposal, including according to trust laws, to interpret the trust agreement or adjust it to arrangements to which it is obligated and not beyond that.

Following the recommendations of the team of regulators, the Company legally examined if the Ministers' arrangement from 1996 obliged it to create a fund for liabilities with respect to the pension components that are of a non-budgetary character, and the ways it can use the money of the trust account. The Company also corresponded on this matter with the team of regulators.

On March 21, 2013, the Board of Directors of the Company decided that, while paying attention to the fact that according to the opinion received by the Company, the conclusion that the 1996 agreement obliges the Company to deposit money in the manner in which the Company acted is not unequivocal, when considering the total considerations pertaining to the matter, including the determinations of the State Comptroller, the recommendations of the team of regulators and after the position of the representative of the employees has also been considered, the Company shall approach the trustee and instruct him to transfer the money of the trust account to cover the deficit of the Central Pension Fund and/or to reimburse the Company (subject to an application to a Court of Law as detailed below).

Money that has accumulated in the trust account with respect to the non-budgetary components detailed in Annex A of the 1996 arrangement with respect to Generation A employees, that are designated to cover these payments to these employees and pensioners, the Company will not apply to the Trustee for their release and they will remain in the trust account and serve the stated need.

In view of the agreement reached in June 2012 at the District Court between the trustee, the Company, the representatives of the employees and the Attorney General, regarding the trust account, the Company applied to the District Court of the Central District with a suitable application for the purpose of implementation of the stated decision of the Board of Directors. On November 5, 2015, the Lod District Court (hereinafter: the "Court") gave its ruling in a proceeding conducted between the Company and the New National Labor Federation and the employees' union, the Attorney General and Mizrahi Tefahot Trust Company Ltd., within which the Court partially consented to the Company's application to use funds deposited in the Trust Account as of the year 2000 onward to cover the Company's liability to pension and compensation, and ruled as follows:

- (1) The trust secures the non-budgetary liability of the Electric Company towards generation A employees and generation B employees. The trust does not ensure liability towards employees who are not considered generation A employees and generation B employees, and this includes not ensuring any liability towards generation C employees and employees by special contracts.
- (2) The Company will prepare an actuarial calculation as on December 31, 2015 which relates to non-budgetary liabilities towards generation A employees and generation B employees (hereinafter: the "Actuarial Calculation"), and will deliver it to the trustee, together with a demand for payment regarding the actuarial surplus existing in the trust at present, by February 1, 2016.
- (3) The trustee will transfer to the Company the surplus money in the trust beyond the actuarial calculation within 30 days from the date of receiving an application from the Company with respect to the actuarial surplus.
- (4) From here on, the trustee will honor all special payment orders and special refund orders given by the Electric Company in accordance with the relevant sections in the deed of trust. Special refund orders will only relate to payments executed by the Electric Company from the date the Court ruled and onwards.
- (5) The trustee will transfer the trust money only in accordance with that stated in section 1-4 above, unless he receives an order from the Court in this matter.

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**NOTE 12:- FUNDS IN TRUST (continued)**

c. (continued)

- (6) On February 1, 2016, the Company applied to the Trustee, in accordance with the provisions of the ruling, with a payment demand to transfer the actuarial surplus in the trust account to the Company, according to a calculation by the Company. On February 4, 2016, the employees' union applied to the Court with an urgent application to instruct the Trustee not to execute the payment, claiming that the application of the Company is contrary to the ruling. The Court scheduled a hearing with the parties during the month of February and also determined that the Trustee will not transfer funds from the trust account to the Company until a decision is reached regarding the application.
- (7) On March 2, 2016, the District Court instructed the Trustee to immediately transfer to the Company NIS 280 million from the trust account. In accordance with the decision, by April 10, the Company will deliver to the trustee an updated actuarial calculation. Within 14 days from this date, the Trustee has to transfer to the Company the balance, insofar as will be, between the updated actuarial calculation and the actuarial calculation which was transferred in February 1, 2016.

d. The funds of the trust account are invested in Government and corporate debentures and presented at fair value (see also Note 11 b above).



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**NOTE 13:- FIXED ASSETS**

a. (1) <u>Composition and changes in 2015</u>	COST				ACCUMULATED DEPRECIATION					Depreciated balance	
	Balance on January 1, 2015	Classification	Deduction	Net addition (*)	Balance on December 31, 2015	Balance on January 1, 2015	Classification	Deduction	Addition	Balance on December 31, 2015	On December 31, 2015
	(NIS in millions)										
<b>FIXED ASSETS IN USE</b>											
Power plants (including land, buildings and machinery).....	71,916	103	(15)	295	72,299	47,856	-	(13)	2,113	49,956	22,343
Sub-stations .....	13,296	271	(4)	152	13,715	8,051	-	(4)	434	8,481	5,234
Overloading control center .....	1,021	2	(96)	19	946	939	-	(95)	19	863	83
Telecommunications .....	1,654	3	-	43	1,700	1,397	-	-	55	1,452	248
Switching stations .....	6,146	446	-	35	6,627	3,684	-	-	223	3,907	2,720
400 KV voltage lines .....	2,319	32	(4)	(19)	2,328	1,198	-	(1)	80	1,277	1,051
High voltage transmission lines.....	6,047	317	(44)	185	6,505	3,264	6	(34)	167	3,403	3,102
Distribution networks .....	36,071	216	(120)	872	37,039	19,140	-	(84)	977	20,033	17,006
Meters .....	1,897	15	(38)	48	1,922	1,374	-	(34)	93	1,433	489
Land, office buildings .....	3,275	1	(18)	20	3,278	1,905	-	(13)	88	1,980	1,298
Office equipment and tools .....	1,619	6	(3)	25	1,647	1,462	-	(3)	34	1,493	154
Computers .....	1,587	8	(12)	14	1,597	1,541	-	(12)	23	1,552	45
Motor vehicles .....	789	-	(88)	86	787	443	-	(83)	100	460	327
Mobile mechanical equipment .....	596	-	(42)	18	572	341	-	(39)	36	338	234
Emergency equipment .....	69	-	-	34	103	54	-	-	3	57	46
Other projects .....	337	11	-	12	360	71	-	-	18	89	271
Spare parts for power plants and substations.....	1,417	(48)	-	79	1,448	424	-	(27)	66	463	985
<b>Total fixed assets in use .....</b>	<b>150,056</b>	<b>1,383</b>	<b>(484)</b>	<b>1,918</b>	<b>152,873</b>	<b>93,144</b>	<b>6</b>	<b>(442)</b>	<b>4,529</b>	<b>97,237</b>	<b>55,636</b>
<b>FIXED ASSETS UNDER CONSTRUCTION</b>											
Power plants, buildings and other installations.....	3,395	(10)	(2)	1,094	4,477	4	-	-	-	4	4,473
Sub-stations .....	573	(261)	-	36	348	54	-	-	1	55	293
High voltage lines .....	734	(266)	(3)	57	522	2	(6)	-	-	(4)	526
Switching stations .....	330	(336)	-	58	52	-	-	-	-	-	52
400 KV voltage lines .....	99	(57)	(1)	43	84	-	-	-	-	-	84
Payments on account of equipment .....	149	(74)	-	25	100	-	-	-	-	-	100
Other investments .....	712	(5)	(4)	52	755	15	-	-	1	16	739
Materials and payments on account of materials designated for investments in fixed assets .....	552	(374)	(13)	374	539	-	-	-	-	-	539
<b>Total fixed assets under construction .....</b>	<b>6,544</b>	<b>(1,383)</b>	<b>(23)</b>	<b>1,739</b>	<b>6,877</b>	<b>75</b>	<b>(6)</b>	<b>-</b>	<b>2</b>	<b>71</b>	<b>6,806</b>
<b>Total fixed assets.....</b>	<b>156,600</b>	<b>-</b>	<b>(507)</b>	<b>3,657</b>	<b>159,750</b>	<b>93,219</b>	<b>-</b>	<b>(442)</b>	<b>4,531</b>	<b>97,308</b>	<b>62,442</b>

(\*) Less receipts from development works orders.

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**NOTE 13:- FIXED ASSETS (continued)**

a. (2) <u>Composition and changes in 2014</u>	COST				ACCUMULATED DEPRECIATION				Depreciated balance	
	Balance on January 1, 2014	Classification	Deduction	Net addition (*)	Balance on December 31, 2014	Balance on January 1, 2014	Deduction	Addition	Balance on December 31, 2014	On December 31, 2014
	(NIS in millions)									
<b>FIXED ASSETS IN USE</b>										
Power plants (including land, buildings and machinery) .....	70,378	1,094	-	444	71,916	45,808	-	2,048	47,856	24,060
Sub-stations .....	13,169	54	(17)	90	13,296	7,641	(11)	421	8,051	5,245
Overloading control center .....	999	1	-	21	1,021	918	-	21	939	82
Telecommunications .....	1,625	4	-	25	1,654	1,336	-	61	1,397	257
Switching stations .....	6,105	65	-	(24)	6,146	3,471	-	213	3,684	2,462
400 KV voltage lines .....	2,320	-	(6)	5	2,319	1,119	(3)	82	1,198	1,121
High voltage transmission lines .....	6,008	61	(18)	(4)	6,047	3,111	(14)	167	3,264	2,783
Distribution networks .....	35,203	306	(127)	689	36,071	18,281	(91)	950	19,140	16,931
Meters .....	1,883	19	(51)	46	1,897	1,333	(46)	87	1,374	523
Land, office buildings .....	3,237	9	(6)	35	3,275	1,824	(6)	87	1,905	1,370
Office equipment and tools .....	1,588	4	-	27	1,619	1,427	-	35	1,462	157
Computers .....	1,606	-	(33)	14	1,587	1,549	(33)	25	1,541	46
Motor vehicles .....	735	-	(62)	116	789	409	(58)	92	443	346
Mobile mechanical equipment .....	687	-	(108)	17	596	412	(107)	36	341	255
Emergency equipment .....	66	-	(1)	4	69	54	(1)	1	54	15
Other projects .....	308	11	-	18	337	57	-	14	71	266
Spare parts for power plants and substations .....	1,472	(87)	-	32	1,417	397	(31)	58	424	993
<b>Total fixed assets in use .....</b>	<b>147,389</b>	<b>1,541</b>	<b>(429)</b>	<b>1,555</b>	<b>150,056</b>	<b>89,147</b>	<b>(401)</b>	<b>4,398</b>	<b>93,144</b>	<b>56,912</b>
<b>FIXED ASSETS UNDER CONSTRUCTION</b>										
Power plants, buildings and other installations .....	3,411	(1,021)	(31)	1,036	3,395	4	-	-	4	3,391
Sub-stations .....	505	14	(1)	55	573	53	-	1	54	519
High voltage lines .....	547	8	(1)	180	734	2	-	-	2	732
Switching stations .....	246	(40)	-	124	330	-	-	-	-	330
400 KV voltage lines .....	49	6	-	44	99	-	-	-	-	99
Payments on account of equipment .....	176	(50)	-	23	149	-	-	-	-	149
Other investments .....	646	13	-	53	712	15	-	-	15	697
Materials and payments on account of materials designated for investments in fixed assets .....	565	(471)	(12)	470	552	-	-	-	-	552
<b>Total fixed assets under construction .....</b>	<b>6,145</b>	<b>(1,541)</b>	<b>(45)</b>	<b>1,985</b>	<b>6,544</b>	<b>74</b>	<b>-</b>	<b>1</b>	<b>75</b>	<b>6,469</b>
<b>Total fixed assets .....</b>	<b>153,534</b>	<b>-</b>	<b>(474)</b>	<b>3,540</b>	<b>156,600</b>	<b>89,221</b>	<b>(401)</b>	<b>4,399</b>	<b>93,219</b>	<b>63,381</b>

(\*) Less receipts from development works orders.

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**NOTE 13:- FIXED ASSETS (continued)**

**b. Assets Impairment Test according to IAS 36**

The work was executed in accordance with forecasts of future cash flow expected to be derived for the Company, and it was prepared based on the current rates structure and on assumptions representing, inter alia, the economic conditions that, according to the opinion of the management of the Company, will exist during the useful life span of unit assets.

Following are the main assumptions which served the work:

- 1) In reviewing the cash-generating units, the Company identified the three operating segments of the Company as one cash-generating unit. The Company is of the opinion that cash yielding in the Company is integrated in all the segments and is not independent.
- 2) The current rate base for the generation segment, as determined in February 2010, set the level of costs recognized for the Company in the generation segment for 2010-2014. The estimate of the Company is that the new rate base for this segment will become effective as of January 2017.
- 3) The new rate base for the transmission and distribution sectors will become retroactively effective From April 1, 2012, based on the Decision of the Electricity Authority on March 22, 2012. Regarding the draft of the work of the consulting company on behalf of the Electricity Authority (the Navigant draft report) - update of rate base for transmission and distribution. The impact of the draft report regarding a new rate base was not reflected in the cash flow forecast, but its impact was examined in the sensitivity analyses (see Note 3 c above).

- 4) Based on past experience, work principles of the Electricity Authority and directives of the Electricity Sector Law, the Company's Management assumes that the rate base will be updated over time.

Pursuant to understanding the way in which the Electricity Authority determined rates recently, the Company assumes that the future rate bases also included normative components. These normative components are currently determined and will probably be determined in the future on the basis of costs of the Company in the past or the economic environment in which it operates.

The Company believes that the normative components will be structured in a way that will allow the Company to gain profit from some of them by performance that exceeds the norms and will earn less or incur a loss from costs that are higher than the rate coverage, for some components.

The policy of the Company in recent years is to decrease actions and investments that do not have full cost coverage in the rate from the Electricity Authority, for the purpose of meeting the rate outline. Therefore, the Company estimates that after the update of the rates bases, it is anticipated that full coverage will be provided to all investment and operating costs incurred by the Company, in each of the segments, starting from the update date of the rate base for this segment.

However, the Company estimates that certain events may prevent it from meeting the rate outline during a certain period, while in other periods it will meet the rate outline in a way that will yield a higher than required gain. On the average, and in view of the aforesaid, the Company expects that it will meet the rate outline in a way that will allow full costs coverage for its investment and operation costs.

- 5) Fuels expenses incurred by the Company will be covered by the electricity rate throughout the periods of the forecast.
- 6) Weighted Average Capital Cost (WACC) - 3.6% after tax for the generation segment. This value reflects the time value of the money and the specific risks as determined in the electricity rate. With respect to the transmission and distribution segments, the rate of capitalization was assumed to be equal to the rate of return that will be granted by the Electricity Authority, in order to reflect the estimation of the Management of the Company with respect to the full coverage in these segments, as stated.

The aforementioned calculations show that the recoverable amount of the Company's assets is not lower than their value in these Financial Statements

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**NOTE 13:- FIXED ASSETS (continued)**

- c. Investments in land (before amortization), which are included under fixed assets include NIS 1,011 million for long term land leases and NIS 702 million for land owned by the Company.  
A substantial portion of the land property, in which the Company has rights, is not registered in the Land Registry and the status of such properties has not been settled for various technical reasons, such as the absence of parcelization in a portion of those areas, the requirements of planning authorities to assemble master plans, and disputes with the various authorities, including the tax authorities, mainly regarding assets that were purchased many years ago and changes in registration, which prevent obtaining authorizations for registration in the Land Registry. Due to the great complexity of the matter, it is not possible to estimate the period of time which will be required to conclude registering the land, but, in the Company's opinion, this cost of registering the land, as aforesaid, is not anticipated to be substantial.  
There are capitalized contracts with respect to the majority of the land leased by the Company from the Israel Land Administration.
- d. As of the date of the expiration of the Concession period (March 5, 1996), the Company had fully written off the cost of acquiring land in the amount of NIS 576 million as to which the Company's right to receive compensation at the expiration of the Concession was unclear. Land purchased in late 1995 at a cost of NIS 353 million, as to which there is confirmation that it would receive adequate compensation, was not written off.
- e. See Note 20 h for liens related to fixed assets.
- f. See Note 35 a 6) for fixed asset investment commitments.
- g. 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 1,104 million as of December 31, 2015. 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.
- h. According to the circular of the Companies Authority (see Note 2 a1 above) the Company is required to provide disclosure in the Financial Statements of the implementation of the directives of the Government Companies Authority regarding control and reporting rules for land and attached assets in Government companies in accordance with the Financial Statement Circular 2006-3 of September 17, 2006. The information required above was not included in the Financial Statements. In a letter to the then Director of the Government Companies Authority dated January 10, 2007, the Company's CEO states that back in 1998, the Company stated that it was preparing to collect the extensive amounts of material required. Furthermore, in 1998, a list of the Company's assets was transferred to the Ministry of Finance as of the date of the expiration of the concession and since then and, to date, the list of added assets is immaterial in relation to total assets and is irrelevant with relation to the assets arrangement prescribed by the Electricity Sector Law.  
The former CEO also mentioned that in meetings held with the Government Companies Authority and representatives of the Company's Management in negotiations regarding the structural change, the representatives of the employees' organization announced that they would not allow giving out information to the State or transferring any documents in connection with the Company's assets, etc.  
In recent years, a focused and continuous process is conducted for gathering and coordinating all the information of all the Company's assets and arranging them in all that relates to book of assets, registering rights, management and regulation. The Company has 318 major sites and a book of secondary sites which is being completed at present.
- i. Regarding the draft of recommendations of the steering committee published on March 23, 2014, see Note 1 e above.

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**NOTE 14:- INTANGIBLE ASSETS, NET**

The composition:

	Balance as of January 1, 2015	Additions in 2015	Deductions in 2015	Balance as of December 31, 2015
NIS in millions				
Cost of software .....	4,568	180	-	4,748
Accumulated amortization of software .....	(3,184)	(269)	-	(3,453)
<b>Intangible assets, net .....</b>	<b>1,384</b>	<b>(89)</b>	<b>-</b>	<b>1,295</b>

	Balance as of January 1, 2014	Additions in 2014	Deductions in 2014	Balance as of December 31, 2014
NIS in millions				
Cost of software .....	4,474	193	(99)	4,568
Accumulated amortization of software .....	(3,122)	(157)	95	(3,184)
<b>Intangible assets, net .....</b>	<b>1,352</b>	<b>36</b>	<b>(4)</b>	<b>1,384</b>

The Company annually examines the useful lifespan of the software it uses.

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**NOTE 15:- REGULATORY ASSETS/LIABILITIES**

a. As of January 1, 2015, the Company applies, by early implementation, IFRS 14, and its significance is the continued implementation of the existing practice in the subject of recognition of regulatory deferral accounts. The Company recognizes regulatory deferral accounts in its financial statements, and they are similar in essence to the regulatory assets and liabilities that existed in the Company's books prior to the implementation of IFRS 14.

However, IFRS 14 presents changes to some of the previous accounting principles for balance of regulatory deferral accounts which are in essence related to the presentation of these accounts. (See also Note 2 y. above).

**b. Details of the amounts and transactions in regulatory deferral accounts for the year ended on December 31, 2015 (before tax effect):**

	NIS in millions			Balance As of December 31, 2015	Period remaining for refund / cancellation  Years
	Balance	Transactions for the year ended on December 31, 2015			
	As of January 1, 2015	Creation / recognition	Refund / cancellation		
<b>Debit balance of regulatory deferral accounts</b>					
With respect to the erosion of the Company's liabilities in foreign currency, passed on to the electricity consumers (see section e below) .....	230	(29)	(81)	120	1-2
With respect to the gap between dates for actual updating rates and the theoretical rate (see section f below) .....	1,502	(253)	(1,191)	58	1
With respect to social rate (see section g below) .....	376	251	(455)	172	1-3
With respect to electricity purchases from private producers and photovoltaic facilities (see section h below) .....	314	(35)	(279)	-	-
With respect to load management arrangements (see section i below) .....	125	45	(156)	14	1-3
With respect to not updating the electricity rate for the transmission and distribution segment (see section l below) .....	148	5	-	153	1-2
With respect to deemed interest (see section m below) .....	53	63	(2)	114	21-33
With respect to recognition of investments that were reduced in the past (see section n below) .....	122	141	(57)	206	14-22
Others .....	6	-	(6)	-	-
<b>Total .....</b>	<b>2,876</b>	<b>188</b>	<b>(2,227)</b>	<b>837</b>	
With respect to electricity purchases from private electricity producers and photo-voltaic installations (see section h below) .....	-	383	-	383	1-3
With respect to consecutive non-update of the fuels component in the rate (see section j below) ....	2,029	264	(1,783)	510	1-3
With respect to consumers participation in financing emergency plan stage B (see section k below) .....	1,333	61	(496)	898	1-3
<b>Total .....</b>	<b>3,362</b>	<b>708</b>	<b>(2,279)</b>	<b>1,791</b>	<b>Change</b>
<b>Total balance of regulatory deferral accounts (see section o below) .....</b>	<b>(486)</b>			<b>(954)</b>	<b>(468)</b>

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**NOTE 15:- REGULATORY ASSETS/LIABILITIES (continued)**

**c. Details of the amounts and transactions in regulatory deferral accounts for the year ended on December 31, 2014 (before tax effect):**

	NIS in millions			Balance As of December 31, 2014	Period remaining for refund / cancellation  Years
	Balance	Transaction for the year ended on December 31, 2014			
	As of January 1, 2014	Creation / recognition	Refund / cancellation		
<b>Debit balance of regulatory deferral accounts</b>					
With respect to the erosion of the Company's liabilities in foreign currency, passed on to the electricity consumers (see section e below) .....	-	230	-	230	1-2
With respect to the gap between dates for actual updating rates and the theoretical rate (see section f below) .....	461	1,129	(88)	1,502	1-2
With respect to non-consecutive update of the fuels component in the rate (see section j below) ....	3,335	(110)	(3,225)	-	1-2
With respect to social rate (see section g below) .....	306	249	(179)	376	1-2
With respect to electricity purchases from private electricity producers and photovoltaic facilities (see section h below) .....	327	252	(265)	314	1-2
With respect to load management arrangements (see section i below) .....	141	121	(137)	125	1-3
With respect to not updating the electricity rate for the transmission and distribution segment (see section l below) .....	148	-	-	148	1-2
With respect to deemed interest (see section m below) .....	-	53	-	53	21-33
With respect to recognition of investments that were reduced in the past (see section n below) .....	-	122	-	122	14-22
Others .....	-	6	-	6	-
<b>Total .....</b>	<b>4,718</b>	<b>2,052</b>	<b>(3,894)</b>	<b>2,876</b>	
<b>Credit balance of regulatory deferral accounts</b>					
With respect to non-consecutive update of the fuels component in the rate (see section j below) ....	-	2,029	-	2,029	1-3
With respect to the erosion of the Company's liabilities in foreign currency, passed on to the electricity consumers (see section e below) .....	624	-	(624)	-	-
With respect to consumers participation in financing emergency plan stage B (see section k below) .....	1,758	68	(493)	1,333	2-3
With respect to provision for fines .....	20	-	(20)	-	-
Others.....	45	-	(45)	-	-
<b>Total .....</b>	<b>2,447</b>	<b>2,097</b>	<b>(1,182)</b>	<b>3,362</b>	<b>Change</b>
<b>Total balance of regulatory deferral accounts (see section o below) .....</b>	<b>2,271</b>			<b>(486)</b>	<b>(2,757)</b>

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**NOTE 15:- REGULATORY ASSETS/LIABILITIES (continued)**

d. The return rate used to calculate the balance of the regulatory deferral accounts as of December 31, 2015 is 4.13% (4.42% as of December 31, 2014).

**e. Regulatory Deferral Account with Respect to the Hedging Mechanism**

The Former Hedging Mechanism

The debt collection with respect to the former hedging mechanism ended in February, 2015 and differences accrued were expressed in the compensation mechanism with respect to consecutive non-updating.

The New Hedging Mechanism

At the same time, within the decision of the Authority of February 2010 regarding the rate base in the generation segment, a new hedging mechanism was defined, to be completely decreased by March 31, 2013.

Within the Authority's decision of September 7, 2015, regarding the 2015 annual update, it was determined that the hedged capital sum will remain in effect until application of a new rate base for the generation segment.

The balance of the regulatory deferral account with respect to this debt, as of the date of the statement of financial position, is approximately NIS 120 million (as of December 31, 2014, approximately NIS 230 million).

**f. Regulatory Deferral Account with Respect to a Gap between Rate Updating Dates (without fuel)**

The electricity rate is not updated in a continuous manner; therefore, a gap was created in income between the income collected according to the actual rate and the income that is due to the Company according to the theoretical rate. The gap accumulates during the whole calendar year and is added to the recognized cost of the Company on the date of the annual update in the following year. The Company creates a regulatory asset in its Financial Statements with respect to this gap. The change in the assets for the period starting January 1, 2015 to December 31, 2015 is calculated as the difference between the total theoretical cost recognized and the actual recognized cost less the theoretical collection.

The theoretical recognized cost for the period of January-December 2015 is calculated in accordance with the decision of the Authority with regard to the 2015 annual update.

The balance of this asset as of December 31, 2015 is NIS 58 million (as of December 31, 2014, approximately NIS 1,502 million).

**g. Regulatory Deferral Account with Respect to Social Rate**

On March 27, 2007, the Electricity Sector Law (Amendment No. 6, Reduced Rates), 2007 was made public. According to the Law, a consumer who has reached legal retirement age and is entitled to income support from the State, will pay a reduced rate of 50% of the home consumption rate for the first 400 kWh consumed on a monthly basis for home consumption only.

In addition, a number of additional groups of the population received this entitlement during 2007-2012:

- 1) Disabled holocaust survivors.
- 2) Disabled who receive old age pensions for the disabled.
- 3) Six additional groups are eligible to reduced electricity prices.

The law authorizes the Minister, upon consulting the Minister of Welfare and upon consent of the Minister of Finance, to determine other needy populations which will be entitled to reduced payments, at the determined proportion of the household rate, the quantity of electricity that will entitle it to a reduced payment, as well as discount rates and various quantities for groups of the population, so that the total reduction from the payment for electricity consumption will not exceed an amount equaling to 1.5% of the total payments paid by all consumers for electricity consumption.

In accordance with the decision of the Authority of August 6, 2012, the social rate also applies to consumers of the East Jerusalem Electricity Company who meet the criteria detailed above.

As of the statement of financial position date, the balance of the regulatory deferral account with respect to collecting reduced payment for needy populations is NIS 172 million. According to the decision of the Electricity Authority, this cost will be charged to all electricity consumers. (As of December 31, 2014, approximately NIS 376 million).



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**NOTE 15:- REGULATORY ASSETS/LIABILITIES (continued)**

**h. Regulatory Deferral Account with respect to Electricity Purchases from Private Producers and Photovoltaic Facilities:**

On the annual update date every year, the Electricity Authority updates the recognized cost with respect to purchase of electricity and load management arrangements. Commencing April 1, 2012, advances are paid to the Company for electricity purchases from private electricity producers and the owners of photovoltaic facilities. With respect to the differences that may be created between the advances, as stated, and the actual costs, a regulatory asset or liability is created. The Company records in its books a regulatory deferral account with a balance, as of December 31, 2015 of NIS 383 million with respect to electricity purchases in credit balance of regulatory deferral accounts. (As of December 31, 2014, a balance of NIS 314 million in debit balance of regulatory deferral accounts).

**i. Regulatory Deferral Account with Respect to Load Management Arrangements:**

With respect to the gap in the timing of the recognition of costs with respect to the arrangements within the rate relating to the date of expenses thereof, the Company records in its books a regulatory deferral account with a balance, as of December 31, 2015, of NIS 14 million, with respect to arrangements in debit balance of regulatory deferral accounts. (As of December 31, 2014, of NIS 125 million).

**j. Regulatory Deferral Account With Respect to Non-Update of the Fuel Component in the Rate, Net**

The update of the fuel component in the electricity rate is executed retroactively, every year, according to the actual demand curve and updates of new relevant information with respect to the fuels basket that is recognized for the Company. With respect to the gaps created between the actual rate and the theoretical rate that according to the estimate of the Company will be retroactively recognized, the Company records in its books a regulatory liability or a regulatory asset that is refunded to the consumers or to the Company with the addition of interest and linkage differentials. For details of the rate update mechanism see Note 3 a 2) above.

As of December 31, 2015, the credit balance of the regulatory deferral account with respect to a consecutive non-update of the fuel component is NIS 510 million (as of December 31, 2014, the credit balance is NIS 2,029 million). The balance includes the following components:

- 1) Compensation liability with respect to the delayed updating of the fuel component in the rate in the amount of NIS 1,585 million. This balance reflects the difference between the actual rate and the theoretical rate that is based on existing valid decisions of the Authority as of the date of the report.
- 2) Regulatory asset in the amount of NIS 1,075 million primarily with respect to the Company's projection of a probable change in a compensation liability with respect to a delay in the update of the fuel component for the year 2015, with respect to components for which the decision of the Authority has not yet been received. This calculation includes the impact of changing the theoretical fuels basket in accordance with the decision of the Authority with an updated assessment of income from fuels expected to be recognized with respect to 2015

**k. Regulatory Deferral Account with Respect to Consumers Participation in Financing Stage B**

The creation of the liability in the amount of approximately NIS 2 billion was subject to the Authority's decision of March 7, 2011, regarding the spread of the Company debt for the purpose of financing stage B of the emergency plan. The Authority states that the balance of the principal with respect to the loan will be repaid to consumers retroactively from April 2010, where this repayment will be deducted from the recognized cost.

In its decision of May 6, 2013, pertaining to the updating of the rate increase, the Authority determined to shorten this debt return period by half, so that the debt will already end in 2017 instead of 2025. As of December 31, 2015, the balance of this regulatory deferral account is NIS 898 million. (As of December 31, 2014, the credit balance is NIS 1,333 million).

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**NOTE 15:- REGULATORY ASSETS/LIABILITIES (continued)**

**i. Regulatory Deferral Account With Respect to not updating the Electricity Rate in the Transmission and Distribution Segments**

As detailed in Note 3 c above, pursuant to the decision of the Authority, as of 2012, the Authority recognizes for the Company a supplement for the recognized cost for the Authority's segments as an advance until the determination of a new rate base for the these segments, which will apply retrospectively from April 1, 2012, in the amount of NIS 300 million. As of 2013, the Electricity Authority increased the advance for the recognized cost for the transmission and distribution segments to approximately NIS 400 million a year. In the Authority's decision regarding the 2015 update, the Authority increased the advance to approximately NIS 700 million for 2015.

As of the date of this Report, new rate bases for these segments have not yet been published. The Company estimates that, within the updating of new rate bases, an additional supplement will be provided (beyond the above mentioned advances) for the recognized costs of the transmission and distribution segments for the period between April 2012 and December 2015. Considering this, as of December 31, 2015, there is a debt balance of a regulatory deferral account in the amount of approximately NIS 153 million in the Company books. (As of December 31, 2014, the credit balance is NIS 148 million).

- m. In light of the provisions of IFRS 14, a regulatory deferral account balance should be recognized with respect to a component of deemed interest which includes amounts recognized for financing the construction and which provide the entity with return on equity as well as the foreign capital. Therefore, the difference between the sum of the credit costs that can be capitalized with respect to the qualifying assets pursuant to the provisions of IAS 23, and the sum of the deemed interest that is recognized for the Company within the framework of the rate will be recognized as a regulatory deferral account balance. The balance of this asset as of December 31, 2015 is NIS 114 million (the balance of the asset as of December 31, 2014 is NIS 53 million).
- n. The Company recognizes the sums that were reduced in the past pursuant to the accounting policies which applied to it prior to the implementation of the international accounting principles, and are now recognized in the rate in accordance with the lifetime of the assets. In accordance with the latest rate update of September 2015 (see Note 3.a above), the Company has cancelled part of the impairment it executed in the past and created in its books the debit balance of this regulatory deferral account as of December 31, 2015 in the amount of approximately NIS 206 million (as of December 31, 2014, the credit balance is NIS 122 million).
- o. The total balance of regulatory deferral accounts as of December 31, 2015 is a credit balance of approximately NIS 954 million. This balance includes credit balances of regulatory deferral accounts in the amount of NIS 2,296 million which are based on the decisions of the Electricity Authority and a debit balance of regulatory deferral accounts in the amount of approximately NIS 1,342 million which are based on Company estimates. The debit balances which are based on the estimates of the Company were calculated on the basis of the assessments of the Company of the Authority's recognition of these costs. These costs, as stated, were mainly included in an asset with respect to non-update of the fuels component of the rate, and an asset with respect to non-update of the electricity rate in the transmission and distribution segment.

The total balance of regulatory deferral accounts as of December 31, 2014 is a credit balance of approximately NIS 486 million. This balance includes credit balances of regulatory deferral accounts in the amount of NIS 1,613 million which are based on the decisions of the Electricity Authority and a debit balance of regulatory deferral accounts in the amount of approximately NIS 1,127 million which are based on Company estimates. The debit balances which are based on the estimates of the Company were calculated on the basis of the assessments of the Company of the Authority's recognition of these costs. These costs, as stated, were mainly included in an asset with respect to a gap between the rate update dates, an asset with respect to non-update of the fuels component of the rate, and an asset with respect to non-update of the electricity rate in the transmission and distribution segment.

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**AS OF DECEMBER 31, 2015 (NEW ISRAELI SHEKELS)**

**NOTE 16:- CREDIT FROM BANKS AND OTHER CREDIT PROVIDERS**

**Composition:**

	<b>As of December 31</b>	
	<b>2015</b>	<b>2014</b>
	<b>NIS in millions</b>	
Short term loans.....	259	456
Current maturities of loans and debentures * .....	2,112	7,473
Current maturity of a liability to the State of Israel* .....	319	300
Maturities for forward and swap transactions .....	66	126
<b>Total .....</b>	<b>2,756</b>	<b>8,355</b>

\* With respect to interest rates for current maturities, see Note 20.

**NOTE 17:- OTHER CURRENT LIABILITIES**

**Composition:**

	<b>As of December 31</b>	
	<b>2015</b>	<b>2014</b>
	<b>NIS in millions</b>	
Employees .....	317	220
Institutions .....	363	166
Interest and accrued expenses .....	1,078	1,116
Other payables .....	119	129
	<b>1,877</b>	<b>1,631</b>

**NOTE 18:- CUSTOMER ADVANCES, NET OF WORK IN PROGRESS**

Represents receipts from customers, net of work in progress with respect to attachments to buildings and works for others (see also Note 2(q) above).

**Composition:**

	<b>Connections to buildings</b>		<b>Work paid for by others</b>		<b>Total</b>	
	<b>As of December 31</b>		<b>As of December 31</b>		<b>As of December 31</b>	
	<b>2015</b>	<b>2014</b>	<b>2015</b>	<b>2014</b>	<b>2015</b>	<b>2014</b>
	<b>NIS in millions</b>		<b>NIS in millions</b>		<b>NIS in millions</b>	
Receipts from customers .....	463	418	447	469	910	887
Less: expenses with respect to work in progress .....	(190)	(148)	(224)	(286)	(414)	(434)
	<b>273</b>	<b>270</b>	<b>223</b>	<b>183</b>	<b>496</b>	<b>453</b>

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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
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**NOTE 19:- PROVISIONS**

**Composition:**

	<b>Provision for legal claims (1)</b>	<b>Provision for vacation pay</b>	<b>Municipal tax</b>	<b>Others</b>	<b>Total</b>
	<b>NIS in millions</b>				
Balance as of January 1, 2015 .....	349	307	43	20	719
Additional recognized provisions .....	47	-	4	18	69
Updated current provisions .....	(2)	244	25	-	267
Amounts used during the year .....	-	(236)	(20)	(7)	(263)
Amounts canceled during the year .....	(58)	-	(8)	-	(66)
<b>Balance as of December 31, 2015.....</b>	<b>336</b>	<b>315</b>	<b>44</b>	<b>31</b>	<b>726</b>

	<b>Provision for legal claims (1)</b>	<b>Provision for vacation pay</b>	<b>Municipal tax</b>	<b>Others</b>	<b>Total</b>
	<b>NIS in millions</b>				
Balance as of January 1, 2014 .....	355	302	64	8	729
Additional recognized provisions .....	29	-	4	13	46
Updated current provisions .....	14	230	12	-	256
Amounts used during the year .....	-	(225)	(37)	(1)	(263)
Amounts canceled during the year .....	(49)	-	-	-	(49)
<b>Balance as of December 31, 2014.....</b>	<b>349</b>	<b>307</b>	<b>43</b>	<b>20</b>	<b>719</b>

(1) In 2015, the Company recorded net revenues of approximately NIS 20 million resulting from the settlement of legal claims as existed on December 31, 2014 in amounts smaller than the provisions recorded for them.

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**NOTE 20:- DEBENTURES AND LIABILITIES TO BANKING CORPORATIONS AND OTHERS**

**a. Composition of the long-term debentures and liabilities and hedging transactions**

Linkage Basis:	December 31, 2015							December 31, 2014	
	Unlinked NIS	Linked to the CPI		Denominated in U.S. Dollars			Denominated in Japanese Yen	Total	
				NIS in millions				Total NIS in millions	
Interest rates (%)	4.8, 8.5	1.2-3.9	4.6-6.9	2.1	5.0-6.9	7.3-9.4	3.6-4.1		
<b>(1) Debentures:</b>									
Debtures traded on the Israel Stock Exchange .....	437	1,414	-	-	-	-	-	1,851	3,685
Debtures not traded in Israel .....	657	-	9,283	-	-	-	-	9,940	11,827
Debtures issued abroad .....	-	-	-	976	12,292	8,643	2,430	24,341	24,278
	1,094	1,414	9,283	976	12,292	8,643	2,430	36,132	39,790
Premium/discount/deferred charges.....	45	32	498	(1)	(61)	(51)	(18)	444	495
	1,139	1,446	9,781	975	12,231	8,592	2,412	36,576	40,285
Current maturities:									
Debtures.....	13	-	1,537	-	-	-	-	1,550	4,473
(Discount)/premium.....	13	1	105	-	(8)	(7)	(1)	103	109
Total current maturities .....	26	1	1,642	-	(8)	(7)	(1)	1,653	4,582
<b>Total debtures .....</b>	<b>1,113</b>	<b>1,445</b>	<b>8,139</b>	<b>975</b>	<b>12,239</b>	<b>8,599</b>	<b>2,413</b>	<b>34,923</b>	<b>35,703</b>

THE ISRAEL ELECTRIC CORPORATION LIMITED  
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NOTE 20:- DEBENTURES AND LIABILITIES TO BANKING CORPORATIONS AND OTHERS (continued)

a. Composition of the long-term debentures and liabilities and hedging transactions (continued)

Linkage Basis:	December 31, 2015					Total	December 31, 2014
	Unlinked NIS	Linked to the CPI	Denominated in U.S. Dollars	Denominated in Euro	Denominated in Japanese Yen		Total NIS in millions
Interest rates (%)	NIS in millions						
	1.3-2.2	4.5	1-3.3	0.3-2.5			
<b>(2) Liabilities to banks:</b>							
Loans from banks.....	1,250	328	1,041	1,639	-	4,258	6,272
Less: Deferred charges.....	(1)	-	(37)	(110)	-	(148)	(178)
	1,249	328	1,004	1,529	-	4,110	6,094
Current maturities:							
Loans from banks.....	-	47	105	329	-	481	2,922
Deferred charges.....	(1)	-	(5)	(17)	-	(23)	(35)
<b>Total current maturities.....</b>	<b>(1)</b>	<b>47</b>	<b>100</b>	<b>312</b>	<b>-</b>	<b>458</b>	<b>2,887</b>
<b>Liabilities to banks.....</b>	<b>1,250</b>	<b>281</b>	<b>904</b>	<b>1,217</b>	<b>-</b>	<b>3,652</b>	<b>3,207</b>
<b>Hedging transactions:</b>							
Swap transactions.....	1,852	19,018	(17,610)	(113)	(1,928)	1,219	1,399
Forward transactions.....	2,659	-	(2,734)	-	-	(75)	(4)
Total hedging transactions.....	4,511	19,018	(20,344)	(113)	(1,928)	1,144	1,395
Current maturities of swap transactions.....	-	(158)	-	-	-	(158)	26
Current maturities of forward transactions.....	(75)	-	-	-	-	(75)	(4)
Total current maturities.....	(75)	(158)	-	-	-	(233)	22
<b>Total hedging transactions, net.....</b>	<b>4,586</b>	<b>19,176</b>	<b>(20,344)</b>	<b>(113)</b>	<b>(1,928)</b>	<b>1,377</b>	<b>1,373</b>
Transfer of hedge transactions to long-term receivables, net.....	-	219	-	-	-	219	162
Payables balance with respect to long term hedging transactions.....	<b>4,586</b>	19,395	(20,344)	(113)	(1,928)	1,596	1,535
<b>Total liabilities to banking corporations (including hedge transactions) .....</b>	<b>5,836</b>	<b>19,676</b>	<b>(19,440)</b>	<b>1,104</b>	<b>(1,928)</b>	<b>5,248</b>	<b>4,742</b>

THE ISRAEL ELECTRIC CORPORATION LIMITED  
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NOTE 20:- DEBENTURES AND LIABILITIES TO BANKING CORPORATIONS AND OTHERS (continued)

a. Composition of the long-term debentures and liabilities and hedging transactions (continued)

Linkage Basis:	December 31, 2015					Total	December 31, 2014
	Unlinked NIS	Linked to the CPI	Denominated in U.S. Dollars	Denominated in Euro	Denominated in Japanese Yen		Total NIS in millions
	NIS in millions						
Interest rates (%)		5-5.75					
(3) Debentures to the State of Israel.....	-	2,511	-	-	-	2,511	2,534
(see Note 23 below)							
Interest rates (%)			6.7-7.4				
(4) <u>Liabilities to the State of Israel</u>							
Loans from the State of Israel (see Note 34 b (2)(d) below) .....	-	-	2,930	-	-	2,930	3,223
Less deferred expenses.....	-	-	(20)	-	-	(20)	(18)
	-	-	2,910	-	-	2,910	3,205
<b>Current Maturities:</b>							
Loans from the State of Israel.....	-	-	323	-	-	323	304
Deferred expenses.....	-	-	(4)	-	-	(4)	(4)
<b>Total current maturities.....</b>	-	-	319	-	-	319	300
<b>Loans from the State of Israel .....</b>	-	-	2,591	-	-	2,591	2,905
Interest rates (%)							
(5) <u>Other Liabilities</u>							
Liabilities for finance leases .....	-	17	-	-	-	17	18
Long-term payables .....	220	478	26	16	-	740	669
	220	495	26	16	-	757	687
<b>Current maturities:</b>							
Current maturities .....	-	1	-	-	-	1	4
<b>Total other liabilities.....</b>	220	494	26	16	-	756	683
<b>Total debentures, liabilities to banks and other liabilities .....</b>	7,169	32,265	4,990	1,120	485	46,029	46,567

**THE ISRAEL ELECTRIC CORPORATION LIMITED**  
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**NOTE 20:- DEBENTURES AND LIABILITIES TO BANKING CORPORATIONS AND OTHERS (continued)**

**b. Composition of the long-term debentures**

1) Negotiable series in Israel:

- a) Negotiable debenture Series 25 which was issued in 2012 and listed for trade on the TASE, is linked to the CPI, will be redeemed in 2017.
- b) Negotiable debenture Series 26, which was issued in 2015 and listed for trade on TASE, is not linked to the CPI, is due for redemption in 2016 until 2023.
- c) Negotiable debenture Series 27, which was issued in 2015 and listed for trade on the TASE, is linked to the CPI, is due for redemption in 2017 until 2029.

2) Non-negotiable series in Israel:

- a) Debentures Series listed for trade on the TASE at the institutional continuous floor are: "Series XI", "Series XII", "Series XIII", "2018 Linked Electric", "2018 NIS Electric", "2020 Linked Electric", "2022 Linked Electric", "2029 Linked Electric" and "2024 USD Electric". These series are due for redemption in 2016 to 2029.
- b) Debentures Series not listed for trade on the TASE are: private debentures that were issued in 1991 and 1996. These series will be redeemed in 2016-2020.

3) Non-negotiable series abroad:

The Company has non-negotiable debenture series issued in USD, Euro and Japanese Yen. These series will be redeemed in 2017 to 2032 and in 2096.

**c. Shelf Prospectus Publication**

On November 26, 2015, the Company published a shelf prospectus on the basis of the Company's Financial Statements for December 31, 2014 (as were included in the periodic report), and on the basis of the Company's Financial Statements for the second quarter of 2015. The shelf prospectus enables the Company to issue various securities, except for shares (namely non-convertible debentures, option warrants which can be exercised into Company debentures, and commercial securities) which will be listed on the Tel Aviv Stock Exchange Ltd. during a period of 24 months (which can be extended by another 12 months) on the basis of publication of a shelf offering report. For a raising executed after the statement of financial position date see section d.3) below.

**d. Raisings and Substantial Payments:**

1) Material raisings during the reporting period

- a) On January 15, 2015, a loan was received from Bank Hapoalim in the amount of NIS 1 billion. The loan is in unlinked NIS and variable interest and will be repaid in one payment on January 15, 2018.
- b) On June 7, 2015, the Company executed the public tender stage for the issue of two series of negotiable debentures pursuant to a prospectus as detailed below:
  - Series 26 (NIS) - in an amount of approximately NIS 437 million par value in consideration for a sum of approximately NIS 479 million (price of 109.6 Agorot to NIS 1 par value), at nominal interest of 4.8% (annual yield to maturity of 3.23%). The debenture principal will be repaid in 8 unequal annual payments: 3% on October 12 of each of the years 2016 to 2020, 25% on October 12, 2021, 30% on October 12, 2022, and 30% on October 12, 2023.
  - Series 27 (CPI linked) - in an amount of approximately NIS 404 million par value in consideration for a sum of approximately NIS 444 million (price of 110.1 Agorot to NIS 1 par value), at nominal interest of 3.85% (annual yield to maturity of 2.89%). The debenture principal will be repaid in 13 unequal annual payments: 1% on April 12 of each of the years 2017 to 2026, 20% on April 12, 2027, 35% on April 12, 2028, and 35% on April 12, 2029.



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**NOTE 20:- DEBENTURES AND LIABILITIES TO BANKING CORPORATIONS AND OTHERS (continued)**

**d. Raisings and Substantial Payments: (continued)**

2) Material payments during the reporting period

- a) On February 20, 2015, negotiable debentures of series 22 in the amount of NIS 500 million par value (a total of approximately NIS 623 million including linkage differentials), issued by the Company at the TASE within the May 2002 prospectus to the public, were repaid (final repayment).
- b) On March 20, 2015, private (non-negotiable) debentures of the series J in the amount of NIS 1,363 million par value (a total of approximately NIS 1,664 million including linkage differentials), issued to institutional bodies in 2005, were repaid in full.
- c) On March 31, 2015, loans in the amount of NIS 2,400 million NIS, not linked to the index and backed by State guarantee, which were received on July 1, 2013 from four Israeli banks, were repaid in full.
- d) On July 9, 2015, CPI linked public debentures of series 24, backed by State guarantee, in the amount of approximately NIS 1,997 million nominal value (a total of approximately NIS 2,026 million including linkage differentials), which were issued to the public within a prospectus published in June, 2012, were repaid in full.
- e) On September 6, 2015, private (non-negotiable) debentures of the series Electric Linked 2015 in the amount of approximately NIS 63 million par value (a total of approximately NIS 74 million including linkage differentials), issued to institutional bodies in 2007, were repaid in full.

3) Material raisings after the statement of financial position date

On February 22, 2016, the Company raised approximately NIS 1,510 million through expansion of negotiable debentures of series 26 and 27 under a shelf prospectus which was published on November 26, 2015 (see section c. above), as detailed:

- Series 26 (NIS) - in an amount of approximately NIS 572 million par value in consideration for a sum of approximately NIS 669 million (price of 117 Agorot to 1 NIS par value), at nominal interest of 4.8% (annual yield to maturity of 2.12%). The debenture principal will be repaid in 8 unequal annual payments: 3% on October 12 of each of the years 2016 to 2020, 25% on October 12, 2021, 30% on October 12, 2022, and 30% on October 12, 2023.
- Series 27 (index linked) - in an amount of approximately NIS 756 million par value in consideration for a sum of approximately NIS 841 million (price of 111.2 Agorot to 1 NIS par value), at nominal interest of 3.85% (annual yield to maturity of 2.87%). The debenture principal will be repaid in 13 unequal annual payments: 1% on April 12 of each of the years 2017 to 2026, 20% on April 12, 2027, 35% on April 12, 2028, and 35% on April 12, 2029.

4) Material repayments after the statement of financial position date

On February 17, 2016, the Company executed buyback of its debentures in a total amount of approximately NIS 1,556 million of debentures of series L and M, which are traded on the "Retzef Mosadi'im" institutional trading market system of the Tel Aviv Stock Exchange Ltd., as detailed:

- A total of approximately NIS 768 million par value at a price of 132.91 from debentures (series L).
- A total of approximately NIS 461 million par value at a price of 116.26 from debentures (series M).

With respect to the buyback of debentures of series L and M, an accounting loss was generated from early repayment in the amount of approximately NIS 81 million before tax effect.

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**NOTE 20:- DEBENTURES AND LIABILITIES TO BANKING CORPORATIONS AND OTHERS (continued)**

**e. Terms of the Company's financing agreements that might result in immediate repayment**

The financing contracts of the Company include provisions that provide the lender with the right to demand immediate repayment of the unpaid balance of the loan and the accrued interest on the occurrence of the following main events:

- 1) As is customary in financing contracts, events such as a material violation of the Company's liabilities to the financiers, the granting of a liquidation order, stay of proceedings, issuing an attachment order in a considerable amount as to Company assets, expropriation of a material asset or the appointment of a receiver for material assets of the Company, provide the lenders with the right to demand immediate repayment. Therefore, according to the majority of the bills of charge entered into by the Company, when such events occur, a lender, in whose favor the Company recorded a floating or a fixed charge on its assets, is entitled to realize this charge, subject to certain conditions, if and insofar as these apply to the exercise of the charge.
- 2) In all of the loan agreements, the failure to pay principal or interest on time (or after a period of deferral of repayment as defined in the contract) constitutes a breach that provides the lender with the right to demand immediate repayment. In all of the financing contracts denominated in foreign currency, the Company is obligated to pay the principal and interest in the denominated currency. The Company's inability to purchase foreign currency at the required time and in the required amount may constitute a breach that provides the lender the right to demand immediate repayment.
- 3) In some financing contracts it was determined that the existence of the right to demand immediate repayment of the debt, granted to one lender (namely, even when this lender does not demand immediate repayment), grants the right to another lender, with whom the contract was not breached, to demand immediate repayment (cross default). The volume of financing contracts of the Company, that include a cross default condition, amounts to approximately NIS 26,213 million, as of December 31, 2015. 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, 2015 to approximately NIS 7,359 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) In some of the financing contracts, it is determined that nonpayment pursuant to a ruling against the Company (sometimes only when it is a ruling exceeding a certain sum) provides the lender with the right to demand immediate repayment.
- 5) In part of the financing contracts, there is a 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.
- 6) 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.

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**NOTE 20:- DEBENTURES AND LIABILITIES TO BANKING CORPORATIONS AND OTHERS (continued)**

**e. Terms of the Company's financing agreements that might result in immediate repayment (continued)**

- 7) In some 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.
- 8) 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, 2015, to approximately NIS 28,807 million.
- 9) 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.
- 10) 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.
- 11) 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.
- 12) Under the terms of debentures issued through the Goldman Sachs and Dexia investment banks in the amount of USD 250 million from January 2008, and the framework agreement for issuing debentures in an amount of USD 2 billion from April 2008, the Company undertook that once another company will be engaged in all or most of the electricity transmission operations, the Company will transfer the debt to that other company ("the Transmission Company"). In such circumstances, holders of the debentures have an option to demand immediate pay-off of the debt, when the following accumulated conditions are fulfilled:
  - a) The State of Israel is rated at an Investment Grade.
  - b) The Company is rated at a lower than an Investment Grade rating;
  - 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.
- 13) 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.
- 14) According to some the general terms of the debentures issued by the Company, holders of debentures are entitled to demand immediate repayment of the principal and interest of the debentures, inter alia in a case in which rating of the debentures will cease for a period exceeding 60 consecutive days, due to circumstances under the Company's control (except as a result of replacing the rating company).

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**NOTE 20:- DEBENTURES AND LIABILITIES TO BANKING CORPORATIONS AND OTHERS (continued)**

**e. Terms of the Company's financing agreements that might result in immediate repayment (continued)**

- 15) 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.
- 16) 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.
- 17) According to the trust deeds of the debentures, issued by the Company in July 2012 (series 25), including expansion of this series in 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.
- 18) 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).
- 19) In some of the financing contracts, the lenders have the right to demand immediate repayment of the loan, 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).
- 20) In some of the financing contracts, the lenders have the right to demand immediate repayment of the loan in the event that proceedings (including legal proceedings) have been initiated, regarding the:
  - a) Liquidation or reorganization of the Company, delay in any payment by the Company or compromise or settlement with a creditor of the Company not under sections 350 and/or 351 of the Companies Law.
  - b) Appointment of a receiver or liquidator for the Company or any of its assets whose value exceeds USD 25 million, or realization of a mortgage or lien with regard to such an asset.
- 21) Under the terms of the debentures issued by the Company abroad in the months of June and July 2013 and in November 2014 (within the GMTN plan of April 2008 that was increased from USD 2 billion to USD 5 billion), the debenture holders will be entitled to redeem the debentures, inter alia, in the event that the two following cumulative conditions are fulfilled:
  - a) The debentures are rated both by S&P and Moody's two rating levels below the Company's international long-term corporate credit rating and the senior debt of the Company for 3 continuous months;
  - b) The rating level determined by S&P is lower than the BB+ rating and the rating level determined by Moody's is lower than the rating Baa3.
- 22) According to the trust deeds of the debentures (series 26) and debentures (series 27), issued by the Company in June 2015, the debenture holders will be entitled to demand immediate repayment of the debentures in the following cases:
  - a) The Company did not publish financial statements within 30 days from the last date on which it is required to publish them under any law, or within 30 days from the end of the extension date given to the Company by an authorized authority to publish the aforesaid financial statements, according to the latest;
  - b) The Company ceased to be a reporting corporation, as per the meaning of this term in the Securities Law.

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**NOTE 20:- DEBENTURES AND LIABILITIES TO BANKING CORPORATIONS AND OTHERS (continued)**

**e. Terms of the Company's financing agreements that might result in immediate repayment (continued)**

To the best of the knowledge of the Company, at the time these financial statements were signed, none of the lenders with whom the Company entered agreements have a reason to demand immediate repayment of the Company's debt to them, including the subject of fulfilling the MAC provisions.

**f. 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 1,609 million as on December 31, 2015.

**g. Credit Rating**

On April 2, 2015, the "Midroog Ltd." rating company left the rating of the series with State guarantee unchanged, at Aaa.il with a stable outlook, while the series without State guarantee remained at a rating of Aa3.il but the outlook rating was changed from stable to positive.

According to the "Midroog Ltd." company, raising the outlook rating for the series without State guarantee from stable to positive mainly reflects the improvement in the liquidity profile of the Company, which improves its ability to cope at times of crisis. At the same time, Midroog adds that opening two credit facilities by the Company with two banks enables it financial liquidity and flexibility.

On August 6, 2015, the international rating company Standard & Poor's and the local rating company S&P Ma'alot published an annual review regarding the Company, in which they left the international and local issuer rating of the Company, as was published in the rating report of July 3, 2014, unchanged, a rating of BBB- with a stable outlook and iIAA with a stable outlook, respectively.

On November 30, 2015, the Moody's rating company published an annual review in which it left the rating of the Company's debt secured by foreign currency as was published in the rating report of May 13, 2014, Baa3 with a stable outlook.

**h. Securities and Liens**

To ensure full repayment of the payments with respect to part of the above mentioned debentures and loans (principal, interest and linkage differentials) and to ensure the fulfillment of the remainder of the stated debenture and loan terms, the Company has pledged all its property (including property under construction) that can be pledged according to law and all its rights to this property of any type and nature whatsoever, existing at present and as will be in future by a floating charge - of equal rank with all the other floating charges that were created by the Company, relative (pari passu) to the amounts of obligation as will be secured, from time to time, by each of these liens. The extent of the liabilities of the Company secured by floating charges on December 31, 2015 is approximately NIS 37,367 million.

To ensure the obligations of the Company towards various lenders, the Company has created fixed charges in favor of the lenders over the following assets:

- Three gas turbines for electricity production purchased by the Company from the Siemens Company which were erected at the Ramat Hovav, Eshkol and Hagit sites.
- Six selective catalytic reduction (SCR) systems purchased by the Company from the BNG company to be installed at the "Orot Rabin: power station and at the Rutenberg power station.
- Three steam additions purchased by the Company from the Doosan company for gas turbines at the Ramat Hovav, Eshkol and Hagit sites.

The extent of the liabilities of the Company secured by fixed charges on December 31, 2015 is approximately NIS 1,673 million.

The Minister of National Infrastructures, Energy and Water is authorized to determine: "with regard to certain assets belonging to the license owner, required in the opinion of the Minister for executing the activity according to the instructions of the license, that they cannot be transferred, charged or attached, directly or indirectly, without the approval of the Minister."

According to that stated, the Minister's approval for the pledges detailed in the Note, which were created after the Electricity Sector Law entered into force, was received.

**i. Fair Value of Negotiable Debentures**

The fair value of the debentures traded in the Tel Aviv Stock Exchange is approximately NIS 2,002 million. The fair value of the negotiable debentures is the Stock Exchange value. Also see Note 27 i below.

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**NOTE 21:- PROVISIONS FOR REFUNDING AMOUNTS TO CONSUMERS**

Based on a legal opinion, the Financial Statements include provisions amounting to NIS 2,758 million with respect to refunding sums to consumers arising from the restatement of the financial statements (in the report of June 2009) regarding the difference between calculations (mainly due to the change in the actuarial liability) which served as the basis used to determine the rate in the past and the updated calculations.

At the same time, the Company has claims against the Electricity Authority, stating that the current rate coverage for pension liabilities is lower than that required to cover these liabilities and the Company has addressed the Electricity Authority with a demand to receive them. Therefore, it is too early to estimate whether these provisions will have an eventual effect on the cash flow of the Company.

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**NOTE 22:- INCOME TAXES**

**a. Benefits under the Law for the Encouragement of Industry**

The Company is an "Industrial Company" as defined by the Law for the Encouragement of Industry (Taxes), 1969 and, accordingly, is entitled to certain tax benefits, the most significant of which is depreciation at enlarged rates.

**b. Tax loss carry-forward to future years**

The tax loss available for carry-forward to future years on the report date was NIS 12,954 million.

The Company recorded a deferred tax asset with regard to the loss carry-forward in the aggregate amount of NIS 3,432 million as of December 31, 2015 and NIS 3,458 million as of December 31, 2014 (section j 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 j 2 below).

**c. Tax rates**

On August 5, 2013, the Change in National Priorities (Legislation Amendments for Achieving Budgetary Goals) -2013 Law was published in the Official Gazette, determining, inter alia, the increase of companies' tax rate, from 2014 onwards, to a rate of 26.5% (instead of 25%).

Regarding change of the future tax rate see section k below.

**d.** The tax that will apply to the shareholders due to the payment of dividends by the Company is not expected to be material since almost all of the Company's shares are held by the State of Israel.

**e. Tax assessments**

The Company received final tax assessments through the 2008 tax year and final deductions assessments through the 2008 tax year.

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**NOTE 22:- INCOME TAXES (continued)**

**f. Reconciliation of tax expenses (income) 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:

	<b>For the Year ended December 31</b>	
	<b>2015</b>	<b>2014</b>
	<b>NIS in millions</b>	
Income (loss) before income taxes .....	796	3,457
Statutory tax rate .....	26.5%	26.5%
Computed tax per statutory rate .....	211	917
Expenses disallowed net (including depreciation) .....	22	14
Effect of tax law compared to statements .....	(16)	(15)
Total income tax as presented in profit or loss.....	217	916

**g. Income tax expenses (income) that were recognized in the statement or operations**

	<b>For the Year ended December 31</b>	
	<b>2015</b>	<b>2014</b>
	<b>NIS in millions</b>	
Decrease (increase) in deferred tax assets .....	492	1,199
Increase (decrease) in deferred tax liabilities .....	(279)	(286)
Current taxes of subsidiary .....	4	3
	217	916

**h. Taxes relating to transactions in balances of regulatory deferral accounts**

	<b>Amount before tax</b>	<b>Tax influence</b>	<b>Amount less tax</b>
For year ended December 31, 2014.....	(2,808)	744	(2,064)
For year ended December 31, 2015.....	(468)	124	(344)

**i. Taxes relating to other comprehensive income components:**

	<b>Amount before tax</b>	<b>Tax influence</b>	<b>Amount less tax</b>
For year ended December 31, 2014.....	1,547	(410)	1,137
For year ended December 31, 2015.....	161	(43)	118



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**NOTE 22:- INCOME TAXES (continued)**

**j. Deferred taxes**

**(1) Composition of deferred tax assets:**

	<u>Loss carry-forward</u>	<u>Accrued vacation pay</u>	<u>Allowance for doubtful accounts income not recognized and legal</u>	<u>Debt to Consumers</u>	<u>Accrued pension pay, net</u>	<u>Others</u>	<u>Total</u>
	NIS in millions						
Long term balance as of January 1, 2014 .....	3,818	49	121	708	2,693	-	7,389
Changes during 2014 .....	(360)	1	137	1	(681)	25	(877)
Long term balance as of December 31, 2014.....	3,458	50	258	709	2,012	25	6,512
Changes during 2015 .....	(26)	2	79	22	(529)	41	(411)
Long term balance as of December 31, 2015.....	3,432	52	337	731	1,483	66	6,101

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:**

	<u>Adjustment of depreciable fixed assets, depreciation and other assets</u>	<u>Fuels and other inventories</u>	<u>Total</u>
	NIS in millions		
Balance as of January 1, 2014 .....	12,627	(7)	12,620
Changes during 2014.....	(265)	(21)	(286)
Long term balance as of December 31, 2014 .....	12,362	(28)	12,334
Changes during 2015.....	(215)	(64)	(279)
Long term balance as of December 31, 2015 .....	12,147	(92)	12,055

**(3) Composition of deferred taxes balance presented in the statement of financial position:**

	<u>As of December 31</u>	
	<u>2015</u>	<u>2014</u>
	NIS in millions	
<b><u>Long-term</u></b>		
Deferred tax reserves.....	12,055	12,334
Less: Deferred tax assets .....	6,101	6,512
Advances: for disallowable deductions .....	166	159
	<u>5,788</u>	<u>5,663</u>

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**NOTE 22:- INCOME TAXES (continued)**

**k. Additional Information:**

**Law of Amendment to the Income Tax Ordinance**

In the beginning of January, 2016, the Law of Amendment to the Income Tax Ordinance was published, determining that the companies' tax rate will be reduced to 25% (instead of 26.5%). The new companies' tax rate will apply to income derived or accrued as of 1.1.2016.

According to the provisions of IAS 12 "Taxes on Income", the deferred tax balances as of December 31, 2015 do not take into account the provisions of the aforesaid, as its legislation was completed after the end of the reporting period.

If the law's legislation would have actually been completed up to the end of the reporting period, then this will result in a decrease in the Company's deferred taxes liabilities as of December 31, 2015 by approximately NIS 337 million; the Company's tax expenses for the year ended on the same date would have lessened by NIS 323 million; the transactions in regulatory deferral accounts for the year ended on the same date would have increased by NIS 9 million; and the other comprehensive income of the Company for the year ended on the same date would have increased by NIS 5 million.

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**NOTE 23:- PERPETUAL DEBENTURES TO THE STATE OF ISRAEL**

Pursuant to the Company's arrangement with the Ministry of Finance, perpetual debentures in a nominal amount of about NIS 15 million (the amount as of the statement of financial position date is approximately NIS 2,511 million) were issued in the past to the State of Israel. The principal in respect of these debentures is unlinked and they bear annual interest at a rate of 5% and 5.75% fully linked to the known Consumer Price Index on the date of the statement of financial position. The perpetual debentures, except for a pledge in a nominal amount, have no preference over any other loans extended to the Company.

**NOTE 24:- INFORMATION IN NOMINAL VALUES**

**a. Share Capital**

Composed as follows:

	<b>Authorized</b>	<b>As of December 31</b>	
		<b>2015</b>	<b>2014</b>
		<b>Issued and paid-up</b>	<b>Issued and paid-up</b>
		<b>NIS</b>	
80,167,387 Ordinary shares of NIS 0.1 par value each (issued and paid-up - 80,164,986 Ordinary shares) .....	8,016,739	8,016,499	8,016,499
40,053,252 Ordinary "B" shares of NIS 0.1 par value each (all issued and paid-up) .....	4,005,325	4,005,325	4,005,325
39,531 special shares of NIS 0.1 par value each (not issued and paid-up) .....	3,953	-	-
<b>Total .....</b>	<b>12,026,017</b>	<b>12,021,824</b>	<b>12,021,824</b>

**b. Shareholders' Rights**

1) Upon distribution of dividends:

- The first five percent to the Ordinary shareholders - Ordinary shareholders only.
- The next five percent to the Ordinary shareholders - Ordinary and Ordinary "B" shareholders - equal percentages, until the cumulative sum of dividends paid to Ordinary shareholders reaches 10% and Ordinary "B" shareholders reaches 5% annually.
- The next five percent to the Ordinary shareholders - Ordinary "B" shareholders - twice the percentage of Ordinary shareholders, until the cumulative sum of dividends paid to Ordinary shareholders reaches 15% and Ordinary "B" shareholders reaches 15% annually.
- The following percentages - Ordinary and Ordinary "B" shareholders - equal percentages.

2) Upon liquidation:

The surplus after refund of paid-up share capital to shareholders, first to Ordinary shareholders and then to Ordinary "B" shareholders, is to be allocated among shareholders on a proportional basis to the paid-up capital of shares held by each of them at the start of the liquidation.

3) On the date of the financial statements, the State of Israel held 120,033,262 Ordinary and Ordinary B shares, which represent 99.85% of the paid-up capital of the Company.

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**NOTE 25:- CAPITAL RESERVES**

	For the year ended December	
	31	
	2015	2014
	NIS in millions	
Capital reserve according to the Securities Regulations - transactions with controlling shareholders:		
From the sale of land to the Ports and Railway Authority .....	57	57
From the purchase of the Coal Company .....	(2)	(2)
Company's assets renewal reserve (1) .....	673	673
Capital redemption reserve fund .....	42	42
Premium on shares .....	23	23
Reserves from disposal of assets .....	29	29
Cash flows hedge fund (2) .....	(19)	(6)
	803	816
Remeasurement fund (see Note 11.m above) .....	271	140

(1) The assets renewal reserve represents profits in excess of amounts permitted for payment of dividends under the Concession for 1985 and 1986, which has been designated by the Minister of Energy for the renewal of assets.

(2) For details regarding the hedge transactions existing as of the date of the Statement of Financial Position see note 27 h below.

The Company has established various reserves pursuant to applicable laws or at the discretion of the Minister responsible for the Company at the time of their establishment. Such reserves, other than the reserves from realization of assets, cannot be distributed as dividends.

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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
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**NOTE 26:- RETAINED EARNINGS**

- a. The Company is subject to section 33(c) of the Government Companies Law, which states, inter alia, that the decision of the Board of Directors on the appropriation of profits of a Government company, including a distribution, as defined by the Companies Law, is subject to the approval of the Companies Authority. However, in the event of a disagreement between a board of directors of a company and the Government Companies Authority, then a Government Company of the Company's type (which is not under privatization), will act according to the decision of the Government Companies Authority, as approved by the Government. The current policy of the Government Companies Authority (which may change from time to time) on appropriating profits for dividend distribution, as determined in the Government Companies circular on February 9, 1997, states that:
- (1) Dividends from current income of public utilities companies will be distributed at a rate of 60% of the current net annual income, before profit-based bonus payments to employees.
  - (2) Dividends from accrued profits – a specific demand will be filed for each relevant company. The amount of the dividends will be determined with due consideration of the directives of the incorporation documents of that company, the directive of the law and the following data: Investment needs in the near future, liquid means, cash reserve, cash flow, current/acceptable financial leverage, required working capital and possible privatization of the relevant company.

In contrast to that which has been stated in Sections (1) and (2) above, in accordance with the provisions of Section 302 of the Companies Law, a company is entitled to make a distribution from its profits (as per its definition in Section 302 of the Companies Law) (hereinafter: the "Profit Test") as long as there is no reasonable fear that the distribution will prevent the Company from being able to fulfill its current and expected liabilities once they mature (hereinafter: the "Solvency Test"). In order to perform a required distribution, the Company must pass both the Profit Test and the Solvency Test (hereinafter together: "the Distribution Tests"). Notwithstanding that which has been stated above, the Court may, at the request of the Company, and after its Board of Directors has confirmed that the distribution fulfills the Solvency Test, allow the Company to make a distribution that does not fulfill the Profit Test, as long as it is convinced that the Solvency Test is fulfilled. In accordance with the Articles of Incorporation of the Company, each distribution must be approved by the Board of Directors of the Company and by a meeting of the shareholders of the Company. The Companies Law and the Articles of Incorporation of the Company prescribe that a meeting of the shareholders of the Company cannot resolve to distribute a dividend in an amount in excess of the amount that was recommended by the Board of Directors. The Company maintains, based on a legal expert opinion that it received, that a government company will not be required or allowed to make a distribution if it does not satisfy the distribution tests, and any distribution is subject to the distribution tests (unless the approval of the Court to make a distribution even if only the Solvency Test is fulfilled has been given, as mentioned).

- b. As understood by the Company, the directives of the Government Companies Law as well as the instructions of the circular of the Companies Authority on designating profits for paying dividends do not impose a duty on the board of directors of a Government company to decide to distribute dividends, but oblige it, to receive the approval of the Companies Authority of the decision of the board of directors on this subject and in the event of a conflict between the company's board of directors and the Companies Authority, the Company will act according to the decision of the Companies Authority, as approved by the Government.
- c. The calculated amount of the dividends according to this policy for 2004-2006 was about NIS 2.5 billion. No dividends were calculated for 2007, since according to the former reporting standards, the Company recorded a loss in that year. According to this policy, the dividends for 2008 amount to about NIS 370 million (after an update with respect to the restatements, the calculated sum would have amounted to approximately NIS 566 million). The amount of dividends for 2009 is NIS 804 million (after an update with respect to the restatements, the calculated sum would have amounted to approximately NIS 870 million).
- d. The Company's Board of Directors decided in 2005 to recommend to the General Meeting the distribution of dividends in the amount of NIS 118 million with respect to earnings for 2004, despite that its current profit for that year amounted to NIS 2,847 million. This is based on the opinion of the Board of Directors that dividends should not be distributed out of the earnings deriving from an accounting change and from an amount deriving from a decrease in the tax rate. These dividends were not paid as yet.  
For the time being, the Board of Directors does not recommend the distribution of dividends for the years 2005, 2006, 2008, 2009, 2014. The Company has not distributed dividends with respect to 2004 and onwards. See details in section f below.

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**NOTE 26:- RETAINED EARNINGS (continued)**

- e. Under the bonus policy in Government Business Companies, as stipulated in the Government Companies Authority circular, dated July 15, 2008, (which was in effect until June 2, 2013, and is therefore relevant to the years mentioned in sections c-f), bonus payments to employees are not allowed when no dividends were paid for the year for which the bonus is requested. The Company did not pay bonuses to employees in years where no dividends were paid.
- f. In April 2005, the Company applied to the Director of the Companies Authority to receive his approval to the recommendation of the Company's finance committee concerning the distribution of dividends out of the profits for 2004. The Company also applied to the Director of the Companies Authority requesting approval for non-appropriation of dividends from accrued profits with respect to the years 2005 – 2008, in view of the financial condition of the Company and the condition of its cash flow. According to letters of the Director of the Companies Authority to the Company on March 26, 2008 and May 5, 2009, review of the distribution of profits for the years 2004 to 2008 will be conducted with due consideration of the financing requirements of the Company, its internal sources and debt raising, required to enable the Company to fulfill the instructions of the Electricity Sector Law, 1996 (hereinafter: "the Electricity Sector Law") and its amendments, including all instructions regarding the preparation for implementing the structural change of the Electricity Sector, the development plan and the emergency plan of the Electricity Sector. In his letter of March 26, 2008, the Director of the Companies Authority notified the Company that the Companies Authority does not intend to demand a dividend distribution in 2008 by the Company for the years 2005-2006.

In his letter of May 5, 2009, the Director of the Companies Authority notified the Company that the Companies Authority does not intend to demand a dividend distribution in 2009 by the Company for the years 2004-2008. Moreover, in view of the financial and cash flow condition of the Company, the Company's Board of Directors decided that the Company will not appropriate dividends with respect to profits in 2009. The Company addressed the Director of the Companies Authority in April 18, 2010 to inform the Companies Authority on the decision of the Board of Directors to refrain from appropriating dividends with respect to profits in 2009 and receive its approval. On May 23, 2012, the Director of the Companies Authority notified the Company that the appropriation of dividends of profits in 2009 will be considered with due attention, inter alia, to the financing needs of the Company from its own sources and from funds raising, required to enable the Company to fulfill the directives of the Electricity Sector Law and its amendments, including those related to the preparations for a structural change in the Electricity Sector and implementation of the development plans of the Electricity Sector. Therefore, the Director of the Companies Authority stated in its letter that in 2012 it does not intend to require the Company to appropriate dividends with respect to 2009.

The Company did not distribute and did not calculate dividends with respect to 2010– 2013, since for 2010 the Company recorded in its financial statements a profit of NIS 2 million, in 2011 the Company recorded a loss of NIS 831 million, in 2012 the Company recorded a loss of NIS 1,002 million, and in 2013 the Company recorded a loss of NIS 934 million.

In 2014, the Company recorded a profit of NIS 151 million (NIS 465 after full IFRS implementation). The Board of Directors of the Company discussed the designation of the Company's profit for 2014, and decided that considering the previous decisions of the Board of Directors of the Company about decreasing the extent and rate of the leverage of the Company, the Company will designate its profits to decrease its liabilities, and dividends will not be distributed from the Company's profit for 2014. The Company requested the approval of the Companies Authority for this decision in its letter to the Director of the Companies Authority on May 2, 2015.

On June 8, 2015, the Director General of the Companies Authority approved the decision of the Board of Directors under which dividends will not be distributed from the Company's profit for 2014.

In 2015, the Company recorded a profit of NIS 223 million. After the Board of Directors of the Company discussed the designation of the Company's profit for 2015, it decided that considering its previous decisions about decreasing the extent of the rate of the leverage of the Company, the Company will designate its profits to decrease its liabilities, and dividends will not be distributed from the Company's profit for 2015.

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**NOTE 27:- FINANCIAL INSTRUMENTS**

**a. Groups of Financial Instruments**

	<b>For the year ended December</b>	
	<b>31</b>	
	<b>2015</b>	<b>2014</b>
	<b>NIS in millions</b>	
<b><u>Financial Assets</u></b>		
Cash and cash equivalents.....	2,524	4,504
Short term investments .....	407	2,559
Trade receivables .....	4,145	4,546
Hedge transactions.....	518	267
Accounts receivable.....	344	302
Long term receivables.....	1,440	1,671
	9,378	13,849
<b><u>Financial Liabilities</u></b>		
Trade and other accounts payable .....	3,630	3,556
Hedge transactions.....	1,662	1,660
Debentures and Financial liabilities .....	41,224	46,926
Debentures to the State of Israel .....	2,511	2,534
Liabilities to the State of Israel.....	2,607	2,920
	51,634	57,596

**b. Financial Risk Management Purposes and Policies**

The operations of the Company expose it to different financial risks, e.g. market risk (including currency risk and interest risk), credit risk and liquidity risk. 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. Avi Deutchman, Senior Vice-President of Finance and Economics, is responsible for managing the financial risks according to the policies approved by the Board of Directors. The Finance Department identifies, assesses and defines financial risks. The Board of Directors provides written principles for the overall risk management and also the specific policies for certain exposures to risks, such as exchange rate risk and interest rate risk.

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**NOTE 27:- FINANCIAL INSTRUMENTS (continued)**

**c. Market Risk**

The Company sells its products at prices determined by an external entity – the Electricity Authority. The price is based on the cost principle, as specified in Note 1 above. At the same time, in determining the recognized cost for the Company, the Electricity Authority determined costs of the different components in the rate, which do not match sometimes, the actual costs of the Company. Consequently, the major part of Company activities is not exposed to market risks, except those detailed in following items:

**(1) Currency risk and variable interest in foreign currency**

- a) The Company's policies for managing market risks to exposure to currency risk and variable interest in foreign currency:

The Company is exposed to currency risk mainly with respect to its financial liabilities and accounts payable, including payments to fuel suppliers.

- (1) The Company will execute hedging transactions in foreign currency in order to reduce currency exposure, aiming to fit the expenses structure, as far as possible, to the revenue structure recognized in the electricity rate.
- (2) The Company will execute hedging transactions on part of the foreign currency payments flow that are linked to foreign currency while considering the payment dates of the principal and interest payments.
- (3) The Company will hedge the exposure due to payments to suppliers in foreign currency, as far as possible.
- (4) The Company will examine the need to fixate variable interest, quarterly or upon material developments in the market.
- (5) The Company will execute a volume of hedging transactions which will limit the erosion of equity, due to accounting exposure, at a rate of up to 5% of the equity in case of the NIS weakening against foreign currencies at a rate of 10% and/or with respect to a change in the variable interest.
- (6) The Company is implementing hedge accounting on new transactions henceforth in accordance with the provisions of IAS 39, in order to prevent fluctuations, within the restrictions of the standard, in the profit and loss account for the period.

The main principles of the accounting policies and adopted methods, including recognition conditions, measuring basis and the basis used to recognize income and expenses related to each group of financial assets and financial liabilities are detailed in Note 2 above.

- b) Analysis of sensitivity to changes in fair value:

**Fair value:**

- (1) Debentures

- (a) Debentures in NIS

The non-negotiable debentures issued by the Company are revalued according to individual revaluations, calculated by Mirvach Hogen Ltd., which was chosen by the Ministry of Finance as the company that calculates the individual price quotes and the interest rates for institutional organizations, from March 20, 2011 (the "Transition Date").



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**NOTE 27:- FINANCIAL INSTRUMENTS (continued)**

**c. Market Risk (continued)**

**(1) Currency risk and variable interest in foreign currency (continued)**

b) Analysis of sensitivity to changes in fair value: (continued)

(1) Debentures (continued)

(b) Debentures in Foreign Currency

Debentures quoted individually on the Bloomberg system are revalued according to this quote.

Long term debentures in U.S. Dollars, which are not quoted individually on the Bloomberg system are revalued through the interest rate scheme for the longest debenture for which an individual quote exists, together with the difference between the risk-free interest rate, according to the return on the Treasury Bonds that corresponds to the life span of that debenture, and the risk-free interest according to the return on Treasury Bonds despite the life span of the debenture for which an individual quote exists.

Debentures in Japanese Yen are revalued at the return rate that is converted from a return in U.S. Dollars, using the YAX function in the Bloomberg system plus yield differentials of Japanese Government debentures.

(2) Loans

The fair value of the loans is revalued through discounted cash flow expected with respect to the loans. Discount rates are determined for the different liabilities as follows:

(a) Loans in NIS

Loans in NIS are revalued according to an interest curve, built on the basis of individual quotes for the non-negotiable debentures and according to their liability channels and guarantees given to the lenders.

(b) Loans in Foreign Currency

Loans in U.S. Dollars are revalued on the basis of the interest on U.S.A. Treasury Bonds to the relevant average duration with the addition of the CDS of the Company for the relevant period.

Loans in other foreign currencies are revalued by converting the interest on the aforementioned loans in U.S. Dollars through the SWPM function in Bloomberg system.

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**NOTE 27:- FINANCIAL INSTRUMENTS (continued)**

**c. Market Risk (continued)**

**(1) Currency risk and variable interest in foreign currency (continued)**

b) Analysis of sensitivity to changes in fair value: (continued)

(3) Analysis of foreign currency sensitivity as of December 31, 2015

Market factor: Dollar	Loss (profit) from increase in market factor		Fair value	Loss (profit) from decrease in market factor	
	+10%	+5%		(5%)	(10%)
NIS in millions					
<b>Financial assets:</b>					
Cash and cash equivalents	(18)	(9)	(181)	9	18
Short term investments	(20)	(10)	(195)	10	20
Long and short term receivables	(77)	(39)	(771)	39	77
<b>Financial liabilities:</b>					
Payables	39	19	387	(19)	(39)
Short term loans	18	9	180	(9)	(18)
Loans and debentures	2,876	1,438	28,760	(1,438)	(2,876)
<b>Swap transactions(*):</b>					
NIS or NIS linked - Dollar swap	(2,271)	(1,136)	(22,711)	1,136	2,271
<b>Total</b>	<b>547</b>	<b>272</b>	<b>5,469</b>	<b>(272)</b>	<b>(547)</b>

\* The fair value alone of the Dollar side of the hedge transactions is presented in the sensitivity tests. The total fair value of the hedge transactions against the Dollar is a liability of NIS 365 million.

Market factor: Euro	Loss (profit) from increase in market factor		Fair value	Loss (profit) from decrease in market factor	
	+10%	+5%		(5%)	(10%)
NIS in millions					
<b>Financial Assets:</b>					
Cash and cash equivalents	(21)	(11)	(212)	11	21
<b>Financial liabilities:</b>					
Payables	6	3	62	(3)	(6)
Loans and debentures	164	82	1,639	(82)	(164)
<b>Hedge transactions (*):</b>					
NIS linked - Euro swap	(11)	(6)	(113)	6	11
<b>Total</b>	<b>138</b>	<b>68</b>	<b>1,376</b>	<b>(68)</b>	<b>(138)</b>

\* The fair value alone of the Euro side of the hedge transactions is presented in the sensitivity tests. The total fair value of the hedge transactions against the Euro is a liability of NIS 21 million.

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**NOTE 27:- FINANCIAL INSTRUMENTS (continued)**

**c. Market Risk (continued)**

**(1) Currency risk and variable interest in foreign currency (continued)**

b) Analysis of sensitivity to changes in fair value: (continued)

(3) Analysis of foreign currency sensitivity as of December 31, 2015 (continued)

Market factor: Yen	Loss (profit) from increase in market factor		Fair value	Loss (profit) from decrease in market factor	
	+10%	+5%		(5%)	(10%)
<b>Financial liabilities:</b>					
Loans and debentures	257	128	2,567	(128)	(257)
<b>Hedge transactions (*):</b>					
NIS linked - Yen swap	(229)	(115)	(2,294)	115	229
<b>Total</b>	<b>28</b>	<b>13</b>	<b>273</b>	<b>(13)</b>	<b>(28)</b>

\* The fair value alone of the Yen side of the hedge transactions is presented in the sensitivity tests. The total fair value of the hedge transactions against the Yen is a liability of NIS 1,073 million.

1. Analyzing the sensitivity does not include the effect of the hedging on the rate but part of the costs with respect to exposure or linkage to foreign currency is covered in the current electricity rate.
2. Information regarding the exposure of the financial instruments to foreign currency in accordance with their book value see section f. below - Linkage basis report).

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**NOTE 27:- FINANCIAL INSTRUMENTS (continued)**

**c. Market Risk (continued)**

**(1) Currency risk and variable interest in foreign currency (continued)**

b) Analysis of sensitivity to changes in fair value: (continued)

(4) Analysis of foreign currency sensitivity as of December 31, 2014

Market factor: Dollar	Loss (profit) from increase in market factor		Fair value	Loss (profit) from decrease in market factor	
	+10%	+5%		(5%)	(10%)
NIS in millions					
<b>Financial assets:</b>					
Cash and cash equivalents	(302)	(151)	(3,023)	151	302
Short term investments	(247)	(124)	(2,474)	124	247
Receivables	(20)	(10)	(199)	10	20
Long term receivables	(72)	(36)	(718)	36	72
<b>Financial liabilities:</b>					
Payables	78	39	783	(39)	(78)
Loans and debentures	2,937	1,468	29,365	(1,468)	(2,937)
<b>Swap transactions(*):</b>					
NIS or NIS linked - Dollar swap	(1,656)	(828)	(16,557)	828	1,656
<b>Total</b>	<b>718</b>	<b>358</b>	<b>7,177</b>	<b>(358)</b>	<b>(718)</b>

\* The fair value alone of the Dollar side of the hedge transactions is presented in the sensitivity tests. The total fair value of the hedge transactions against the Dollar is a liability of NIS 350 million.

Market factor: Euro	Loss (profit) from increase in market factor		Fair value	Loss (profit) from decrease in market factor	
	+10%	+5%		(5%)	(10%)
NIS in millions					
<b>Financial Assets:</b>					
Cash and cash equivalents	(25)	(13)	(251)	13	25
<b>Financial liabilities:</b>					
Payables	15	8	154	(8)	(15)
Loans and debentures	210	105	2,101	(105)	(210)
<b>Hedge transactions (*):</b>					
NIS linked - Euro swap	(48)	(24)	(477)	24	48
<b>Total</b>	<b>152</b>	<b>76</b>	<b>1,527</b>	<b>(76)</b>	<b>(152)</b>

\* The fair value alone of the Euro side of the hedge transactions is presented in the sensitivity tests. The total fair value of the hedge transactions against the Euro is a liability of NIS 47 million.

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**NOTE 27:- FINANCIAL INSTRUMENTS (continued)**

**c. Market Risk (continued)**

**(1) Currency risk and variable interest in foreign currency (continued)**

b) Analysis of sensitivity to changes in fair value: (continued)

(4) Analysis of foreign currency sensitivity as of December 31, 2014 (continued)

Market factor: Yen	Loss (profit) from increase in market factor		Fair value	Loss (profit) from decrease in market factor	
	+10%	+5%		(5%)	(10%)
NIS in millions					
<b>Financial liabilities:</b>					
Payables	2	1	21	(1)	(2)
Loans and debentures	259	129	2,589	(129)	(259)
<b>Hedge transactions (*):</b>					
NIS linked - Yen swap	(227)	(114)	(2,272)	114	227
<b>Total</b>	<b>34</b>	<b>16</b>	<b>338</b>	<b>(16)</b>	<b>(34)</b>

\* The fair value alone of the Yen side of the hedge transactions is presented in the sensitivity tests. The total fair value of the hedge transactions against the Yen is a liability of NIS 1,035 million.

1. Analyzing the sensitivity does not include the effect of the hedging the rate but part of the costs with respect to exposure or linkage to foreign currency is covered in the current electricity rate.
2. Information regarding the exposure of the financial instruments to foreign currency in accordance with their book value see section f. below - Linkage basis report).

c) Market risk with respect to interest rates

The Company is exposed to differences in the market interest rate, with respect to the financial liabilities it raised that bear variable interest.

Changing trends of the variable interest rates are monitored constantly in order to examine the need to carry out IRS transactions to reduce exposure to the risk of an increase in interest rates.

Changing interest rates risks are not material to the cash flows of the Company.

Additionally, an increase in the interest rates prevailing in the market may significantly raise the price of the debt raisings the Company is required to take.

d) Interest rates sensitivity analysis

Sensitivity analysis is determined on the basis of exposure to interest rates of the fair value of derivative and non-derivative financial instruments as of the statement of financial position date. The book value of the derivative financial instruments matches their fair value and therefore the sensitivity analyses with respect to them are identical. The book value of non-derivative financial instruments is not exposed to changes in interest rates. Sensitivity analysis of liabilities bearing variable interest is prepared under the assumption that the amount of the liability as of the statement of financial position date remained throughout the reported year.

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**NOTE 27:- FINANCIAL INSTRUMENTS (continued)**

**c. Market Risk (continued)**

**(1) Currency risk and variable interest in foreign currency (continued)**

**d) Interest rates sensitivity analysis (continued)**

(1) Interest rates sensitivity analysis as of December 31, 2015

Change in %	(Profit) loss from increase in market factor			Fair Value	(Profit) loss from decrease in market factor		
	Increase of 200 base points*	+10%	+5%		(5%)	(10%)	Decrease of 200 base points*
	NIS in millions						
<b>Financial liabilities</b>							
Long term loans at fixed interest rate	(245)	(46)	(23)	3,662	23	48	275
Long term loans at variable interest rate	-	-	-	3,977	-	-	-
Negotiable debentures	(159)	(17)	(9)	2,002	9	17	190
Non-negotiable debentures	(3,202)	(673)	(341)	38,593	350	709	3,870
Debentures to the State of Israel	(1,230)	(320)	(167)	3,515	185	390	4,104
Swap transactions (see details below **)	(209)	95	52	1,219	(35)	(79)	277
Forward transactions	-	-	-	(75)	-	-	-
<b>Total</b>	<b>(5,045)</b>	<b>(961)</b>	<b>(488)</b>	<b>52,893</b>	<b>532</b>	<b>1,085</b>	<b>8,716</b>

\* The Company has chosen to state the size of the change in interest, for which stress tests for financial instruments sensitive to change in interest rate will be performed, at a rate of 200 base points (2%), after checking and not finding a higher daily absolute change of the interest rate during the ten years preceding the report, and after estimating that a change of 200 base points is a change that can occur in an acute but plausible scenario at the same interest.

In an increase of 100 base points, the total decrease in financial instruments will amount to NIS 2,732 million, and in a decrease of 100 base points, the total increase in financial instruments will amount to NIS 3,492 million.

\*\* Detailed sensitivity analysis of swap transactions whose fair value is equal to their book value.

Change in interest %	(Profit) loss from increase in market factor			Fair Value	(Profit) loss from decrease in market factor		
	Increase of 200 base points*	+10%	+5%		(5%)	(10%)	Decrease of 200 base points*
	NIS in millions						
<b>Hedging transactions</b>							
NIS	(325)	(20)	(10)	1,623	10	20	416
Linked NIS	(1,601)	(30)	(11)	21,981	27	46	1,859
Dollar	1,452	138	69	(19,977)	(69)	(139)	(1,671)
Euro	3	1	1	(114)	-	1	(2)
Yen	262	6	3	(2,294)	(3)	(7)	(325)
<b>Total</b>	<b>(209)</b>	<b>95</b>	<b>52</b>	<b>1,219</b>	<b>(35)</b>	<b>(79)</b>	<b>277</b>

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**NOTE 27:- FINANCIAL INSTRUMENTS (continued)**

**c. Market Risk (continued)**

**(1) Currency risk and variable interest in foreign currency (continued)**

d) Interest rates sensitivity analysis (continued)

(2) Sensitivity analysis according to fair value as of December 31, 2014

Change in %	(Profit) loss from increase in market factor			Fair Value	(Profit) loss from decrease in market factor		
	Increase of 200 base points*	+10%	+5%		(5%)	(10%)	Decrease of 200 base points*
NIS in millions							
<b>Financial liabilities</b>							
Long term loans at fixed interest rate	(307)	(62)	(31)	4,957	31	63	347
Long term loans at variable interest rate	-	-	-	5,089	-	-	-
Negotiable debentures	(74)	(2)	(2)	3,731	-	1	64
Non-negotiable debentures	(3,684)	(839)	(432)	40,701	413	852	4,370
Debentures to the State of Israel	(580)	(206)	(108)	2,266	119	252	1,189
Swap transactions (see details below **)	(195)	36	48	1,399	(48)	(96)	236
Forward transactions	-	-	-	(4)	-	-	-
<b>Total</b>	<b>(4,840)</b>	<b>(1,073)</b>	<b>(525)</b>	<b>58,139</b>	<b>515</b>	<b>1,072</b>	<b>6,206</b>

\* The Company has chosen to state the size of the change in interest, for which stress tests for financial instruments sensitive to change in interest rate will be performed, at a rate of 200 base points (2%), after checking and not finding a higher daily absolute change of the interest rate during the ten years preceding the report, and after estimating that a change of 200 base points is a change that can occur in an acute but plausible scenario at the same interest.

\*\* In an increase of 100 base points, the total decrease in financial instruments will amount to NIS 2,565 million, and in a decrease of 100 base points, the total increase in financial instruments will amount to NIS 2,892 million.

Change in interest %	(Profit) loss from increase in market factor			Fair Value	(Profit) loss from decrease in market factor		
	Increase of 200 base points*	+10%	+5%		(5%)	(10%)	Decrease of 200 base points*
NIS in millions							
<b>Hedging transactions</b>							
NIS	(218)	(64)	(27)	854	25	44	285
Linked NIS	(1,499)	147	111	18,899	(100)	(198)	1,718
Dollar	1,279	(37)	(28)	(15,605)	18	39	(1,477)
Euro	8	(2)	(2)	(477)	2	4	(9)
Yen	235	(8)	(6)	(2,272)	7	15	(281)
<b>Total</b>	<b>(195)</b>	<b>36</b>	<b>48</b>	<b>1,399</b>	<b>(48)</b>	<b>(96)</b>	<b>236</b>

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**NOTE 27:- FINANCIAL INSTRUMENTS (continued)**

**d. Liquidity Risk**

Liquidity risk is a risk that is connected to the situation in which the Company will not have enough available cash resources to meet the current business requirements, including its financial commitments and maintaining cash reserve. The Company manages its liquidity risks by ensuring, as far as possible, an adequate liquidity level that covers its obligations on time in both normal conditions and extreme situations without incurring significant loss or affecting its image. The Company measures its liquidity risk, inter alia, through the liquidity ratio, which measures the Company's ability to meet its liabilities without additional debt raisings. In general, the Company's liquidity position is better when the liquidity ratio is higher. The Company is meeting the liquidity index it has set for itself and the liquidity risk had been determined as low. The Company manages the liquidity risk by maintaining cash reserves in accordance with the decision of the Board of Directors, creating and maintaining credit facilities in banks in Israel and abroad, and through cash raising for various terms in accordance with its needs.

The Company raises funds in the capital markets in Israel and abroad through raisings executed sufficient time before the required date according to the Company's forecast, in order to enable the financing of the electricity sector development plans and debt recycling.

The following are tables that include the financial instruments of the Company according to contractual repayment dates. The tables include flows with respect to the principal and the interest.

**(1) Liquidity Risk as of December 31, 2015**

	First year	Second year	Third year	Fourth year	Fifth year	Sixth onwards	Total
	NIS millions						
<b><u>Financial Assets</u></b>							
Cash and cash equivalents	2,524	-	-	-	-	-	2,524
Short term investments	407	-	-	-	-	-	407
Trade receivables	4,145	500	-	-	-	-	4,645
Other receivables	254	-	-	-	-	-	254
<b><u>Long-term receivables</u></b>							
Loans in Dollars	73	70	67	66	67	422	765
Unlinked Loans	4	-	21	4	11	5	45
<b>Total financial assets</b>	<b>7,407</b>	<b>570</b>	<b>88</b>	<b>70</b>	<b>78</b>	<b>427</b>	<b>8,640</b>
<b><u>Derivative Financial Instruments, net</u></b>							
<b><u>Swap transactions Net:</u></b>							
In US Dollars	(1,832)	(2,850)	(3,693)	(4,461)	(2,458)	(6,181)	(21,475)
In Euro	(57)	(56)	-	-	-	-	(113)
In Yen	(229)	(33)	(33)	(33)	(516)	(1,412)	(2,256)
In linked NIS	1,959	2,761	3,574	4,501	3,143	6,565	22,503
Unlinked	-	-	-	-	-	1,852	1,852
<b>Total swap transactions:</b>	<b>(159)</b>	<b>(178)</b>	<b>(152)</b>	<b>7</b>	<b>169</b>	<b>824</b>	<b>511</b>
<b><u>Forward transactions Net:</u></b>							
Loans in US Dollars	(2,734)	-	-	-	-	-	(2,734)
Loans in unlinked NIS	2,659	-	-	-	-	-	2,659
<b>Total forward transactions</b>	<b>(75)</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>(75)</b>
<b>Total derivatives</b>	<b>(234)</b>	<b>(178)</b>	<b>(152)</b>	<b>7</b>	<b>169</b>	<b>824</b>	<b>436</b>



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**NOTE 27:- FINANCIAL INSTRUMENTS (continued)**

**d. Liquidity Risk (continued)**

**(1) Liquidity Risk as of December 31, 2015 (continued)**

	First year	Second year	Third year	Fourth year	Fifth year	Sixth onwards	Total
	NIS millions						
<b><u>Financial Liabilities</u></b>							
Trade payables	1,753	-	-	-	-	-	1,753
Accounts payable and accruals	1,877	-	-	-	-	-	1,877
Short term loans	260	-	-	-	-	-	260
<b><u>Debentures</u></b>							
Debentures in US Dollars	1,421	3,306	5,587	4,827	2,643	15,128	32,912
Debentures in Yen	94	94	94	94	94	3,261	3,731
Debentures in linked NIS	2,143	2,986	1,430	368	1,556	5,055	13,538
Unlinked debentures	90	680	104	32	32	408	1,346
Total	3,748	7,066	7,215	5,321	4,325	23,852	51,527
<b>Debentures to the State of Israel in Linked NIS</b>	126	135	130	130	131	1,859	2,511
<b><u>Liabilities to banking corporations:</u></b>							
Loans in Euro	346	346	171	169	140	550	1,722
Loans in US Dollars	126	124	121	120	117	550	1,158
Loans in linked NIS	60	12	12	13	287	-	384
Unlinked loans	25	25	1,009	3	252	-	1,314
Total	557	507	1,313	305	796	1,100	4,578
<b>Loans from the State of Israel in \$</b>	523	519	516	511	508	1,264	3,841
<b><u>Other Liabilities</u></b>							
Other liabilities in linked NIS	2	2	2	3	2	11	22
Other liabilities in non-linked NIS	121	-	-	-	-	7	128
Other liabilities in Euro	-	-	-	-	-	16	16
Other liabilities in Dollars	-	-	-	-	-	26	26
Total other liabilities	123	2	2	3	2	60	192
<b>Total Financial Liabilities</b>	8,967	8,229	9,176	6,270	5,762	28,135	66,539

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**NOTE 27:- FINANCIAL INSTRUMENTS (continued)**

**d. Liquidity Risk (continued)**

**(2) Liquidity Risk as of December 31, 2014**

	First year	Second year	Third year	Fourth year	Fifth year	Sixth onwards	Total
	NIS millions						
<b><u>Financial Assets</u></b>							
Cash and cash equivalents	4,504	-	-	-	-	-	4,504
Short term investments	2,559	-	-	-	-	-	2,559
Trade receivables	4,546	500	-	-	-	-	5,046
Other receivables	192	-	-	-	-	-	192
<b><u>Long-term receivables</u></b>							
Loans in Dollars	90	71	68	65	65	506	865
Unlinked Loans	20	12	6	3	1	-	42
<b>Total financial assets</b>	<b>11,911</b>	<b>583</b>	<b>74</b>	<b>68</b>	<b>66</b>	<b>506</b>	<b>13,208</b>
<b><u>Derivative Financial Instruments, net</u></b>							
<b><u>Swap transactions Net:</u></b>							
In US Dollars	(890)	(1,737)	(2,751)	(3,592)	(4,357)	(6,671)	(19,998)
In Euro	(450)	(63)	(63)	-	-	-	(576)
In Yen	(410)	(229)	(33)	(33)	(33)	(1,880)	(2,618)
In linked NIS	1,793	1,927	2,737	3,557	4,494	7,865	22,373
Unlinked	-	-	-	-	-	1,852	1,852
<b>Total swap transactions:</b>	<b>43</b>	<b>(102)</b>	<b>(110)</b>	<b>(68)</b>	<b>104</b>	<b>1,166</b>	<b>1,033</b>
<b><u>Forward transactions Net:</u></b>							
Loans in US Dollars	(952)	-	-	-	-	-	(952)
Loans in unlinked NIS	947	-	-	-	-	-	947
<b>Total forward transactions</b>	<b>(5)</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>(5)</b>
<b>Total derivatives</b>	<b>38</b>	<b>(102)</b>	<b>(110)</b>	<b>(68)</b>	<b>104</b>	<b>1,166</b>	<b>1,028</b>

**THE ISRAEL ELECTRIC CORPORATION LIMITED**  
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**NOTE 27:- FINANCIAL INSTRUMENTS (continued)**

**d. Liquidity Risk (continued)**

**(2) Liquidity Risk as of December 31, 2014 (continued)**

	First year	Second year	Third year	Fourth year	Fifth year	Sixth onwards	Total	Effective interest rate
	NIS millions							%
<b><u>Financial Liabilities</u></b>								
Trade payables	1,757	-	-	-	-	-	1,757	
Accounts payable and accruals	1,799	-	-	-	-	-	1,799	
Short term loans	455	-	-	-	-	-	455	
<b><u>Debentures</u></b>								
Debentures in US Dollars	1,414	1,415	3,294	5,567	4,811	17,713	34,214	2.1-2.8
Debentures in Yen	95	95	95	95	95	3,367	3,842	3.7-4.3
Debentures in linked NIS	5,209	2,147	2,992	1,423	351	6,143	18,265	1.2-7.1
Unlinked debentures	56	55	647	72	-	-	830	6.6-7.4
Total	6,774	3,712	7,028	7,157	5,257	27,223	57,151	
<b>Debentures to the State of Israel in Linked NIS</b>	<b>132</b>	<b>132</b>	<b>132</b>	<b>132</b>	<b>132</b>	<b>1,874</b>	<b>2,534</b>	<b>5.1-5.8</b>
<b><u>Liabilities to banking corporations:</u></b>								
Loans in Euro	390	378	379	184	181	707	2,219	1.3-4.4
Loans in US Dollars	122	122	119	118	116	655	1,252	1.1-4.6
Loans in linked NIS	61	61	13	13	13	289	450	0.2-4.6
Unlinked loans	2,426	5	5	5	4	252	2,697	2.2-2.4
Total	2,999	566	516	320	314	1,903	6,618	
<b>Loans from the State of Israel in \$</b>	<b>525</b>	<b>521</b>	<b>517</b>	<b>514</b>	<b>509</b>	<b>1,766</b>	<b>4,352</b>	<b>7.1-8.1</b>
<b><u>Other Liabilities</u></b>								
Other liabilities in linked NIS	2	2	3	1	2	13	23	4.5
Other liabilities in non-linked NIS	3	-	-	-	-	8	11	
Other liabilities in Euro	-	-	-	-	-	18	18	
Other liabilities in Dollars	-	-	-	-	-	46	46	
Total other liabilities	5	2	3	1	2	85	98	
<b>Total Financial Liabilities</b>	<b>14,446</b>	<b>4,933</b>	<b>8,196</b>	<b>8,124</b>	<b>6,214</b>	<b>32,851</b>	<b>74,764</b>	

**THE ISRAEL ELECTRIC CORPORATION LIMITED**  
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**NOTE 27:- FINANCIAL INSTRUMENTS (continued)**

**e. Credit Risk Management**

Credit risk is a risk of financial loss incurred by the Company if a customer or the other party in an equity instrument will not fulfill its contractual obligations. The risk derives mainly from debts of customers and others and deposits and derivatives transactions.

The Company's cash and deposits are deposited with banking institutions. The policy of the Company is to deposit funds according to the financial strength of the banks (credit rating or minimal financial ratios).

Hedge transactions in financial instruments are entered with big and stable banking institutions, with high financial stability that have low credit risk.

The Company does not hold or sell financial instruments for trading purposes.

Customers Credit Risk - As detailed in Note 6, 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 6c.

Provisions for doubtful accounts - are adequate according to estimates of the Company.

**Guarantees Provided in Israel and Abroad**

As part of its normal activity, the Company opened bank guarantees/ conditional letters of credit payable for various beneficiaries. The balance of the guarantees and indemnifications as on December 31, 2015 are:

(1) Local guarantees in Israel

- (a) A guarantee in the approximate amount of NIS 24 million is provided to Gas Lines Ltd., to guarantee payment for natural gas delivery according to the agreement.
  - (b) Other bank guarantees amounting to approximately NIS 36 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 60 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, 2015, amounts to approximately NIS 196 million.
- (b) Total balance of guarantees to parties abroad in the form of conditional bank guarantees and letters of credit as on December 31, 2015, amounts to approximately NIS 56 million.

Total letters of credit and guarantees to entities abroad as on December 31, 2015 amount to approximately NIS 252 million.

**THE ISRAEL ELECTRIC CORPORATION LIMITED**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
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**NOTE 27:- FINANCIAL INSTRUMENTS (Continued)**  
**f. Linkage Basis Report**

	As of December 31, 2015						Total
	(in NIS million)						
	Linkage to US\$	Linkage to Euro	Linkage to Japanese Yen	Linkage to CPI	Un-linked	Non-financial	
<b>Assets</b>							
Cash and cash equivalents .....	181	-	-	-	2,343	-	2,524
Short term investments .....	195	212	-	-	-	-	407
Trade receivables for sale of electricity.....	-	-	-	-	4,145	-	4,145
Accounts receivable .....	195	-	-	224	224	72	715
Inventory- fuels .....	-	-	-	-	-	839	839
Inventory – stores .....	-	-	-	-	-	132	132
Long term inventory fuels .....	-	-	-	-	-	1,124	1,124
Long term receivables .....	687	-	-	228	744	-	1,659
Investment in an included company .....	-	-	-	-	-	74	74
Assets with respect to post-employment benefits .....	-	-	-	-	-	7,207	7,207
Fixed assets, net .....	-	-	-	-	-	62,442	62,442
Intangible assets, net .....	-	-	-	-	-	1,295	1,295
Debit balances of regulatory deferral accounts, net of tax.....	-	-	-	-	-	837	837
<b>Total .....</b>	<b>1,258</b>	<b>212</b>	<b>-</b>	<b>452</b>	<b>7,456</b>	<b>74,022</b>	<b>83,400</b>

(\*) Including adjustments to fair value of hedging transactions (including due to credit risk)

**THE ISRAEL ELECTRIC CORPORATION LIMITED**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
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**NOTE 27:- FINANCIAL INSTRUMENTS (Continued)**  
**f. Linkage Basis Report (continued)**

	As of December 31, 2015						
	(in NIS million)						
	Linkage to US\$	Linkage to Euro	Linkage to Japanese Yen	Linkage to CPI	Un-linked	Non-financial	Total
<b>Liabilities</b>							
Short term debentures and credit from banks and other credit providers .....	608	329	-	1,650	93	76	2,756
Trade payables .....	387	62	-	-	1,304	-	1,753
Accounts payable and accruals .....	516	2	21	1,284	54	-	1,877
Provisions .....	-	-	-	-	-	726	726
Advances from work orders less works in progress .....	-	-	-	-	-	496	496
Debentures, liabilities to banks and others.....	22,872	1,326	2,430	9,457	2,459	787	39,331
Long term currency exchange transactions .....	(20,344)	(113)	(1,928)	19,395	4,586	-	1,596
Liability to the State of Israel.....	2,607	-	-	-	-	(16)	2,591
Debentures to the State of Israel .....	-	-	-	2,511	-	-	2,511
Liabilities with respect to post-employment benefits .....	-	-	-	-	-	2,732	2,732
Provision for refunding amounts due to restatement of the financial statements .....	-	-	-	-	-	2,758	2,758
Deferred taxes, net.....	-	-	-	-	-	5,788	5,788
Shareholders' Equity .....	-	-	-	-	-	16,694	16,694
Credit balances of regulatory deferral accounts, net of tax.....	-	-	-	-	-	1,791	1,791
<b>Total .....</b>	<b>6,646</b>	<b>1,606</b>	<b>523</b>	<b>34,297</b>	<b>8,496</b>	<b>31,832</b>	<b>83,400</b>
<b>Total, Net .....</b>	<b>(5,388)</b>	<b>(1,394)</b>	<b>(523)</b>	<b>(33,845)</b>	<b>(1,040)</b>	<b>42,190</b>	<b>-</b>
Exposure cover through hedging mechanism recognized in the electricity rate (**) .....	2,340	849	-	(3,189)	-	-	-
<b>Total .....</b>	<b>(3,048)</b>	<b>(545)</b>	<b>(523)</b>	<b>(37,034)</b>	<b>(1,040)</b>	<b>42,190</b>	<b>-</b>

(\*) Including adjustments to fair value of hedging transactions (including due to credit risk)

Regarding the exposure to the CPI following the transition to IFRS see Note 3.d. to the Financial Statements.

(\*\*) The periodic effect with respect to the hedge mechanism is through the transaction in regulatory deferral account balances (and not through the financing expenses).  
For details of the hedging mechanism see Note 15.d. above.

**THE ISRAEL ELECTRIC CORPORATION LIMITED**  
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**NOTE 27:- FINANCIAL INSTRUMENTS (Continued)**  
**f. Linkage Basis Report (continued)**

	As of December 31, 2014						
	(in NIS million)						
	Linkage to US\$	Linkage to Euro	Linkage to Japanese Yen	Linkage to CPI*	Un-linked	Non-financial	Total
<b>Assets</b>							
Cash and cash equivalents .....	3,023	251	-	-	1,230	-	4,504
Short term investments .....	2,474	-	-	-	85	-	2,559
Trade receivables for sale of electricity.....					4,546	-	4,546
Accounts receivable .....	199	-	-	127	80	131	537
Inventory- fuels .....	-	-	-	-	-	1,053	1,053
Inventory – stores .....	-	-	-	-	-	146	146
Long term inventory fuels .....	-	-	-	-	-	1,509	1,509
Long term receivables .....	772	-	-	163	898	-	1,833
Investment in an included company .....	-	-	-	-	-	86	86
Assets with respect to post-employment benefits .....	-	-	-	-	-	6,219	6,219
Fixed assets, net .....	-	-	-	-	-	63,381	63,381
Intangible assets, net .....	-	-	-	-	-	1,384	1,384
Debit balances of regulatory deferral accounts .....						2,876	2,876
<b>Total .....</b>	<b>6,468</b>	<b>251</b>	<b>-</b>	<b>290</b>	<b>6,839</b>	<b>76,785</b>	<b>90,633</b>

(\*) Including adjustments to fair value of hedging transactions (including due to credit risk)

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**NOTE 27:- FINANCIAL INSTRUMENTS (Continued)**  
**f. Linkage Basis Report (continued)**

	As of December 31, 2014						
	(in NIS million)						
	Linkage to US\$	Linkage to Euro	Linkage to Japanese Yen	Linkage to CPI*	Un-linked	Non-financial	Total
<b>Liabilities</b>							
Credit from banks and other credit providers	761	370	-	4,649	2,505	70	<b>8,355</b>
Trade payables .....	385	150	-	-	1,390	-	<b>1,925</b>
Accounts payable and accruals .....	398	4	21	419	789	-	<b>1,631</b>
Provisions .....	-	-	-	-	-	719	<b>719</b>
Advances from work orders less works in progress .....	-	-	-	-	-	453	<b>453</b>
Debentures, credit from banks and others .....	22,922	1,749	2,441	10,748	907	826	<b>39,593</b>
Long term currency exchange transactions .....	(16,983)	(566)	(2,311)	18,596	2,799	-	<b>1,535</b>
Liability to the State of Israel.....	2,920	-	-	-	-	(15)	<b>2,905</b>
Debentures to the State of Israel .....	-	-	-	2,534	-	-	<b>2,534</b>
Liabilities with respect to other post-employment benefits .....	-	-	-	-	-	2,930	<b>2,930</b>
Provision for refunding amounts to customers .....	-	-	-	-	-	2,675	<b>2,675</b>
Deferred taxes, net.....	-	-	-	-	-	5,663	<b>5,663</b>
Shareholders Equity .....	-	-	-	-	-	16,353	<b>16,353</b>
Credit balances of regulatory deferral accounts .....	-	-	-	-	-	3,362	<b>3,362</b>
<b>Total .....</b>	<b>10,403</b>	<b>1,707</b>	<b>151</b>	<b>36,946</b>	<b>8,390</b>	<b>33,036</b>	<b>90,633</b>
<b>Total, Net .....</b>	<b>(3,935)</b>	<b>(1,456)</b>	<b>(151)</b>	<b>(36,656)</b>	<b>(1,551)</b>	<b>43,749</b>	<b>-</b>
Exposure cover through hedging mechanism recognized in the electricity rate (**).....	2,332	944	-	(3,276)	-	-	-
<b>Total, net .....</b>	<b>(1,603)</b>	<b>(512)</b>	<b>(151)</b>	<b>(39,932)</b>	<b>(1,551)</b>	<b>43,749</b>	<b>-</b>

(\*) Including adjustments to fair value of hedging transactions (including due to credit risk)

Regarding the exposure to the CPI following the transition to IFRS see Note 3.d. to the Financial Statements.

(\*\*) The periodic effect with respect to the hedge mechanism is through the transaction in regulatory deferral account balances (and not through the financing expenses).  
For details of the hedging mechanism see Note 15.d. above.



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**NOTE 27:- FINANCIAL INSTRUMENTS (Continued)**

- g. The following are details of open commitments for carrying out swap transactions in foreign currency, interest swap transactions and forward transactions in 2015 and 2014 respectively:

	Swap Transactions (1)		Forward Transactions (2)	
	2015	2014	2015	2014
	NIS in millions			
<b>Purchase of:</b>				
Dollar .....	17,610	16,031	2,734	952
Euro .....	113	566		-
Japanese Yen .....	1,928	2,311		-
	<b>19,651</b>	<b>18,908</b>	<b>2,734</b>	<b>952</b>
<b>In return for:</b>				
Linked NIS (3).....	(19,018)	(18,455)		-
NIS.....	<b>(1,852)</b>	<b>(1,852)</b>	<b>(2,659)</b>	(948)
	<b>(20,870)</b>	<b>(20,307)</b>	<b>(2,659)</b>	<b>(948)</b>

- (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.  
(3) Including adjustments to fair value of hedge transactions (including with respect to credit risk).

Gains and losses from the financial instruments in this item:

In 2015, losses amount to NIS 16 million

In 2014, gains amount to NIS 1,545 million.

As stated, these gains are intended to cover the balance-sheet exposures.

The Company does not hold financial instruments for sale or profit producing purposes.

**h. Cash flow hedging**

The Company finances its development plan and refinances its debt, inter alia, by executing issuances and other debt raising in foreign currency. This financing exposes the Company to risk with respect to foreign currency. In order to hedge the foreign currency risk of this activity, the Company executed transactions to hedge foreign currency swap (for the term until repayment of the debt on dates and in amounts conforming to the expected payment schedules) in order to hedge the exchange rate risk deriving from those same future transactions, that are intended to hedge cash flows.

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**NOTE 27:- FINANCIAL INSTRUMENTS (Continued)**

**h. Cash flow hedging (Continued)**

The following table details the foreign currency swap contracts intended to hedge cash flows existing on the reporting date:

**As of December 31, 2015**

Swap transaction	Expiry date	Dollar purchase		NIS sale		Fair value of assets (liabilities)
		Dollar millions	Interest rate	NIS millions	Interest rate	NIS millions
300747	June 21, 2018	250	5.625%	995	4.77%	(32.6)
300749	June 28, 2018	250	5.625%	980	4.80%	(20.8)
300754	June 21, 2023	150	6.875%	589.5	6.25%	(16.5)
300757	November 12, 2024	150	5.00%	597	3.95%	(2.4)
300759	November 12, 2024	100	5.00%	398	3.94%	(1.8)

These hedge transactions are treated in the Financial Statements as cash flow hedge transactions. As of December 31, 2015, these transactions fully hedge the exposure with respect to foreign currency risks with respect to the principal and interest of the debentures.

Regarding the accounting policy of the Company with respect to the cash flow hedging, see Note 2 o above.

**i. Fair value of financial instruments**

	Book Value		Fair Value	
	December 31		December 31	
	2015	2014	2015	2014
	NIS in millions			
<b>Financial Assets :</b>				
Long term debts (including current maturities)				
Fixed Interest (2) .....	75	92	61	71
Variable interest .....	772	836	764	797
<b>Financial liabilities:</b>				
Long term debentures and loans (including current maturities)				
Long term loans at fixed interest (2) .....	3,207	4,415	3,662	4,957
Long term loans at variable interest.....	3,830	4,906	3,977	5,089
Fixed interest marketable debentures (in Israel) (1) .....	1,920	3,682	2,002	3,731
Fixed interest non-marketable debentures (in Israel and abroad) (3) .....	33,682	35,631	37,616	39,729
Variable interest non-negotiable debentures (in Israel and abroad)	974	972	976	972
Perpetual debentures to the State of Israel (2)	2,511	2,534	3,515	2,266

(1) The fair value is based on quoted market prices in an active market as of the statement of financial position date.

(2) The fair value is based on fair interest rates as of the statement of financial position dates (the fair value of a long-term loan received, bearing fixed interest is based on the calculation of the present value of cash flow at an interest rate acceptable for a loan of similar characteristics).

(3) The fair value is based on individual prices, quoted by Mirvach Hogen Ltd., for non-negotiable debentures in Israel as on the statement of financial position date and on individual prices, calculated according to the aforementioned non-negotiable liabilities revaluation method, for non-negotiable debentures.

The carrying amount of cash and cash equivalents, short-term investments, receivables, other current assets, payables and accrued expenses is not materially different from its fair value.

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**NOTE 27:- FINANCIAL INSTRUMENTS (Continued)**

**j. Classification of financial instruments**

The financial instruments of the Company, measured at fair value through the statement of operations and comprehensive income according to levels are detailed as follows:

Financial instruments measured at fair value are classified according to the lowest level at which significant use is made to measure the fair value of the whole instrument.

Level 1: Quoted prices (unadjusted) in active markets for financial assets and liabilities.

Level 2: Data which are not quoted prices included in level 1, expected directly (namely prices) or indirectly (data derived from prices), regarding financial assets and liabilities.

Level 3: Data of financial assets and liabilities which are not based on expected market data.

Hedging transactions included in level 2 are calculated at fair value, based on expected interest curves (see Note 2 o above).

	<b>Year ended December 31</b>	
	<b>2015</b>	<b>2014</b>
	<b>Level 2</b>	
	<b>NIS in millions</b>	
<b>Financial Assets</b>		
Swap and Forward transactions.....	518	267
<b>Financial Liabilities</b>		
Swap and forward transactions .....	1,662	1,662
<b>Total</b> .....	<b>1,144</b>	<b>1,395</b>

**THE ISRAEL ELECTRIC CORPORATION LIMITED**  
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**NOTE 28:- REVENUES**

**a. The composition:**

	<b>For the Year ended December 31</b>	
	<b>2015</b>	<b>2014</b>
	<b>NIS in millions</b>	
Residential.....	8,575	8,693
Public-Commercial .....	7,073	8,193
Agricultural.....	573	846
Industrial .....	3,243	3,782
Water pumping.....	713	986
East Jerusalem Electricity Company and Palestinian Authority (also see Note 6) .....	1,775	2,005
Infrastructure services * .....	892	388
<b>Revenues from the sale of electricity(**)</b> .....	<b>22,844</b>	<b>24,893</b>
Other income (mainly includes income from works on account of others) .....	214	412
	<u>23,058</u>	<u>25,305</u>

(\*) Infrastructure services are mainly electricity transmission and distribution services that are provided to private electricity producers, and income from system costs.

(\*\*) On February 1, 2015, the electricity rate decreased on average by approximately 11.8%.

On September 13, 2015, the electricity rate decreased on average by an approximately 5.89% additional percent.

**b. The scope of sales deriving from private producers:**

	<b>For the Year ended December 31</b>	
	<b>2015</b>	<b>2014</b>
	<b>NIS in millions</b>	
Total electricity sales of the Company (in millions kWh) (*).....	50,601	49,902
Scope of electricity sales of the Company deriving from purchasing electricity from private producers (in millions kWh) .....	4,311	1,929
Their measure of the total electricity sales of the Company (in %) .....	<u>9%</u>	<u>4%</u>

\* Without infrastructure services

**THE ISRAEL ELECTRIC CORPORATION LIMITED**  
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**NOTE 29:- COST OF OPERATING THE ELECTRICITY SYSTEM**

Following is the composition of the cost of operating the electricity system after separation of wage and depreciation components:

	<b>For the Year ended December 31</b>	
	<b>2015</b>	<b>2014</b>
	<b>NIS in millions</b>	
Fuels .....	8,269	7,873
Electricity purchases .....	2,653	1,708
Operation of the generation system .....	632	903
Operation of the transmission and distribution system .....	436	394
	<u>11,990</u>	<u>10,878</u>
Wages.....	1,982	1,961
Depreciation.....	4,314	4,116
	<u>18,286</u>	<u>16,955</u>

**NOTE 30:- SALES AND MARKETING EXPENSES**

	<b>For the Year ended December 31</b>	
	<b>2015</b>	<b>2014</b>
	<b>NIS in millions</b>	
Wages.....	589	593
Consumer services .....	165	166
Depreciation.....	150	142
	<u>904</u>	<u>901</u>

**NOTE 31:- ADMINISTRATIVE AND GENERAL EXPENSES**

	<b>For the Year ended December 31</b>	
	<b>2015</b>	<b>2014</b>
	<b>NIS in millions</b>	
Wages.....	450	462
Provision for doubtful accounts and bad debts .....	2	280
Depreciation and amortization .....	114	118
Others .....	197	297
	<u>763</u>	<u>1,157</u>

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**NOTE 32:- WAGE COSTS**

	<b>For the Year ended December 31</b>	
	<b>2015</b>	<b>2014</b>
	<b>NIS in millions</b>	
Wage costs without remeasurements .....	4,970	4,986
Remeasurements .....	(66)	(482)
<b>Total wage costs</b> .....	<b>4,904</b>	<b>4,504</b>
Less:		
Wages charged to works on account of others .....	102	85
Wages charged to fixed assets .....	1,781	1,403
<b>Total wage costs included in statement of operations items, net</b> .....	<b>3,021</b>	<b>3,016</b>

**NOTE 33:- FINANCIAL EXPENSES (INCOME)**

	<b>For the Year ended December 31</b>	
	<b>2015</b>	<b>2014</b>
	<b>NIS in millions</b>	
<b>a. Interest expenses:</b>		
Interest expenses due to debentures .....	2,138	2,033
Interest expenses due to liabilities to banks .....	120	201
Interest expenses due to debentures to the State of Israel .....	131	132
Interest expenses due to liabilities to the State of Israel .....	228	234
Interest expenses (income) due to hedge transactions .....	(168)	(37)
Other interest expenses (income) .....	(7)	68
<b>Total interest expenses</b> .....	<b>2,442</b>	<b>2,631</b>
<b>b. Other expenses</b>		
Changes in the fair value of the hedge transactions .....	34	(1,537)
Sums transferred to other comprehensive income due to cash flow hedging .....	(18)	(8)
Expenses (income) from differences in exchange rate differentials .....	(151)	2,110
Expenses (income) from differentials of linkage to the CPI .....	(157)	(18)
<b>Total other expenses (income)</b> .....	<b>(292)</b>	<b>547</b>
<b>c. Less - credit costs capitalized as part of fixed assets cost*</b> .....	<b>372</b>	<b>340</b>
<b>Total financing expenses</b> .....	<b>1,778</b>	<b>2,838</b>
* the capitalization rate which served the calculation of non specific credit costs	5.51%	5.25%

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**NOTE 34:- 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**

	<b>December 31,</b>	
	<b>2015</b>	<b>2014</b>
	<b>NIS in millions</b>	
Trade receivables for sales of electricity and others.....	69	20
Natural Gas Lines Ltd., see section b (1) a) below (including current maturities).....	738	794
Other receivables from institutions.....	6	7
Liabilities to suppliers and service providers (including debt to Natural Gas Lines Company Ltd. and to infinity – Central Pension Fund Management Ltd.) .	76	45
Trade payables to institutions .....	61	52
Debentures to the State of Israel, see Note 23 above .....	2,511	2,534
Liabilities to the State of Israel (including current maturities), see section b2) d) below.....	2,910	3,202

The Company sent requests for balances confirmations at the end of 2015 to approximately 460 electricity customers, and approximately 320 suppliers and other customers who conform to the aforementioned criteria. The Company received 38 confirmations from customers and 79 confirmations from suppliers.

- 2) The total transactions with the related and interested parties, taken from the consolidated report:  
The Company's revenues from those transactions carried out with interested parties, during its ordinary course of business, are: sales of electricity, electricity connections and works according to execution contracts. In the framework of its purchases, the Company primarily buys natural gas transmission, water and land leasehold services from the above interested parties. Payments to the State and its authorities as a sovereign entity, namely payments pursuant to law, such as taxes and fees, are transactions not deviating from the Company's ordinary course of business.
- a) Revenues:
- (1) Revenues from related and interested parties (in accordance with invoices that were issued, and not including income receivable) – approximately NIS 1,891 million (mainly revenues from Mekorot Ltd. of approximately NIS 252 million and from the Israel Airports Authority of approximately NIS 66 million and local authorities).
  - (2) Invoices issued to the Gas Lines Company for building the natural gas pipeline, of approximately NIS 7 million (see details in section b (1)(a) below).
- b) Expenses:
- (1) Expenses for natural gas transmission to Natural Gas Lines – about NIS 286 million (see details in section b(2)(e) below).
  - (2) The remaining expenses (primarily local authorities, leasehold fees, transmission of fuels and water) - about NIS 784 million.

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**NOTE 34:- RELATED AND INTERESTED PARTIES (continued)**

**b. The Company enters Several Types of Transactions with Related and Interested Parties:**

**1) Irregular Transactions (according to Section 270(4) of the Companies Law):**

To the best knowledge of the Company, the following are details of irregular transactions with a controlling party, or in which the controlling party has a personal interest according to section 270(4) of the Companies Law, entered by the Company, that are in effect as of the date of the statement of financial position, and transactions in the two years preceding the statement of financial position 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 2015, NIS 57 million of the loan principal was repaid.

(2) The Financial Statements include an adequate provision for covering damages that may be charged.

(3) On November 23, 2015, an agreement in principle was reached between the Company and the Gas Lines Company (a compromise agreement was formulated) which still requires the approval of the State.

(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 738 million.

**b) E.M.G.**

See details on the agreement with E.M.G. to supply natural gas in Note 35 b 5 b) below.

**c) Establishment of a Desalination Facility at the Orot Rabin site**

On September 7, 2004, an agreement was signed between the State and the Company, to grant the right to use land with an area of about 71 thousand sq. m. in the proximity of the "Orot Rabin" power station, for the purpose of constructing a sea water desalination facility by the H2ID Ltd. The right is for a period of 24 years and 11 months.

Estimated original cost of the transaction is approximately NIS 69 million. The effect of this transaction on the profitability of the Company is negligible.



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**NOTE 34:- 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, 2015 was approximately NIS 9 million as compared with NIS 15 million as of December 31, 2014. The amount is linked to the U.S. dollar with the addition of interest at customary rates (see Note 2 r above).

The estimated original cost of the transaction is approximately NIS 72 million. The effect of this transaction on the profitability of the Company is negligible.

**b) The Eilat Ashkelon Pipeline Company Ltd. ("EAPC")**

Pursuant to an agreement, entered in September 1997, between the Company and EAPC, EAPC allocated an area that it owns to the Company for the purpose of building a pier for the unloading of coal for the Rutenberg power plant. In the context of this agreement, the Company entered into an agreement for the building of two tugboats by the Israel Shipping Ltd. In 2000, the tugboats were chartered to the Ashkelon port for periods of 204 months each from the date of their delivery.

The monthly leasing fees for the tugboats are spread over 264 months and are with the addition of Libor interest for 10 years plus approximately 1.25% interest.

The balance of the amount of the charter fees as of December 31, 2015 is approximately NIS 36 million and as of December 31, 2014 is approximately NIS 39 million. The amount is linked to the U.S. dollar with the addition of interest at customary rates (see Note 2r above).

The estimated original cost of the transaction is approximately NIS 70 million. The effect of this transaction on the profitability of the Company is negligible.

According to the agreement between the Company and the EAPC, considering the operational status and maintenance costs of the tugboats, the Company will be obliged to purchase 2 new tugboats and to lease them to EAPC starting 2017.

Following this, the Electricity Authority has been contacted with a request to recognize the unreturned principal expected in 2017 (approximately Dollar 7 million with respect to the two tugboats) plus the costs of purchasing the new tugboats.

On December 23, 2015, a letter was received from the Electricity Authority, under which the professional team of the Electricity Authority will recommend to recognize the cost of purchasing the new tugboats and the balance of the unreturned principal subject to cost control and examination of the purchase process.

**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, 2015 amounts to approximately NIS 17 million as compared with NIS 18 million as of December 31, 2014. The amortized amount as of December 31, 2015 is approximately NIS 13.8 million and NIS 15.1 million as of December 31, 2014.

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, 2015 is NIS 2,910 million (including current maturities). The interest rate of this loan was lower than the interest in the market, but it has an immaterial effect on the profitability of the Company.

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**NOTE 34:- RELATED AND INTERESTED PARTIES (continued)**

**b. The Company enters Several Types of Transactions with Related and Interested Parties: (continued)**

**2. Other Transactions (which are not Irregular and Negligible): (continued)**

**e) Commitment for the Transmission of Natural Gas**

In June 2006, the Company and the Gas Lines Company (hereinafter: Gas Lines) signed an agreement for the transmission of natural gas according to the version published by the Natural Gas Authority, which is applicable to all gas consumers. In January 2009, the agreement of 2006 was replaced by a new agreement with a validity of 15 years from the date of connection of each site to the gas transmission system. The Company's Board of Directors approved the agreement on February 2, 2008.

The original cost of the transaction for the period of the agreement was estimated at approximately NIS 2,520 million. Within the electricity rate, the Electricity Authority grants the Company recognition for the capacity and energy costs in accordance with the gas quantities calculated by it in the fuels basket.

Following the update of the transmission rate in accordance with the decision of the Natural Gas Authority in the Ministry of Infrastructures, Energy and Water, the capacity cost that is paid by the Company to Natural Gas Lines starting from December 1, 2013, amounts to approximately NIS 22 million every month, or an aggregate amount of approximately NIS 264 million a year.

As of 2010, the Company approached the Gas Lines and the Natural Gas Authority with a demand to update the sum of the gas transmission and to adapt it to changes and developments which had occurred in the electricity and gas sector in recent years (the addition of the LNG buoy, cessation of the supply of Egyptian gas, entry of private producers).

Gas Lines unilaterally announced that in accordance with section 15.3 of the gas transmission agreement and under the instructions of the Natural Gas Authority, as of April, 2014, the capacity increase of the Company will apply for a period of 5 years, due to the Company's accumulated deviations from the contractual system capacity. The financial implication of this increase in capacity is an additional cost of approximately NIS 530 thousand a month and approximately NIS 6.4 million a year.

Gas Lines presented invoices with respect to the above mentioned forced capacity addition as of April, 2014, and the Electric Company is refusing to pay these invoices.

After the communication processes and attempt to find an agreed outline to settle the dispute between the parties failed, the handling of regulating the forced capacity increase and the dispute on the matter of updating the agreement was transferred to the responsibility of Companies Authority as part of settling disputes in civil matters between a government company and another government entity.

**f) Israel Ports Company**

The Israel Ports Company – Assets and Development Ltd. (hereinafter "IPC") wants to establish a new marine terminal for container conveying in the Port of Ashdod adjacent to the premises of the Company.

A need to shift these infrastructures arose because the infrastructures of the Company are also situated at present in the area of IPC and in other areas along the coastal strip, and infrastructures and facilities belonging to third parties are also situated there.

On February 26, 2014, the contract was signed, within which the Company will execute the general and detailed planning as well as the construction works for the changes in the infrastructures of the Company as are required by the construction of the new marine terminal that will be constructed by IPC in the port of Ashdod.

The project will be financed by the IPC on the basis of actual costs of the Company or of sub-contractors, with the addition of 17.5% (of the total price that will be paid to sub-contractors) for planning, preparation and execution of acquisition, management, supervision of the construction and overall supervision. During July, 2014, the IPC notified the Company of its intention to construct a small port and accordingly it wishes to change the agreement with the Company, which was based on the implementation of a full scale port. The Management of the Company clarified that it will examine the implications following the proposed change. During 2015, additional disputes arose regarding the capacity of the project and they are under prolonged discussions between the Company and IPC. The scope of the original contract is estimated at approximately NIS 230 million.

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**NOTE 34:- 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)**

**g) Establishing solar power stations at Ashalim**

Within the framework of a Government tender for construction of solar power stations in the Ashalim area, the Company is promoting the construction of a joint switching station to intake the energy that will be created to serve the entire site, at a cost of approximately NIS 38.9 million. The estimated activation date is June 30, 2016. 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.

**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.

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**NOTE 34:- 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 (continued)**

**Negligible Transactions Procedure (continued)**

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.

**c. Benefits to Interested Parties**

	Year Ended December 31,		Year Ended December 31,	
	2015	2014	2015	2014
	Number of Individuals		NIS in millions	
<b>Group</b>				
1) Salary of interested parties employed by the Company *	4	3	1.5	1.8
2) Directors not employed by the Company ....	10	12	0.8	1.1
3) Other interested parties not employed by the Company**	-	-	-	-

\* In 2014 and 2015, one director was in office, who does not receive salary for his participation in meetings of the Board of Directors on behalf of the employees.

\*\* The Company does not have benefits to other interested parties who are not employed by the Company.

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**NOTE 34:- RELATED AND INTERESTED PARTIES (continued)**

**d. Compensation to Key Management Personnel**

- 1) Key management personnel in the Company include: Chairman of the Board of Directors, CEO, members of Company Management, directors (the data in the table below does not include remuneration to directors. See details of remuneration to Directors in section c above), a total of 30 persons in 2015.
- 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 with updates 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 general meeting of the Company approved the Company's compensation policy, after it was previously approved by the Compensation Committee and the Board of Directors of the Company, as was requested by the committee. The approval is in effect for 3 years from the approval date. On February 9, 2015, after previously receiving approval for it from the Compensation Committee and the Board of Directors of the Company, the general meeting of the Company approved an amendment to the compensation policy of the Company. According to this, in 2015, a bonus was paid to seven senior officers with a personal contract in the amount of NIS 0.9 million. Considering the Company's compensation policy as described above, the Company executed a provision of NIS 1.5 million for bonuses for senior officers with a personal contract, although actual payment of the bonuses, in full or in part, still requires the approval of the Company's authorized organs. These amounts are not included in the salary data in sections c and d.

	<b>For the year ended December 31</b>	
	<b>2015</b>	<b>2014</b>
	<b>NIS in millions</b>	
Total salaries cost.....	<b>23.3</b>	<b>32.4</b>
Of which, costs due to the pension plan .....	<b>1.7</b>	<b>2.0</b>
Twelve key Management personnel retired during the year 2015, for which payment of compensations and retirement grants were made .....	<b>11.4</b>	<b>4.1</b>
Balance of pension liability .....	<b>157.5</b>	<b>171.0</b>
Balance of vacation reserve .....	<b>1.9</b>	<b>1.2</b>

- e. Regarding details of transactions with related parties of investee companies, see Note 10 above.**

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**NOTE 34:- RELATED AND INTERESTED PARTIES (continued)**

**f. Several Indemnification Letters furnished by the Company:**

**1) Indemnification of Directors and Officers of the Company**

- a) Following the approval of the audit committee and the Board of Directors of the Company from November 1, 2012, on November 22, 2012, the general assembly of shareholders, approved the issuance of a letter of indemnity to the Directors of the Company, the CEO of the Company, the VP Finance and Economics of the Company and the Legal Consultant and Secretary of the Company (hereinafter: "**the Officers**"), who served in the Company on the relevant determining date that will apply to the events detailed below, even if the date of occurrence of the event to be indemnified took place prior to the date of issuing the letter of indemnity:
- 1) 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").
  - 2) Preparation, approval, signing and publication of a prospectus by the Company, including the disclosure under the prospectus and the issuance of debentures by the Company based on the prospectus (including an agreement with the State of Israel on the provision of a guarantee and the receipt of the State of Israel's guarantee for the issuance and including the resolution to issue securities by the Company for the purpose of covering fuel costs in excess of those which will be recognized in the rate as part of the Electricity Authority's Outline), provided that the proceeds of the securities to be issued by the Company are allocated to the financing of fuel costs in excess of those that will be recognized on the date of publication of the prospectus as part of the rate in accordance with the Electricity Authority's Outline for the gradual increase in electricity rates, namely, not later than June 30, 2012.

In this section, "the prospectus" means the prospectus of June 26, 2012 (as amended July 2, 2012).

The "Relevant Determining Date" means, in relation to the prospectus– the date of publication of the prospectus; in relation to a private placement of debentures – the date of the Resolution by the Board of Directors of the Company regarding the execution of the private placement.

The amount of indemnification the Company may have to pay for all the Officers, cumulatively, under the Indemnity Letter, and pursuant to any other undertaking and letter of indemnity issued to the Officers (within their meaning in the Companies Law) and the employees of the Company (including commitments and letters of indemnification issued by the Company to Officers and/or employees of the Company, in connection with the preparation, approval and publication of the Financial Statements of the Company as of June 30, 2009), or insofar as they will be issued by the Company in the future, including, if and insofar as the Company will provide indemnification in connection with a restructuring in the Company and/or privatization, shall not exceed an amount of NIS 10 billion or an amount constituting 25% of the Company's equity as of June 30, 2009, linked to the Israeli Consumer Price Index on July 2009.

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**NOTE 34:- RELATED AND INTERESTED PARTIES (continued)**

**f. Several Indemnification Letters furnished by the Company: (continued)**

**1) Indemnification of Directors and Officers of the Company (continued)**

- b) On April 20, 2015, the Audit Committee and the Board of Directors of the Company, and on May 25, 2015, the general meeting of shareholders, approved granting letters of indemnification to the directors, Company CEO and officeholders of the Company, who are serving and/or have served in the Company, which will apply to the events detailed below, even if the date of occurrence of the event to be indemnified occurred before the date of granting the letter of indemnification:
- 1) Issuing securities and listing them within a public offering, including in all that pertains, directly or indirectly, to the proceedings of the public offering and providing information for the proceedings of the public offering, including preparation, approval with respect to the issue and submitting the Company's prospectus, signing and submitting the prospectus and disclosure within the framework of the prospectus (including, for the avoidance of doubt, Chapter A of the periodic report of the Company for 2014, as well as the report of the Board of Directors of the Company for 2014 and the Financial Statements of the Company for 2014 which will be attached to the prospectus by way of reference), including preparation, approval, submission and signing drafts of the prospectus and the disclosure within them. Regarding this context, "the prospectus" means a prospectus which the Company intends to publish (insofar as will be published) on the basis of its Financial Statements as of December 31, 2014 for the purpose of issuing debentures to the public, which will be listed on the Tel Aviv Stock Exchange Ltd.
  - 2) Preparation, signing and publication of Financial Statements as their meaning in Regulation 9 of the Securities Regulations (Periodic and Immediate Reports) - 1970 (the "Report Regulations"), as well as a separate financial statement of the Company as its meaning in Regulation 9 c of the Report Regulations, Interim Financial Statements as their meaning in Regulation 40 of the Report Regulations if applies, after issue of the securities pursuant to the prospectus and listing them within the framework of the public offering and for as long as they are listed as stated.

Regarding this section, "The Prospectus" means the prospectus of May 25, 2015.

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.

According to the provisions of the letter of indemnification, the cumulative indemnification sum the Company might have to pay all the officeholders, pursuant to the letter of indemnification and pursuant to any obligation and other letter of indemnification for officeholders which was given or insofar as will be given in future, will not exceed an amount constituting 25% of the Company's equity as of the date of payment (the "Maximum Indemnification Sum"), according to the Company's latest financial statements which were approved before the actual payment date, according to the lowest among them.

Additionally, it was determined in the letter of indemnification that except in the event that the Companies Authority publishes a policy document with regard to indemnification of officeholders, which would benefit the officeholders in the issues arranged in this paragraph (in which case the provisions of the stated policy with respect to this issue will apply), executing any payment pursuant to the letter of undertaking to indemnify is dependent on the approval of a committee of the Board of Directors, consisting of at least two members, when none of its members have a personal interest, direct or indirect, in the execution of the payment, and most of its members are independent or external directors, that the terms set in the letter of undertaking to indemnify for executing the payment are fulfilled. If the Company does not have a committee of the Board of Directors as detailed in this paragraph, the payment will be dependent pursuant to the letter of undertaking to indemnify on the approval of the general meeting, that the terms set in the letter of undertaking to indemnify for executing the payment are fulfilled.

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**NOTE 34:- RELATED AND INTERESTED PARTIES (continued)**

**f. Several Indemnification Letters furnished by the Company: (continued)**

**1) Indemnification of Directors and Officers of the Company (continued)**

- c) On November 19, 2015, and November 26, 2015, the Remuneration Committee and the Board of Directors of the Company, and on December 21, 2015, the general meeting of shareholders, approved the granting of letters of indemnification to directors and office holders serving in the Company and/or who served in the Company, which will apply to the events detailed below, even if the date of occurrence of the event for which indemnification is possible occurred prior to the date of granting the indemnification letter:
- (1) Issuing securities and listing them, within a public offering including all that relates, directly or indirectly, to the proceedings of the public offering and giving information for the purpose of the public offering proceedings, including preparation, approval with respect to the issuance and submitting a shelf prospectus by the Company, signing and submitting the Prospectus, and the disclosure within the Prospectus (including the Periodic Report of the Company for 2014, the Company's quarterly report for the first quarter of 2015 and the Company's quarterly report for the second quarter of 2015, which were attached to the Prospectus by way of reference) including preparation, approval, submission and signing of drafts of the Company Prospectus and the disclosure within them.
- (2) Preparation, approval, submission and signing of the shelf offering reports (including their appendices) on the basis of the prospectus and including all that pertains, directly or indirectly, to the proceedings of offering to the public and delivering information for the proceedings of offering to the public, including preparation, approval with respect to the issue and submitting the shelf offering reports by the Company, signing and submitting the shelf offering reports and disclosure within the shelf offering reports (including information which will be attached to the shelf offering report by way of reference).
- (3) Preparation, approval, signing and publication of financial statements as their meaning in Regulation 9 of the Reports Regulations, as well as a separate financial statement of the Company as its meaning in Regulation 9c of the Reports Regulations and interim financial statements as their meaning in Regulation 40 of the Reports Regulations, as the case may be, after issuing the securities pursuant to the prospectus and listing them within the offering to the public and as long as they are listed as stated.

The indemnification sum the Company might pay for all the officers, cumulatively, pursuant to the indemnification, will not exceed NIS 2 billion (the "Maximum Indemnification Amount") and will be set in stages as follows:

- (a) as of the date of execution of the Company's first raising on the basis of the shelf prospectus, and until the date on which the Company will raise, on the basis of the shelf prospectus, a sum of NIS 1.25 billion, the maximum indemnification amount will be NIS 0.5 billion. For the removal of doubt, as of the date of execution of the first raising as stated, the indemnification will apply to all the actions with respect to a prospectus or financial statement (as their definition in the letter of indemnification), including actions which were executed by the Company before the date of execution of the issue on the basis of the shelf prospectus.
- (b) to the extent that the Company will raise, on the basis of the shelf prospectus, securities in an amount exceeding NIS 1.25 billion and up to a total amount of NIS 5 billion, the maximum indemnification amount will be determined as the multiplication of the total amount raised by the Company on the basis of the shelf prospectus by 0.4.
- (c) to the extent that the Company will raise, on the basis of the shelf prospectus, securities in an amount of NIS 5 billion and more, the maximum indemnification amount will be NIS 2 billion.

It is clarified that despite the above mentioned, in any case the total indemnification amount which will be paid by the Company with respect to all the indemnification letters issued or that will be issued to officers will not exceed 25% of the Company's equity according to the Company's latest financial statements before the date of the actual payment of any indemnification.

As of the date of publication of the report, other than the aforesaid, the Company has not approved the granting of indemnification letters to its Directors and Officers.



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**NOTE 34:- RELATED AND INTERESTED PARTIES (continued)**

**f. Several Indemnification Letters furnished by the Company: (continued)**

**1) Indemnification of Directors and Officers of the Company (continued)**

On October 15, 2015, the Companies Authority published a document of criteria to examine applications to grant advance undertakings to indemnify office holders in Government Companies. Within the document, inter alia, are details of the criteria the Authority should consider when formulating its recommendation to the Ministers regarding an undertaking to grant indemnification to the office holders, which also include adoption and assimilation of an internal enforcement plan in Government Companies by the Company pursuant to that stated in the document. The criteria will be considered in each case before the decision is brought to the Company's general meeting. The Company is working to ensure its compliance with all the criteria set in the document.

**2) Other Indemnification Letters Provided by the Company**

- a) The Company furnished a letter of indemnification to the Caesarea Development company in connection with the damages likely to be caused due to the emissions reduction project performed at Orot Rabin power station, on lands in which the Caesarea Development company is the holder of the rights.
- b) The Company furnished a letter of indemnification to the Nes Ziona local municipality in connection with damages likely to be caused due to the Nes Ziona sub-stations works, which may cause damage to the land and impair its value, in accordance with section 197 to the Planning and Building Law.
- c) The Company furnished a letter of indemnification to the Rishon Le-Zion local municipality in connection with damages likely to be caused due to works in the Gan Sorek logistic center plan, which may cause damage to the land and impair its value, in accordance with section 197 to the Planning and Building Law.
- d) The Company furnished a letter of indemnification to the Caesarea Development company against receiving a permit for firefighting works in the "Caesarea" sub-station in connection with the damages likely to be caused to the Caesarea Development company due to these works.
- e) The Company furnished a letter of indemnification to the administrator general in connection with the damages likely to be caused to land of absentee owners, on which a fuel container of the Company is located. Under the letter of indemnification, the Company will be obliged to incur expenses of an environmental survey and land cleaning in the event of damage.
- f) On November 18, 2013, a letter of undertaking to indemnify was signed by the Company and the Municipality of Rishon Le-Zion in favor of the Israel Land Authority with respect to payment of lease fees for the advancement of land allocation for the "Victoria" sub-station.
- g) On November 25, 2013, the Company signed a letter of undertaking and indemnity in favor of the municipality of Tel Aviv as part of the construction of the "Tel Aviv University" sub-station.
- h) On April 13, 2014, the Company signed a letter of undertaking to indemnify in favor of the Israel Lands Authority for the purpose of signing a building permit before allocation of land for the "Ashalim" substation.
- i) On April 13, 2014, the Company signed a letter of undertaking to indemnify in favor of the Israel Lands Authority for the purpose of signing a building permit before allocation of land for the "Shfayim" substation.
- j) On May 27, 2014, the Company signed a letter of undertaking to indemnify in favor of the Israel Lands Authority for issuance of a building permit for construction of the "Victoria" substation.
- k) On June 28, 2015, the Company signed a letter of undertaking to indemnify in favor of the IPC for issuance of a building permit for works at the coastal strip near the "Eshkol" power station.

**g. State Guarantees**

For details of guarantees received from the State, see Note 20 f above.

**h. Central Provident Fund**

For additional information see Note 11 k 1 above.

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**NOTE 35:- AGREEMENTS, CLAIMS, CONTINGENT LIABILITIES AND LABOR DISPUTES**

**a. Agreements**

**1) Agreement on the Supply of Gas from the Tamar Field**

- a) In March, 2012, the Company signed an agreement with the holders of the rights of the "Tamar" license (Nobel Energy and the limited partnerships Isramco Negev 2, Delek Drillings, Avner Oil Exploration and Dor Gas Exploration (all together in this section: the "Sellers" or "Tamar Partnership") under which the Company undertook to purchase natural gas at a total minimal volume of approximately 42.5 Billion Cubic Meters ("BCM") natural gas (hereinafter: the "Agreement").
- b) The Company was given an option to increase the contractual quantity supplied during the period of the agreement after updating the array for supply of gas from the reserve (hereafter: the "Option"). The position of the parties, as was also delivered to the Antitrust Authority, is that upgrading the array of gas supply from the reserve in a manner which will enable to exercise the option can be executed, inter alia, through a compressor array in a manner which will enable the increase of the quantity of gas supplied to the local economy, through the present gas transmission piping (hereinafter: the "Option").
- c) The price of gas in the agreement was determined by a formula that includes a base price and linkage to the U.S. CPI with the addition of 1% in each of the years 2012 to 2019 and a reduction of 1% each year from 2020 and until the end of the period of the agreement.

The agreement includes a mechanism of "Take or Pay" (hereinafter: the "Take or Pay Mechanism") under which the Company is obliged to pay for the right to purchase a minimal amount of natural gas, even if it did not use it, at an amount of 3.5 BCM a year in the first five years and afterwards at an amount of 2.5 BCM a year, and during the option period, if actually 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). For details of the minimal amount of natural gas the Company will be required to purchase in view of the Board of Directors' decision to partially exercise the second option (as it is defined below), see section g) below.

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

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

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

- d) 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).

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**NOTE 35:- AGREEMENTS, CLAIMS, CONTINGENT LIABILITIES AND LABOR DISPUTES**

**a. Agreements (continued)**

**1) Agreement on the Supply of Gas from the Tamar Field (continued)**

e) On April 19, 2012, the Company submitted an application to the Antitrust Authority, requesting exemption from a binding arrangement with respect to the agreement. On June 15, 2012, the Antitrust Authority delivered its decision to the Company, under which it exempted the agreement under section 14 of the Restrictive Trade Practices Law, subject a series of terms detailed in its decision, primarily splitting the option (of which the last date for its exercise was postponed from April 2, 2013 to April 15, 2013) according to the following outline:

(1) The option will be split into two stages. The first option exercise date will be not later than April 15, 2013. The date of termination of the option period will be December 31, 2019.

(2) The second option exercise date will be not later than April 15, 2015. The validity of extension of the second option will apply from January 1, 2020 until the end of the agreement.

f) Pursuant to the Electricity Authority's decision of June 14, 2012, the Company can increase the rate of change of hourly gas supply beyond that set in the agreement, as long as in terms of the system, the hourly change rate can be increased in coordination with the system manager. Additionally, pursuant to the aforesaid Electricity Authority's decision, for gas quantities that will be supplied within the option, the mechanism under which the increase/decrease of 1% in the price adjustment formula will be executed was cancelled within Amendment no. 1 to the option. Additionally, the linkage to the U.S. CPI was reduced to a linkage rate of 30% as of January 1, 2013, and until termination of the option period including insofar as the Company will extend the option date as mentioned above.

g) On April 11, 2013, the Audit Committee and the Board of Directors of the Company, in their separate meetings, approved the exercise of the first option and the Company informed the Tamar Partnerships of its decision to exercise the first option that will end on December 31, 2019. When the Company's option exercise notice will enter into effect, the Company will be able to increase its hourly quantity of use by 50% and decrease the use of more expensive and polluting fuels. In January 2016, a letter was received from the "Tamar" partners, under which the gas flow within the first option is expected to occur in the window that will begin in January 2016 and end in March 2016. The exact date will be given by the Company within this window, 7 days in advance. On March 21, 2016, the Company received a letter from the Tamar partnerships regarding the status of the compressor construction project. The Company is studying the letter and its implications for the agreement.

On April 16, 2015, the Board of Directors of the Company decided to partially exercise the second option. Following the aforesaid, on May 7, 2015, the parties signed the necessary documents pertaining to the option exercise with a reduced quantity, under which beginning from January 1, 2020, the minimum quantity to be debited will be approximately 3 BCM. The maximum amount at the Company's disposal after the partial exercise of the second option is 87 BCM.

**h) Volume of gas purchase from the Tamar reserve**

In 2015, amounted to 4.25 BCM, and total amount from the beginning of the agreement until the end of 2015, the total gas quantity purchased by the Company within the agreement is 10.84 BCM.

AS of the beginning of 2016, the total gas quantity at the Company's disposal from the Tamar field, after partial exercise of the second option and until the end of the agreement, is approximately 76BCM.

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**NOTE 35:- AGREEMENTS, CLAIMS, CONTINGENT LIABILITIES AND LABOR DISPUTES**

**a. Agreements (continued)**

**1) Agreement on the Supply of Gas from the Tamar Field (continued)**

i) TOP mechanism

The Company examines, currently and prior to the publication of the Company's quarterly financial statement, if the minimum annual gas quantity with respect to which the Company has to pay the Tamar partnerships according to the TOP mechanism existing in the gas purchase agreement is expected to be larger than the quantity the Company expects it will consume in practice each year, in the years of the agreement.

The Company is conducting ongoing talks with the Tamar partnerships regarding the Gas Purchase Agreement and its implementation, and on November 19, 2015, a letter was received from the Tamar Partnership, pursuant to which, inter alia, they confirm that if, at the date of termination of the agreement, the Company will have a right to use unused gas with respect to which the Company paid to the Tamar Partnerships according to the ToP mechanism (hereinafter: "Make-Up Aggregate"), the Company will be permitted to extend the period of the agreement until utilization of the Make-Up Aggregate, and this according to the mechanism determined in the letter.

The letter is subject to the approval of the Director General of the Antitrust Authority (if required by the provisions of the law), and the consents of the financing banks of the Tamar partners, and it determines that if the stated approvals will not be received within reasonable time, the parties will discuss an alternative mechanism which will enable the Company to utilize the Make-Up Aggregate after termination of the agreement. On December 13, 2015, the Company delivered a notice to the Antitrust Authority regarding the aforesaid letter, within which the Company notified the Antitrust Authority that according to its understanding, the update of the mechanism for extending the agreement's period does not constitute a material change which requires permission from the Antitrust Authority. Within the Company's notice to the Antitrust Authority, the Company requested that if the position of the Antitrust Authority is different from the Company's position as aforesaid, the Antitrust Authority will inform the Company of this. To the best of the Company's knowledge, the Tamar partnerships also sent a similar letter to the Antitrust Authority. As of the date of publication of the report, the Company has not received any notice from the Antitrust Authority concerning this issue.

Based on the aforesaid, and in light of results of analysis of the Company's gas consumption forecasts, the Company is not expected to pay for gas it will not consume. Additionally and following the directive of the Minister of National Infrastructures, Energy and Water of January 2016 (see Note 1.g. above), the Company estimates that it is not expected to bring forward payment with respect to gas in the foreseeable future.

j) Sale of surplus natural gas

On November 5, 2014, the Natural Gas Authority at the Ministry of National Infrastructures (hereinafter: the "Gas Authority") gave the Company approval to market and sell surplus natural gas. The Gas Authority's approval was subject to various terms, included as detailed below:

- (1) The Company is permitted to sell or market natural gas only to certain consumers who are directly connected to the national transmission system, who have a signed transmission agreement with the Israel Natural Gas Lines Company Ltd., and that the natural gas is intended for their self use, to entities engaged in marketing natural gas to consumers connected to the transmission system, provided that they themselves do not consume natural gas, to private electricity producers whose annual consumption exceeds 50 million cubic meters a year, or that their installed capacity exceeds 50 megawatts, and to compressed natural gas supplier license owners.
- (2) The Company is permitted to sell or market natural gas only under agreements whose last date for selling or marketing the gas will be July 1, 2018 at the latest. The Company is also permitted to close occasional deals to sell or market natural gas for short periods with private electricity producers, subject to the rest of the license's terms.

The Company has expressed reservations about the Gas Authority's decision, and in a letter of December 25, 2014, requested from the Gas Authority to be given an appropriate opportunity to present its position on the issue in writing and orally within a lawful hearing to be held in this matter.

On November 29, 2015, the Company received the update of the Gas Authority's approval, under which the Company may also sell natural gas to the owner of a license to construct and operate the transmission system for operating needs; the Company may only sell or market natural gas under agreements in which the last date for selling or marketing the gas will not be later than July 1, 2010, and in limited annual quantities as

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**NOTE 35:- AGREEMENTS, CLAIMS, CONTINGENT LIABILITIES AND LABOR DISPUTES**

**a. Agreements (continued)**

**1) Agreement on the Supply of Gas from the Tamar Field (continued)**

**j) Sale of surplus natural gas (continued)**

determined in the Gas Authority's approval. Within the Gas Authority's approval, the Ministers' approval to sell natural gas which originates from liquefied natural gas to private electricity producers, of March 6, 2013, was expanded to additional consumers. It is noted that possible sale of gas in practice may require approvals of regulatory entities and as of the date of the report, there is no certainty that they will be given, and subject to the law.

It is further noted that on July 27, 2015, the Antitrust Authority notified the Company that it may perceive the gas nomination exceeding the quantities required for the Company for generating electricity in its facilities in practice as abuse of a monopolistic position, and that it believes that given the restriction of the capacity of the infrastructure transmitting the gas to the transmission system, nomination of surplus gas quantities which are not for a specific use and known by the Company in advance may arouse competitive apprehensions in the electricity generation market, as a result of unnecessary reduction of the natural gas quantity which will be available for private electricity producers.

**k) Regulation of the use of the gas pipeline capacity from the "Tamar" rig to the exit of gas from the Ashdod reception terminal**

On December 9, 2012, the Company received the decision of the Natural Gas Authority Council of November 29, 2012 from the Ministry of National Infrastructures, Energy and Water, with respect to regulation of the use of the natural gas pipeline capacity from the Tamar rig to the natural gas exit from the Ashdod reception terminal. This decision was reached due to the limitation and inability of the gas pipeline's capacity to supply all the expected hourly demands of the sector in the coming years.

This decision determines, inter alia, that:

- (1) The "Tamar" owners will not refuse to sign contracts for sale or marketing of natural gas with consumers who wish to enter contractual engagements with it, only due to the fact that entering a contractual engagement with them means that the total amount of hourly natural gas to be supplied through the pipeline exceeds the maximum capacity (as defined in the stated decision) in a certain hour or year.
- (2) A mechanism that determines the capacity that a marketer in the distribution grid and/or a consumer of the distribution grid will receive during a capacity exhaustion event (every hour in which the aggregate hourly demand of all the consumers and marketers for conveying natural gas through the gas pipeline is expected to surpass the maximum capacity) ("Excess Capacity"), and the total Excess Capacity to be allocated to all consumers and marketers during a capacity exhaustion event. Every hour in which the aggregate hourly demand of all the consumers and marketers for conveying natural gas through the pipeline is expected to surpass the maximum capacity (namely, a capacity exhaustion event), the gas consumers and marketers will reduce the volume of their natural gas consumption under the pro rata principle, according to the relative part of their capacity in the national transmission system, according to the formula detailed in the decision. In any case, the hourly maximum capacity of each of the consumers will not exceed the hourly maximum capacity signed for by the consumer with the Tamar reserve owners.

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**NOTE 35:- AGREEMENTS, CLAIMS, CONTINGENT LIABILITIES AND LABOR DISPUTES (continued)**

**a. Agreements (continued)**

**2) L.N.G.**

In accordance with the Minister's decision of February 2011, the Israel National Gas Lines Company constructed a buoy approximately 10 kilometers west of the Hadera coast, connected to the national gas transmission system. A LNG (liquid natural gas) ship, leased by the Company, connects to the buoy, has the capability to gasify the liquid natural gas aboard it and supply it through the buoy to the national transmission system.

As of the date of beginning of the supply of natural gas from the "Tamar" field, LNG is only used when there is a break or malfunction in the supply of gas from the "Tamar" field, when the quantities of gas available to the Company from the "Tamar" field are not enough to produce electricity in order to meet the electricity demand of the Company and during times of sectorial peak demand that may damage the survivability of the electricity system.

The Electricity Authority recognizes the costs of leasing a gasification ship and the cost of purchasing liquefied natural gas, for the Company, as well as additional direct and auxiliary costs that are expressed in agreements with suppliers, subject to controlling the costs.

In November 2015, the Company agreed the main points and the terms for extending the engagement period for leasing the gasification ship as of October 2017 for a period of at least two years and up to five additional years, with the possibility for the Company to end the engagement period by a 24 month advance notice. In January, 2016, the Company's Board of Directors approved the extension of the engagement. The engagement extension is subject to approval of the Electricity Authority.

In December, 2015, a letter was received from the Electricity Authority, under which the professional body of the Authority will recommend to the Authority's plenum to approve the extension of the engagement and to recognize the costs and exposures deriving from this.

**3) Agreement with the Palestinian Authority on the Construction of Sub-Stations**

In February 2012, the Company entered into an agreement with the Palestinian Energy Authority on the construction of four sub-stations in the Judea and Samaria region (in Tarqumiya, Jenin, Ramallah and Nablus). In addition, 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 plan 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 as stated, the Palestinian Energy Authority will pay the Company the rate of connection to the transmission grid, according to the rate determined by the Electricity Authority and will pay with respect to electricity according to the high voltage consumer rate, as prescribed by the Electricity Authority. The Company has started execution of the project. The Company provided the Palestinian Energy Authority with performance guarantees and advance payment guarantees as is customary in contractual engagements of this kind.

The construction of the Ramallah sub-station - the construction has not yet commenced but the project is presently at the final stage of a civil tender. In addition, the Palestinian Energy Authority has a debt of NIS 0.5 million and the construction of the sub-station will not commence until it is paid to the Company.

The construction of the Nablus sub-station - work has halted because the Palestinian Energy Authority has not yet approved a financial supplement for arranging the slopes in the area of the sub-station.

The Jenin and Tarqumiya sub-stations - construction of the sub-stations has ended but they are not electrified at this stage, as the connection fees have not yet been paid and commercial and operating agreements have not yet been signed between the Palestinian Energy Authority and the Company.

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**NOTE 35:- AGREEMENTS, CLAIMS, CONTINGENT LIABILITIES AND LABOR DISPUTES (continued)**

**a. Agreements (continued)**

**4) Contractual Engagements by the Company with Private Producers**

Following are details of engagements of the Company with private producers as of December 31, 2015:

The scope of production capacity of active private producers:

<b>Name of Producer</b>	<b>Status</b>	<b>Technology</b>	<b>Capacity (megawatts)</b>
Dalia Power Energy Ltd.	Active	Conventional	912
Dorad Energy Ltd.	Active	Conventional	860
Rotem O.P.C	Active	Conventional	466
Mashav Initiating and Development Ltd.	Active	Conventional	122
Paz Ashdod Oil Refineries Ltd.	Active	Cogeneration	109
IPP Delek Ashkelon	Active	Cogeneration	87
Others	Active		592
<b>Total</b>			<b>3,148</b>

The following is the scope of production of entrepreneurs with conditional licenses who have signed an agreement with the Company:

<b>Name of Producer</b>	<b>Status</b>	<b>Technology</b>	<b>Capacity (megawatts)</b>
P.S.P Investments Ltd.	Inactive	Pumped storage	300
Negev Ashalim	Inactive	Photovoltaic	242
Ramat Negev Energy Ltd.*	Inactive	Cogeneration	126
Others (including entrepreneurs who have signed an agreement with the Company after the statement of financial position date)	Inactive		244
<b>Total</b>			<b>912</b>

\* Ramat Negev Energy commenced commercial operation in January 2016.

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 3,649 megawatts.

As of December 31, 2015 the installed capacity of the small photovoltaic systems, including those photovoltaic systems belonging to the 'Net Meters' arrangement, is approximately 326 megawatts.

During July 2015, the Dalia Power Energy Ltd. power station began commercial operation of one unit. The second unit of this power station began commercial operation during September 2015.

As of the date of signing the financial statement, the installed generation capacity of private producers is approximately 21% of the total installed generation capacity in the economy.

The entrance of private producers with significant capacity is affecting and is expected to continue to affect the scope of revenue in the Company.

During the periods of December 31, 2015, and December 31, 2014, the electricity production by private producers constituted in practice approximately 23%, and approximately 16%, respectively, of the total production of the sector.

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**NOTE 35:- AGREEMENTS, CLAIMS, CONTINGENT LIABILITIES AND LABOR DISPUTES (continued)**

**a. Agreements (continued)**

**5) Agreements of the subsidiary**

- a) The subsidiary, The National Coal Supply Company Ltd. ("the Coal Company") entered into long term agreements with suppliers and international shipping companies for the purchase and transportation of coal consignments. The commitment to purchase coal is made according to the same long term agreements with coal suppliers, where the price of the major quantity of coal is linked to international indices of the coal price. Some of the coal purchasing and marine shipping agreements are at fixed prices, in accordance with the Coal Company's policy. In coal purchasing agreements, fixed prices are determined for a maximum period of 12 months in advance while marine shipping agreements are for various periods, and as to periodic leasing agreements, even for several years in advance. As of the publication date of the Financial Statements, shipping prices in the market are lower than the prices of shipping agreements at fixed prices entered into by the Coal Company and most of the coal purchasing agreements entered by the Coal Company are linked to international coal price indices, therefore, current market prices of coal are the same as prices of the aforementioned coal purchasing agreements and there are no differences between the market prices and the agreements prices. Due to the agreement with the Electric Company that determines, inter alia, that the price of coal sold is determined on the basis of cost plus calculated as a fixed rate yield on equity, differences with respect to the coal agreements and differences with respect to transportation and lease agreements and the prices quoted in the market, if any, will be included in the price of coal and the Coal Company has no exposure with respect to them.
- b) The Coal Company entered into agreements with shipping companies to ship coal up to 2016 in the amount of Dollars 5.6 million and for long term leasing of ships, up to 2021, in an approximate amount of \$ 142 million. The Coal Company also entered long term agreements to purchase coal up to 2017, in a total quantity of 9 thousand tons.
- c) On January 16, 2013, and in effect as of September 2012, an agreement was signed between the Company and the Coal Company for the giving of various services to acquisition activities and import of liquid natural gas shipments. As part of the agreement, the Coal Company provides the Company with ship border services and various coordinating and 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 total revenues of the Coal Company, mainly following this agreement, for 2015 and 2014, are approximately NIS 1.1 million and for each year.
- d) On March 3, 2013, a lease agreement was signed between the Coal Company and Port of Hadera (Ministry of Transport). In accordance with this agreement, the Coal Company leases a tugboat that was purchased by it on December 4, 2012, to the Port of Hadera, for a period of 5 years in return for agreed leasing fees. At the end of the lease period, the Port of Hadera will be able to extend the lease by one additional year each time, up to an additional accumulated period that will not exceed 15 years. The tugboat will return to the Coal Company at the end of the lease period and the extended period. The total investment in net lease as of December 31, 2015 and December 31, 2014 are approximately NIS 19 million and approximately NIS 24 million, respectively.
- e) On December 25, 2013, the Coal Company entered an agreement with an Israeli company to lease a bulk ship for 10 years.
- f) On June 9, 2014, the Coal Company entered an agreement with a foreign company to execute a transaction combining a purchase of a new bulk ship that will be built in a shipyard in Japan, and its long-term lease by the Coal Company. The cost of the ship is USD 55 million and its lease period is 10 years. The ship will be delivered in 2016. The Coal Company's part in the transaction is 49%.  
Until December 31, 2015, the Coal Company paid a total of approximately NIS 39 million, which constitute 40% of the transaction value, as advances on account of the aforesaid purchase.



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**NOTE 35:- AGREEMENTS, CLAIMS, CONTINGENT LIABILITIES AND LABOR DISPUTES (continued)**

**a. Agreements (continued)**

- 6) As of December 31, 2015, 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 USD 165 million, EUR 144 million, approximately £1 million and NIS 1 million. 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 2,147 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 statement of financial position date in the amount of approximately Dollar 8,361 million and NIS 1,800 million.
  - d) The Company has contractual engagements with ultra high, high and low voltage private electricity producers for future purchase of electricity in a comprehensive annual amount of approximately NIS 4,433 million. The above mentioned amount is based on production forecasts and payments to private producers (existing producers and those that will enter the sector in the coming years) with respect to contracts signed by December 31, 2015, for a period of 15-20 years.

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**NOTE 35:- AGREEMENTS, CLAIMS, CONTINGENT LIABILITIES AND LABOR DISPUTES (continued)**

**b. Contingent Claims and Liabilities**

There are approximately 520 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, 2015, to approximately NIS 22,403 million, of which NIS 17,652 million with respect to applications to recognize the claims as class actions and applications for class actions that were accepted (as of December 31, 2014, a sum of approximately NIS 31,004 million, of which NIS 25,245 with respect to claims requiring recognition as class actions). A provision with respect to part of these contingent claims was included in the Financial Statements in the other current assets item which as of December 31, 2015, was in the net amount (less income due from insurance companies with respect to insured claims) of approximately NIS 329 million (as of December 31, 2014 amounted to approximately NIS 340 million) as follows:

- 1) A provision of approximately NIS 73 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 230 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 12 million with respect to uninsured claims for which a full provision was recorded.
- 4) Approximately NIS 14 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**

- 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 judge.

The request for approval dealt with the collection of the special surcharge to the electricity rate. The claimant claimed, inter alia, that this special surcharge is a "hidden tax" that is being unlawfully collected, and that the Company must return it, together with interest and linkage, in the amount of approximately NIS 2,847 million in values of the date on which the claim was filed. It should be noted that the special addition which was intended to finance the Company's liability for pension of active employees and pensioners who started working in the Company up to March 31, 1975 and accumulated up to March 5, 1996, is an addition to the electricity rate which was fully collected from consumers, from 1997 to 2005 inclusive (by force of the pension agreement in June 1996 between the Government and the Company and by force of section 62(e) to the Electricity Sector Law). At the end of 2005, the collection of the special surcharge ended.

The Company had collected a nominal sum of NIS 9 billion on account of the special surcharge.

The parties completed filing their complementary pleas during 2010.

On January 16, 2016, a judgment was given in the proceeding, under which the request for approval is dismissed. In the judgment, the Court noted two reasons for dismissing the request for approval, as follows:

- (1) The delay, which afflicted the submission of the request for approval, which was submitted several years after the collection of the special supplement began. The Court ruled that in light of the unique circumstances and the wide scope of this case, the delay by the applicant had significant implications, in light of which the request for approval should be dismissed.
- (2) The conceptually internal contradiction inherent in the request for approval. This is because of the applicant's attempt to match the argued grounds of the claim to a class action. Moreover, the Court further determined that whether the sums of money, collected unlawfully according to the applicant, will be classified as "tax", or classified as "price", the proceeding of a class action is not the suitable proceeding for investigating the matter.

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**NOTE 35:- AGREEMENTS, CLAIMS, CONTINGENT LIABILITIES AND LABOR DISPUTES (continued)**

**b. Contingent Claims and Liabilities (continued)**

**1) Claims requested to be recognized as class actions (continued)**

The Court determined that its two determinations, presented above, suffice for dismissing all the arguments presented in the request for approval, and therefore did not continue to discuss them. According to the judgment, the applicant has to pay court fees in a total amount of NIS 50,000, which will be equally divided between the State and the Company. On March 8, 2016, an appeal of the aforesaid judgment was submitted to the Supreme Court. As of the date of this financial statement, the appeal has not yet been served to the Company. In light of this, the Company's legal advisors cannot estimate the appeal's prospects.

- b) On July 6, 2009, a claim and a request was filed with the Tel Aviv District Court against the Company, (hereinafter: "The Request for Approval") to approve a claim as a class action.

This claim was filed by a group of 512 claimants, residing in Gush Etzion dealing in granting adequate compensation to group members for alleged pecuniary and non-pecuniary damages caused by repeated disruptions and faulty electricity supply to villages in the Gush Etzion district.

Consequently, the amount of the claim which the Court is requested to approve as a class action is approximately NIS 39 million.

On October 14, 2012, a decision was given on the Request for Approval, in which the Court approved the submission of the claim as a class action (hereinafter: the "Decision of Approval").

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, the Supreme Court accepted the request for leave to appeal and cancelled the Decision of Approval, and remanded the case to the Tel Aviv District Court for a new decision to be given in the application for approval.

On December 31, 2015, the parties submitted an agreed application to approve the arrangement of the applicants' abandonment of the proceeding and dismissing their personal claim against the Company. As part of the abandonment arrangement, the Company undertook, ex gratia and without admitting to the arguments of the applicants in the request for approval, to provide 100 hours of consultation for energy improvement for public institutions, public buildings and public premises in the area of Gush Etzion, and to pay the representatives of the applicants lawyers' fees in the amount of NIS 15,000.

On January 3, 2016, the Court ruled, approving the application for abandonment, verbatim, in accordance with the stated consents between the parties, and thus the proceeding ended.

- c) On February 15, 2011, a request to approve a class action against the Company was filed at the District Court of the Central District, in the amount of NIS 166 million (hereinafter: "The Request for Approval"). The request for approval claims that the Company collects, contrary to the law, two separate fees, one for disconnecting a consumer from the electricity supply (for any reason) and the other for reconnecting the consumer.

A compromise agreement was approved between the claimant and the Company on September 21, 2015, under which the claimant will withdraw the causes of action detailed above, except for the cause of connection and disconnection outside premises, regarding which the Company will partially return the surplus sums that were allegedly collected.

According to the approved compromise agreement, the Company was required to pay a negligible sum, which in any case had already been charged in the past in the books as a provision.

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**NOTE 35:- AGREEMENTS, CLAIMS, CONTINGENT LIABILITIES AND LABOR DISPUTES (continued)**

**b. Contingent Claims and Liabilities (continued)**

**1) Claims requested to be recognized as class actions (continued)**

- d) On January 31, 2013, two claimants (hereinafter: "the Claimants") filed a petition to the District Court for the approval of a class action against the Company in an amount of approximately NIS 178 million (hereinafter: "the Request for Approval").

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. Additionally, the Claimants alleged that as a result of the performance of the consumption assessments, the diagram that appears on the electricity bills that are sent to the Company's customers does not reflect actual consumption, and consequently the consumers are unable to examine the reasonability of their current consumption charges based on that diagram.

On April 2, 2015, the District Court provided judgment dismissing the petition for approval (hereinafter: the "Judgment"). The Court determined that the Electricity Authority permitted the Company to execute initiated skipping, due to various constraints.

The claimants did not submit an appeal against the judgment during the time set for this by law, and this proceeding has ended.

- e) On May 6, 2013, three applicants (hereinafter – the "Applicants") filed an application to approve the filing of a class action against the Company (hereinafter – the "Request for Approval") at the District Court (Central District), on behalf of all the Company's customers who were debited with arrears interest, warning expenses or other debit with respect to delay in payment during the seven years that preceded the filing of the claim, when the bill to be paid reached them less than five days before the deadline for payment, on the deadline date or after it.

The Applicants noted that they cannot estimate the exact damage that was allegedly caused to the group of claimants, but they estimate that it is an amount of "tens of millions of NIS, and maybe even more".

On September 23, 2014, an application to strike off two applicants, an application for abandonment and an application to remove their depositions from the Court file was submitted. The Court accepted the application and the request for approval has therefore remained with one applicant (hereinafter: the "Applicant").

Evidentiary hearings were held on October 7 and 22, 2014, within which the court announced it is considering requesting the position of the Electricity Authority and/or the position of the Attorney General on the issue discussed.

The Court recommended that the Company reach consents with the Applicant, and has also set dates for submitting summaries in the proceeding.

Before submitting summaries in the application, the Applicant submitted a request for disclosure of specific documents of the Company, and this request was dismissed.

The parties submitted summaries and argument completions, following the applicant's submission of an application to file additional evidence.

It is the estimate of the legal advisors of the Company that it is more likely than not that the request for approval will be approved with regard to the Company's conduct regarding the delivery of bills in the future. It is not possible to estimate the prospects of acceptance of the request for approval pertaining to the claim for compensation with respect to damages caused by the delays in delivering the electricity bills in the past, but in any case, the legal advisors of the Company estimate that even if the request for approval is accepted, it is more likely than not that the Company will ultimately not be obligated to pay with respect to delays that occurred in the past (inter alia, due to absence of proof of damage).

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**NOTE 35:- AGREEMENTS, CLAIMS, CONTINGENT LIABILITIES AND LABOR DISPUTES (continued)**

**b. Contingent Claims and Liabilities (continued)**

**1) Claims requested to be recognized as class actions (continued)**

- f) On May 8, 2013, an application to approve a class action was filed against the Electric Company (hereinafter: the "Application for Approval").

The application to approve concerns the engagements of the Company in agreements with the Siemens Company, in the years 2001-2003, to purchase combined cycle gas turbines ("CCGT") and related services. The sum of damage claimed in the application for approval is based on the sum of damage claimed by the Company in the action it submitted against Siemens, Dan Cohen and others (hereinafter: the "Company Action against Siemens").

According to the claim, the damage to the Company was "rolled over" to the electricity consumers within the determination of electricity rates by the Electricity Authority for the consumers. According to the arguments in the application to approve (based, inter alia, on the decision of the Tel Aviv District Court of April 21, 2013), the Company has exclusive influence on the determination of the rate. Therefore, the applicant claims that the electricity consumers were excessively charged within the framework of the electricity rates in the amount of NIS 200 million.

On September 1, 2013, the Company submitted an application for a stay of proceedings of the application to approve until a decision is reached in two proceedings: (1) the application for leave to appeal mentioned in section 2(a)(1) below; (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 2(a)(1) below. On November 11, 2013, the Court instructed a stay of proceedings in the application to approve until a decision is reached as stated.

On October 28, 2015, a hearing was held by the Supreme Court with respect to the application for leave to appeal mentioned in section 2 (a)(1) below, and the Company updated the court on this matter. The case is scheduled for an internal reminder for May 15, 2016.

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.

- g) On September 30, 2013, an application to approve a class action against the Company and five other companies (hereinafter: the "Cartel Companies") was submitted to the Central District Court, in the amount of approximately NIS 2.4 billion and an additional amount of approximately NIS 412 million against the Company alone, NIS 2.8 billion in total.

The application deals with the global cartel in the GIS (Gas Integrated Switchgear - hereinafter: "GIS") array market between the years 1988-2004, in which the Cartel Companies took part, and within which they coordinated a tender that was published by the Company for the purchase of dozens of GIS arrays. The application is based, inter alia, on the determination of the General Director of the Israel Anti-Trust Authority of September 16, 2013, with regard to the implementation of the cartel in Israel (hereinafter: the "Determination of the General Director").

Within the application for approval it is argued that the Cartel Companies, that maintained among themselves a restrictive arrangement contrary to the restrictive trade practices law, are responsible for the damage in the amount of NIS 2.8 billion, as well as the Company itself, which, according to the argument in the application for approval, conducted itself negligently and in breach of duties from the administrative law, by "surrendering" to the cartel out of indifference to damages that were "rolled over" on to the consumers (although the applicants note that in their opinion the Cartel Companies are the direct and major damagers, and insofar as liability will be imposed on the Cartel Companies, they do not demand that the Company compensate them with respect to this liability). It is further argued in the application for approval that the Company even increased the consumers' damage beyond the damages by the cartel, with unjust enrichment at the expense of the consumers, in the amount of NIS 412 million, because of a gap between the interest for the damages by the cartel and the interest for the electricity rate.

On September 4, 2014, the court accepted the Company's request for a stay of proceedings in the application for approval submitted against it due to a proceeding pending at the Supreme Court that the Company is party to (mentioned in section b) above). The Court even ordered a stay of proceedings in the application for approval against the other defendants until a decision is reached in the stated proceeding. On October 19, 2014, the Claimants submitted an application for leave to appeal the above mentioned decision to the Supreme Court (hereinafter: the "Application for Leave to Appeal").

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**NOTE 35:- AGREEMENTS, CLAIMS, CONTINGENT LIABILITIES AND LABOR DISPUTES (continued)**

**b. Contingent Claims and Liabilities (continued)**

**1) Claims requested to be recognized as class actions (continued)**

On February 19, 2015, the Company and the Cartel Companies submitted their responses to the application for leave to appeal. In its decision of March 11, 2015, the Court proposed an outline for consolidation of the proceeding of the Company's claim (see section 5) below) with the application for approval and an additional application for approval (that was not filed against the Company and has since been stricken off by a decision of the District Court of May 28, 2015) regarding the liability of the Cartel Companies (hereinafter: "the Liability Issue").

On March 26, 2015, the Supreme Court ruled that the hearing of the Liability Issue should be consolidated (see section 5)a) below). On April 13, 2015, the President of the District Court, Central District, instructed that the consolidated hearing will be held in front of the panel of judges hearing the Company's claim. On April 29, 2015, a consolidated pretrial hearing was held, at which the Court instructed the parties to conduct preliminary proceedings among them pertaining to the Liability Issue.

On August 19, 2015, the parties to the proceedings submitted a consensual application to approve a procedural arrangement pertaining to the dates for completing the pretrial proceedings, submitting amended statements of defense on behalf of the Cartel Members, and submitting an amended statement of response on behalf of the Company. The Cartel Members submitted the statements of defense on their behalf, according to the procedural arrangement, and on November 2, 2015, the Company submitted an amended statement of response on its behalf. The pretrial proceedings are expected to be completed during the coming weeks.

An additional consolidated pretrial hearing has been scheduled for March 24, 2016.

It is the opinion of the legal advisors of the Company that the Company has good defense pleas for dismissing the application for approval and it is more likely than not that the application for approval will be dismissed.

- h) On December 16, 2014, an application to approve a class action against the Company (hereinafter: the "Application for Approval") was submitted to the Central District Court, in the amount of approximately NIS 19 million on grounds of breach of statutory duties on the part of the Company, deception under the Consumer Protection Act, 1981 (hereinafter: the "Consumer Protection Act") and the Unjust Enrichment Law, 1979 (hereinafter: the "Unjust Enrichment Law"). The Application for Approval is a claim that the Company denies the rights of discount in the electricity rate for consumers that are entitled to it by law, at the time of changing a place of residence.

A pretrial was held in the case on October 19, 2015, during which the applicant retracted its argument with respect to violation of the criteria pertaining to compensation with respect to delay in response to requests, and also notified that it is accepting the Court's recommendation to also abandon the cause pertaining to not providing a discount when changing place of residence. In view of the above mentioned, the applicant submitted an application of abandonment with the consent of the Company, and a verdict was given on November 2, 2015, pursuant to which the abandonment application is accepted in full, and is effective as a judgment. Therefore, the application for approval was dismissed and the applicant's personal claim was dismissed without order for costs. The proceedings in this case thus ended.

- i) On July 6, 2015, an application for approval for a class action against the Company was submitted to the Tel Aviv District Court (hereinafter: the "Application for Approval"). The application for approval concerns the applicants' claims that the Company customers who call the 103 call center have to wait a long time on the line, exceeding the time permitted as determined in the Consumer Protection Regulations (Providing Service by Telephone), 2012. The applicants claim that as a result of this, they and the group they wish to represent have various causes of action against the Company, including causes of action originating from the consumer protection laws, torts, unjust enrichment, and cause of action with respect to damage to the autonomy and free will.

The sum of the claim the Court is requested to approve as a class action was set by the applicants at approximately NIS 25 million. The applicants also requested a remedy of mandatory injunction against the Company, which will oblige the Company to allocate resources which will enable it to meet the time for answering as set by law. On January 11, 2016, the Company submitted a response to the application to approve the action as a class action and on February 9, 2016, the applicants submitted a reaction to the response. The legal advisors of the Company estimate, by preliminary estimate, that in view of the preliminary stage of the proceeding, it is more likely than not that the application for approval will be dismissed.

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**NOTE 35:- AGREEMENTS, CLAIMS, CONTINGENT LIABILITIES AND LABOR DISPUTES (continued)**

**b. Contingent Claims and Liabilities (continued)**

**1) Claims requested to be recognized as class actions (continued)**

- j) On October 27, 2015 and November 1, 2015, two applications to approve class actions against the Company were submitted to the Central Region District Court, in the amount of NIS 240 million and NIS 354 million, respectively, in light of the disruptions in the supply of electricity which occurred following the stormy weather which visited the country during October 25-28, 2015.

Additionally, on December 31, 2015, an application for an additional class action against the Company was filed with the Central Region District Court, with the same cause of action which is not denominated in an amount but is estimated by the applicants at approximately tens of millions NIS. The applicants of this application and the group they wish to represent are businesses which allegedly suffered damage from the disruptions in the electricity, while the applicants and the group in the two other applications for approval which were submitted against the Company regarding the events of October 2015 are private individuals.

Within the applications, it was argued against the Company that in its conduct regarding the stated disruptions it allegedly violated a series of provisions of the law and various legal obligations and that the Company's alleged acts and omissions create for the claimed groups on behalf of whom it is requested to submit the class actions a series of various causes of actions according by virtue of the law, including the criteria. It is noted that, prima facie, at least some of the claimed sums in the two requests to approve are overlapping.

The Company filed an application to consolidate the three applications for approval mentioned above, which deal with the damages of the storm of 25-28 October, 2015, and a decision has not yet been made regarding this application.

According to the Court's decision of January 21, 2016, the date for submitting a response to the application for approval of December 31, 2015 will only be set after a decision is made in the Company's application to consolidate the overlapping proceedings according to the law.

At this first and preliminary stage, the legal advisors of the Company cannot estimate the exposure existing for the Company (if any) in view of the stated requests for approval.

- k) After the statement of financial position date, on January 14, 2016, two applicants, cooperative societies of kibbutzim, submitted an application to approve a class action against the Company to the Petah Tikva Central District Court (hereinafter: "Application for Approval"). It should be noted that some of the arguments in the application are to a large extent similar to the arguments raised in a group action submitted against the Company, as detailed in section 6) below, and which has reached the stage of submission of summarizing arguments on behalf of the parties.

The applicants claim that they and the members of the group purchase electricity from the Company in a "collective sale", in order to supply it to others, as this term is defined in the Criteria Book of the Electricity Authority (hereinafter: "Criteria"). Therefore, the applicants claim that they and the group members are entitled to be charged to pay for consumption according to a "collective sale rate", as its definition in the Criteria Book, but instead they are charged according to the load and time rate which is on average higher by 3% from the concentrated sale rate. The applicants claim that the Company discriminates between consumers in a collective sale who purchase electricity of low voltage, and (in general) are charged at the collective sale rate, and consumers purchasing electricity of high voltage, who are charged at a higher rate. The applicants further claim that the Company sometimes also charges consumers in a collective sale who purchase low voltage electricity with a higher rate than the collective sale rate.

The applicants claim that they cannot estimate the sum of the claim and that the relevant information on these issue lies with the Company, but note that it cannot be disputed that the aggregate amount of damage is estimated at many millions of NIS. It should be noted, in this context, that the sum of the "personal" claims of the two applicants is, together, approximately NIS 514 million.

The applicants claim that in its conduct, the Company violates the provisions of the criteria and the Electricity Sector Law. The applicants claim that they have causes of action against the Company of breach of statutory duty, unjust enrichment and negligence.

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**NOTE 35:- AGREEMENTS, CLAIMS, CONTINGENT LIABILITIES AND LABOR DISPUTES (continued)**

**b. Contingent Claims and Liabilities (continued)**

**1) Claims requested to be recognized as class actions (continued)**

According to the law, the Company must submit its response to the application for approval by April 13, 2016. The applicants will be permitted to respond to the Company's response by May 22, 2016. A pretrial hearing of the application for approval has been scheduled for July 14, 2016.

At this preliminary stage, the legal advisors of the Company cannot estimate the likelihood of the application for approval to be accepted.

- l) After the statement of financial position date, on February 29, 2016, an application to approve a class action against the Company was submitted to the Haifa District Court (hereinafter: the "Application for Approval"). The application deals with compensation due to non-payment of arrears interest of the Comptroller General for the customers' credit balance, and with a demand for compensation for violation of the criteria provisions pertaining to giving a response to complaints in general and on the date set in the criteria.

The group of claimants is defined as including all the Company's customers with a credit balance accrued in their favor, for any reason, and who received refunds of nominal values (principal values) without attaching to the refund the General Comptroller's interest and/or interest and linkage under the Interest and Linkage Award Law.

The sum of the class action the Court is requested to approve is approximately NIS 20 million.

A pretrial of the Application for Approval is scheduled for July 20, 2016.

At this preliminary stage, the Company's legal advisors cannot estimate the prospects that the application will be accepted.



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**NOTE 35:- AGREEMENTS, CLAIMS, CONTINGENT LIABILITIES AND LABOR DISPUTES (continued)**

**b. Contingent Claims and Liabilities (continued)**

**2) Claims that have been recognized as class actions as of the date of these Financial Statements**

- a) (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, abusing the status of a monopoly according to the Anti-Trust Law, enrichment by force of the Unjust Enrichment Law and deceit and negligent wrongs in the Damages Act, 1968 (hereinafter: the "Request for Approval on the subject of salary payments"). The claimant alleges that the Company collects through electricity bills illegal amounts from electricity consumers, as part of the price of the electricity it supplies, to cover excessive, illegal and invalid salary (according to the claimant's claim) of Company employees. The claimant claims that the accrued amount of the allegedly illegal salary payments, collected in contrast with the Government Companies Law, and the Foundations of Budget Law, 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, an additional request to approve a class action against the Company was filed with the Central District Court for causes based on the Consumers Protection Law, the Trade Limitation Law, Unjust Enrichment Law, Damages Law and Contracts Law (hereinafter: "The Request for Approval on the subject of pension"). The claimants claim, that an error in the actuarial calculations of the pension to which Company employees are entitled led to the increase of the Company's pension liabilities as were recognized in the electricity rate. The claimants also claim that the cost of the increased pension liability was allegedly passed on to the consumers through setting higher than required electricity rates and alleged excessive payments for electricity consumption, estimated at approximately NIS 6 billion during the seven years preceding the filing date of the claim and during the proceedings of the claim. The claimants also claim that the Company was aware of the said error, but refrained from correcting it and even presented erroneous data to the Electricity Authority.

The hearing of the two applications was united and on May 17, 2010, all the applicants, together, submitted a joint application for approval (hereinafter: the "Joint Application").

On April 17, 2013, the District Court gave its decision approving the request for approval (hereinafter: the "Decision of Approval").

The Company's legal advisors are of the opinion that the Decision of Approval is erroneous and on May 13, 2013, the Company filed a request for leave to appeal the decision with the Supreme Court. At the same time, the Company filed a request for a stay of performance of the Decision of Approval. On June 9, 2013, the Supreme Court gave its decision, under which the Decision of Approval will be delayed until another decision is made.

In accordance with the decision of the Supreme Court, on January 20, 2014, the Attorney General of the Government submitted his position in the application for leave to appeal, within which the Attorney General of the Government supported the position of the Company, i.e. the acceptance of the request for leave to appeal and cancellation of the Decision of Approval. In accordance with the decision of the Attorney General, inter alia, the electricity rates cannot be challenged within the framework of a class action, and this can only be done within the framework of an administrative proceeding against the Electricity Authority.

A hearing of the Company's application for leave to appeal the stated decision of the District Court was held on October 28, 2015.

The Court noted in its decision that within the hearing, the Electricity Authority announced that a decision will be reached within 6 months regarding the issue which was raised in 2009 pertaining to an amount of NIS 1.9 billion which was presented as an accounting provision, and it was stated that any surplus sums located will be returned to the public. Additionally, the Court noted in its decision that it will await the Authority's notice until the end of April, 2016, and that this may serve as a public base for ending the proceeding. The other parties will be able to respond to the Authority's notice within 30 days. Additionally, within the decision, the Court requested the parties to discuss among themselves with regard to an appropriate ending of the case.

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**NOTE 35:- AGREEMENTS, CLAIMS, CONTINGENT LIABILITIES AND LABOR DISPUTES (continued)**

**b. Contingent Claims and Liabilities (continued)**

**2) Claims that have been recognized as class actions as of the date of these Financial Statements (continued)**

a) (2) An additional application was submitted by the applicants "solely for the sake of caution" (as claimed by them) in view of the arguments of the Company within the procedure of application to approve, and it is based on the Joint Application and constitutes an expansion of it, both by the aspect of the period of time the Additional Application relates to and the scope of issues the Additional Application relates to. The amount of the class action whose approval is requested in the Additional Application is not explicitly specified (in view of the fact that the applicants claim that the Joint Application also includes the causes of action of the Additional Application), and they estimate that it is an addition of approximately NIS 2-3 billion to the Joint Application (that derives from the passage of time from the date of submission of the first application to approve until today).

The Company submitted an application to postpone the date for filing its response to the additional application and delay of the proceeding for as long as the Decision of Approval is delayed. On March 2, 2014, the Court approved the stated stay of proceedings until the Supreme Court will give its judgment in the application for leave to appeal that was submitted by the Company with regard to the approval decision of April 17, 2013 (see section (1) above).

The Company's legal advisors estimate that despite the Decision of Approval, 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 (among other things, due to the position of the Legal Counsel of the Government), and the claim will be dismissed. Regarding the Additional Application, since it is in its early stages, 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

b) On November 10, 2009, a request to approve a class action against the Company and ten other respondents was filed with the Central District Court, by force of principles in the Damages Law and Consumers Contracts Law in the amount of approximately NIS 24 million ("The Request for Approval" "The Respondents", respectively).

The claimants claim that each of the respondents violated their statutory duty to provide free of charge telephone services to the customers to be used for calls on matters of faults, defective goods or faults in services provided by the respondents to their customers, all according to section 18 b of the Consumer Protection Law.

Regarding the Company, the claimants claim that a consumer that calls the call center (103) from a mobile phone pays the full charge for this call and similarly, also a consumer who calls one of the direct telephone numbers of the Company from any telephone (both mobile and land-line) pays the regular price for a call.

On August 11, 2013, the Court gave its decision on the application for leave, within which the Court gave its approval to conduct the claim as a class action with the causes of breach of sections 18b and 31 to the Consumer Protection Law, in that the respondent does not enable free calls to the call center, and breach of statutory duty as stated in the Torts Ordinance with respect to breach of the provision of section 18 b to the Consumer Protection Law. However, the Court decided that the applicant did not prove that it has a personal cause of action against the Company, and instructed the representative of the applicant to locate another class action claimant who has personal cause of action against the Company.

On August 7, 2014, the Court gave its ruling, within which the Court accepted the application of the representative of the claimants to change the class action claimant with the Israel Consumer Council and instructed it to file an amended statement of claim. A pretrial hearing of the action was held on January 5, 2015, in which the Court recommended a process of mediation between the parties and it was agreed that a mediation process will be conducted simultaneously with the continued hearing of the action.

The process is in preliminary stages and a date for hearing the action has not yet been scheduled. At the same time, a mediation proceeding is being conducted between the parties.

In light of the decision to approve the class action, the legal advisors of the Company estimate that it is more likely than not that the action will be accepted. However, it is possible to estimate that the Company is not expected to bear the expenses with respect to this claim, beyond a negligible amount that is attributed in its books as a provision.

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**NOTE 35:- AGREEMENTS, CLAIMS, CONTINGENT LIABILITIES AND LABOR DISPUTES (continued)**

**b. Contingent Claims and Liabilities (continued)**

**3) Claims for the pollution of the Kishon River**

As part of a claim submitted against "Haifa Chemicals Ltd.", "Refineries Ltd", the Association of Municipalities (Haifa Region) (Sewage) and the municipality of Haifa (hereinafter: the "Defendants") by 95 soldiers and estates of soldiers (at present, the total amount is 74 plaintiffs), claiming that the soldiers fell ill with cancer and/or other diseases due to their alleged exposure during their military service to the Kishon River waters, Haifa port, Shemen beach and surrounding waters, a joint notice was submitted in 2005 on behalf of the defendants against numerous third parties, among them the Company (hereinafter: the "First Claim"). In 2007, an additional claim was submitted, incorporating seventeen claims by soldiers and estates (at present, the total amount is 16 plaintiffs) against the defendants of the first claim and their insurers (hereinafter: the "Second Claim").

A hearing of the first claim was held at the Supreme Court on September 7, 2015, and within the judgment, the Court dismissed the appeal after determining that the appellants failed to prove a causal connection according to the accepted scientific tools, between the type of the claimed exposure to materials claimed by them and their illnesses. It was further determined in the judgment that the respondents succeeded in proving that the appellants became ill due to personal risk factors - as detailed with respect to each and every one of them in the judgment of the lower Court. Furthermore, the Supreme Court determined that under the circumstances of the matter a situation of "causal ambiguity" did not exist, and also dismissed this claim of the appellants. In the final part of the judgment, the court of appeal ruled that ex gratia it is not ruling that the appellants pay the costs.

Regarding the second claim which was heard separately, a procedural arrangement was reached, according to which the hearing of the claim is suspended until a decision is reached in the appeal of the judgment of the first claim. Once a peremptory rule was reached dismissing the first claim, the claimants of the second claim announced their desire to "cancel their claim" and on December 7, 2015, a judgment was passed dismissing the claim without costs.

**4) Derivative Claims**

a) On September 10, 2009, a letter was sent to the Chairman of the Board of Directors by Mr. Dov Zelinger, who is, according to him, a shareholder of the Company. Within the aforesaid letter, Mr. Zelinger related to two issuances of debentures executed by the Company, abroad, in May 2008 and January 2009 (hereinafter: the "Debentures"). Mr. Zelinger claims that during the months of August and September 2009, the Company published that a mistake occurred in the actuarial calculation of the pension funds that the Company employees are entitled to, leading to the increase of the pension liabilities of the Company. Mr. Zelinger claims that due to the aforesaid mistake in the actuarial calculation, the interest rate paid by the Electric Company on the Debentures is higher than the rate it would have paid had the aforesaid mistake not occurred, and thus damage is caused to the Company.

In light of the aforesaid, Mr. Zelinger requested the Chairman of the Board of Directors to ensure that the Company files a claim with respect to the aforesaid damage, against the relevant members of the Board of Directors for each of the aforesaid Debenture issuances, and against the actuary of the Company, who, according to Mr. Zelinger, violated their duties towards the Company, and, as he claims, are responsible to the damage caused to the Company with respect to the aforesaid mistake. Mr. Zelinger announced that the aforesaid letter constitutes a preliminary application, in accordance with the Companies Law, before submitting an application to the Court, requesting permission to submit a derivative claim on behalf of the Company against the members of the Board of Directors and the actuary of the Company.

On October 21, 2012, Mr. Zelinger again approached the Company, and claimed, considering the publication of the Annual report number 63A of the State Comptroller on October 17, 2012, that the contents of the report of the State Comptroller strengthen the claims of Mr. Zelinger that were raised in the previous correspondence between the parties. Mr. Zelinger noted that considering the new findings (as he claimed) the Company is requested to "reexamine and reconsider its position not to file a claim against those responsible for the financial damage caused to the Company as a result of capital raisings" the object of the first letter, and that if it refuses to file a claim as aforesaid, Mr. Zelinger will consider filing a derivative claim in its name. On November 26, 2012, the Company replied to Mr. Zelinger's latest letter and once again rejected his claims.

At this stage, it is not possible to estimate the risk to the Company as a result of the aforesaid, inter alia because an application to approve the filing of a derivative claim (which in general is not even a claim against

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**NOTE 35:- AGREEMENTS, CLAIMS, CONTINGENT LIABILITIES AND LABOR DISPUTES (continued)**

**b. Contingent Claims and Liabilities (continued)**

**4) Derivative Claims (continued)**

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 (hereinafter: "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 (hereinafter: the "Financial Fine"), is under the responsibility of the CEO of the Company and those who were at the time in office as Senior Vice President Finance of the Company and Head of the Financial Division of the Company. In light of the above, Mr. Zelinger requests in the Letter of Demand that the Company will submit an action in the amount of the financial fine against the persons mentioned above. Additionally, according to the Letter of Demand, if the Company refuses to submit an action as stated, Mr. Zelinger will consider submitting a derivative action in his name. On February 13, 2014, the Company replied that it does not intend to submit a claim against the office holders.

At this stage, it is not possible to estimate the risk to the Company as a result of the aforesaid, inter alia because an application to approve the filing of a derivative claim (which in general is not even a claim against the Company, but rather a claim by the Company) was not submitted, and therefore it is not possible to know what claims will be presented in it (if any), and against who will the derivative claim be, or what scope will it have, and also because the complete relevant facts have not yet matured at this stage.

Even if a derivative action of the claimant (in the name of the Company) against the office holders aforementioned is filed and accepted, there is no direct financial exposure to the Company with respect to this claim, except for a possible exposure with respect to the deductible of the insurance company, of a negligible amount.

**5) Other Legal Proceedings**

**a) Legal Proceedings on the Subject of GIS Arrays**

On December 29, 2013, the Company submitted a claim to the District Court of the Central District against foreign companies that supplied the company with GIS arrays (gas insulating voltage arrangements): Siemens AG (hereinafter: "Siemens"), ABB Ltd. (hereinafter: "ABB"), Alstom Societe Anonyme (hereinafter: "Alstom"), Alstom Grid AG and Alstom Grid SAS (hereinafter together: the "Cartel Companies" or the "Defendants"). Regarding the application to approve a class action against the company on this subject see section 1) g) above.

The claim is based on the determination of the General Director of the Israel Anti Trust Authority of September 16, 2013, which exposed that the global cartel that was conducted in the GIS arrangement market between the years 1988 - 2004 was also implemented by the Cartel Companies in Israel towards the Electric Company, and that the acquisition proceedings conducted by the Company to purchase GIS arrangements 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.

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**NOTE 35:- AGREEMENTS, CLAIMS, CONTINGENT LIABILITIES AND LABOR DISPUTES (continued)**

**b. Contingent Claims and Liabilities (continued)**

**5) Other Legal Proceedings (continued)**

a) Legal Proceedings on the Subject of GIS Arrays (continued)

On March 26, 2015, the Supreme Court determined that the hearing of the claim should be partially consolidated with the hearing of the two applications for approving a claim as a class action (hereinafter: the "Two Applications for Approval"), for the purpose of deciding the liability of the Cartel Companies. On April 13, 2015, the President of the District Court, Central District, instructed that the consolidated hearing will be held in front of the panel of judges hearing the Company's claim (see section 1) g) above).

On April 29, 2015, a consolidated pretrial hearing of the two applications for approval was held before the District Court, in which the Court ordered the parties to conduct pretrial proceedings among them with respect to the liability issue.

After the parties filed revised statements of defense and response, the preliminary proceedings should be completed within the coming weeks. An additional consolidated pretrial hearing has been scheduled for March 24, 2016.

b) E.M.G

In August 2005, the Company entered an agreement with E.M.G. (the Company's Egyptian supplier of natural gas) for the supply of natural gas. Additionally, the Company had signed a tripartite agreement with EMG and the gas company owners, the Egyptian companies EGAS and EGPC, under which the Egyptian companies have undertaken towards the Company to place the gas it has undertaken to supply to the Company at the disposal of EMG.

Due to the continuing disruptions in the supply, the Company's Board of Directors decided in September 2011, that the Company will enter an international arbitration process versus the national Egyptian gas supply companies and EMG, to receive compensation for the heavy damages incurred and that will be incurred by the Company by non-delivery of the gas from Egypt due to their breach of the agreements with the Company.

The sum claimed by the Company is approximately USD 4.15 billion.

The arbitration ended in the middle of 2014 and on December 4, 2015, the Company received the arbitration award, within which it was ruled, inter alia, that EGAS and EGPC breached their obligation in the tripartite agreement. The Egyptian companies were ordered to pay the Company approximately USD 1.76 billion plus interest and legal costs, which are estimated, as on December 31, 2015, at approximately USD 218 million.

On February 11, 2016, the Company received an application to appeal the arbitration award that was granted, which was submitted by the Egyptian national gas companies to the Superior Court in Switzerland. The Company submitted its response to the Court.

The Company will act to collect the sums it is entitled to under the arbitration award. However, as of this date, the Company cannot estimate the prospects for collecting the sum awarded in its favor within the arbitration.

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**b. Contingent Claims and Liabilities (continued)**

**6) Claim on the Subject of a Collective Sale Rate**

The cause of the claim that was filed against the Company on February 3, 2010 is the electricity rate that is payable to the Company by collective settlements that consume electricity collectively and at a high voltage.

Following several proceedings that were held in relation to the claim, the statement of claim has been amended several times and currently the claim includes 150 collective settlements.

In the current amended format of the claim, the claimants claim financial relief in the amount of NIS 96 million (plus interest and linkage) for charging higher rates than required and declaratory relief regarding the claimants' right to purchase electricity in accordance with the collective sale rate - high voltage.

On January 14, 2013, the Court ordered that the Electricity Authority would be added as an additional respondent in the claim. The aforesaid resolution also determined that the claims included in the statement of claim, will be deemed as having also been addressed against the Electricity Authority. On May 12, 2013, the Electric Authority filed a statement of defense on its behalf, within which the Authority claims, inter alia, that the collective sale rate - high voltage was intended to apply only to bodies holding a legal distribution license, or historic electricity distributors that joined the outline for regulating the legal operation of historic electricity distributors, and that as long as the claimants do not fulfill these conditions, the correct rate for them in accordance with the criteria is the high voltage LTR.

Evidentiary hearings on the claim were held on June 24, 2015 and July 6, 2015. The claim is in the summaries stage.

In light of the arguments of the Company, as detailed in the amended statement of defense, and in light of the position of the Electric Authority, as detailed in the statement of defense on its behalf, and after confronting these arguments with the claims of the claimants alone, as detailed in the amended statement of claim, the legal advisors of the Company believe, as of this date, that the Company has good defense arguments against the claim and it is more likely than not that the claim will be dismissed.

**7) Claims for Payment of Municipal Taxes**

As of the statement of financial position date, there are demands against the Company for municipal taxes in amounts exceeding the relevant provision that was recorded in the Financial Statements by about NIS 77 million. These demands derive from the changes in classification of lands held by the Company, the demand to increase the areas being billed and the demand with respect to municipal tax rates.

The Company estimates (based in part on the opinion of its legal advisors, that there is a low probability it will be required to pay these amounts, for which the Company did not make a provision in its Financial Statements.

**8) The Planning and Building Law**

The Planning and Building Law prescribes that the holders of rights in land who were adversely affected by a zoning plan are entitled to indemnification from the local committees for the sectors to which that zoning plan applies. In order to set up 400 kilovolt lines and 161 new kilovolt lines (except for a list of lines that was excluded and maintenance work and upgrading to 161 kilovolt lines), zoning plans are required. The Company undertook to indemnify the local committees for the sectors to which approved zoning plans that determined the establishment of 400 kV lines apply for the full amounts that the committees will be obliged to pay to the landowners who will be adversely affected, as stated above (aside from one plan, in which the burden of indemnification will be divided among the institutional bodies that are involved in the plan).

These undertakings for indemnification were delivered after it was made clear to the Company that not providing them would result in the failure to approve the plans or their suspension.

As of the statement of financial position date, claims are pending in an amount of about NIS 567 million, in excess of the provisions that were recorded in the Company's Financial Statements.

In the Company's opinion, based on the opinion of its attorneys, which takes into consideration the opinion of the real estate assessor advising the Company with regard to the above claims, if all of its arguments shall be rejected and the Company shall be forced to expend funds for these claims, then the Company's exposure for these claims will not exceed the provision that was recorded in the Financial Statements. The Company is of the opinion that should any amounts whatsoever be paid, these amounts will be part of the cost for setting up the relevant transmission lines, and due to the indispensability of the transmission lines, and based on the opinion of its attorneys, if and when the Company pays indemnification with respect to the indemnity letters, the Electricity Authority will be obligated to recognize them in the electricity rate.

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**NOTE 35:- AGREEMENTS, CLAIMS, CONTINGENT LIABILITIES AND LABOR DISPUTES (continued)**

**b. Contingent Claims and Liabilities (continued)**

**9) Other Contingent Liabilities**

**a) The Israel Lands Administration**

The Company held and is holding discussions and clarifications with the Israel Lands Administration from time to time, as needed, with respect to the lease fees for certain real estate properties at different sites.

As of the statement of financial position date, the Company is unable to estimate if it will be required to pay the usage fees for these sites and, if required, what amounts will be demanded. However, if the Company will be eventually required to pay with respect to all these sites, it is probable that the total amount will not exceed NIS 15 million. The Company did not record any provision with respect to these demands in its Financial Statements.

**b) Project D**

In December, 2010, the development plan was approved by the Minister. According to the plan, the Company has to construct and operate two generation units with a capacity of 630 megawatts each, in a gas-coal configuration. In July, 2011, the National Council for Planning and Building gave instructions to prepare National Outline Plan ("NOP") 10 for a station that will be powered by natural gas as a primary fuel and coal as backup fuel only, and approved the instructions for preparing a review of the impact on the environment.

On March 10, 2013, the development plan for project D was changed and the Minister approved as follows: "Construction of two steam thermal units with a natural gas-coal configuration, each combined with a gas turbine operated by natural gas with diesel oil as backup, at the Rutenberg site (Project D). The capacity of each steam thermal unit will not exceed 550 megawatts and the capacity of each gas turbine will not exceed 180 megawatts". The project was updated following the amendment of the development plan by the Minister.

On January 1, 2014, the Company received a letter from the Antitrust Authority, according to which the General Director of the Antitrust Authority is considering to make use of the authority vested in him and instruct the Company to refrain from increasing, directly or indirectly, its electricity production capacity beyond 13,307 megawatts, and this as long as the electricity production capacity of the Company exceeds 50% of the total sectorial production capacity in the electricity sector. In the letter, it was noted that the above mentioned does not prevent the Company from executing works to improve the efficiency in the electricity production stations it owns, but if these works can increase the electricity production capacity beyond the maximal production capacity mentioned above, it will have to receive approval for this in advance from the General Director of the Antitrust Authority.

On March 4, 2014, the Company submitted its position to the General Director of the Antitrust Authority within a written hearing held for the Company, and presented legal and economic arguments against issuing an order as stated.

On March 17, 2014, an oral hearing was held for the Company. On May 26, 2014, following the hearing, the Company delivered to the General Director of the Antitrust Authority its complementary comments to the position that was presented to the General Director.

As of the date of publication of these financial statements, the final decision of the General Director of the Antitrust Authority on the issue has not yet been published.

Due to the financial position of the Company and until clarification with the regulators and finding budgetary resources, the Company has decided to stop the planning proceedings (including preparation of a review, advancing an emission permit and outline plan), the preparations for financial closure and all the investments associated with project D, and to remove the project from the five-year financial plan of the Company. The Company is examining, inter alia, the possibility that Project D will be executed in cooperation with a strategic partner, subject to receiving approval from the Board of Directors of the Company and approval from the relevant State entities as required by law.

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**NOTE 35:- AGREEMENTS, CLAIMS, CONTINGENT LIABILITIES AND LABOR DISPUTES (continued)**

**b. Contingent Claims and Liabilities (continued)**

**9) Other Contingent Liabilities (continued)**

**c) Fees, Betterment Levies and Others**

**(1) Alon Tavor**

On November 28, 2013, the Company received a betterment levy assessment with respect to the Alon Tavor power station in the amount of approximately NIS 680 million with respect to NOP 10/b/9, which allegedly added an amount of 370 megawatts to the generation output capacity of the power station. On May 21, 2014, the Company filed an appeal on its behalf, and within the legal proceedings, the Company argued its arguments against the obligation of betterment levy itself and against the obligation sum.

The parties have a procedural arrangement which was validated as a decision, pursuant to which the Appeals Committee will first discuss the preliminary pleas (limitation and collection of betterment levy by virtue of approval of a national outline plan), and if they will be dismissed, then the Appeals Committee will discuss the arguments against the sum of the obligation (the assessor's opinion).

On December 7, 2014, the Appeals Committee held a hearing, during which the parties presented oral summaries, at the end of which the Appeals Committee instructed the parties to submit summaries in writing regarding the significance of extending the building permits in 2007 on the issue of limitation. After the parties submitted their summaries, the local committee submitted an application to strike out evidence that was submitted by the Company. The Electric Company submitted its response on April 21, 2015.

On May 21, 2015, the decision of the Appeals Committee (of May 14, 2015) was received, pursuant to which the appeal should be accepted by reasons of limitation and delay, and therefore the betterment levy assessment was cancelled.

In light of the decision of the Appeals Committee which cancels, as stated, the betterment levy assessment by reason of limitation and delay, the Appeals Committee did not discuss the additional argument of the Company, under which the local committee is not entitled to collect a betterment levy by virtue of approval of a national outline plan.

On September 9, 2015, the Yizraelim Planning and Building Committee submitted an administrative appeal to the Nazareth District Court against the decision of the Appeals Committee.

A pretrial hearing of the administrative appeal was postponed to May 3, 2016.

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. The opinion of the legal advisors of the Company is that on the basis of data known at this stage and according to the legal situation as of the date of signing the report, it is more likely than not that the assessment will be dismissed.



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**NOTE 35:- AGREEMENTS, CLAIMS, CONTINGENT LIABILITIES AND LABOR DISPUTES (continued)**

**b. Contingent Claims and Liabilities (continued)**

**9) Other Contingent Liabilities (continued)**

**c) Fees, Betterment Levies and Others (continued)**

**(2) Tzafit**

On July 13, 2014, the Company received a betterment levy assessment with respect to the Tzafit power station in the amount of approximately NIS 660 million with respect to approval of NOP 10/b/10, which allegedly added a quantity of approximately 370 megawatts to the generation output capacity of the power station.

On December 22, 2014, the Company submitted an appeal on its behalf and within the proceeding the Company presented its arguments against the betterment levy charge itself and a consensual request for exemption from submitting a counter assessment. The Appeal Committee decided on that day to exempt the Company from submitting a counter assessment at this stage.

On February 1, 2015, the Appeals Committee decided to combine the Company's appeal with other appeals, all of which raise the judicial question of whether the Planning Committee has a right according to law to collect betterment levy by virtue of a national outline plan approval, and to request the position of the Attorney General in this matter.

The Attorney General is expected to deliver his position by November, 2015. As of this date, the position document has not yet been delivered.

The opinion of the legal advisors of the Company is that on the basis of data known at this stage and according to the legal situation as of the date of signing the report, it is more likely than not that the assessment will be dismissed.

The Company is of the opinion that if it will be required to pay any sums with respect to this levy, these sums will be a part of the fixed assets cost of the Company, and they are expected to be recognized in the electricity rate by the Electricity Authority.

**(3) Others**

As of the statement of financial position date, the Company has demands with respect to fees and other levies in amounts exceeding the provision existing in the financial statements by approximately NIS 164 million. There is provision in the books with respect to some of the demands and in the opinion of the legal advisors of the Company with respect to the rest of the demands, as on the date of the report, the Company does not have the ability to estimate the exposure to these demands.

**10) Guarantees**

Regarding guarantees provided by the Company, see Note 27e above.

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**NOTE 35:- AGREEMENTS, CLAIMS, CONTINGENT LIABILITIES AND LABOR DISPUTES (continued)**

**c. Labor disputes**

- 1) On December 5, 2012, the Chairman of the Trade Union Division of the New National Labor Federation announced a labor dispute. The disputed matters are:
  - a) One-sided actions of the Company's Management, that in practice constitutes the initiation of a reform, overlooking discussions that have been held between the parties. In the opinion of the Federation, these processes have a significant adverse effect on the position of the Company and its financial strength as well as implications on the rights of the employees and their employment security.
  - b) The demand by the employees' representatives to refrain from one-sided actions, to hold negotiations for the purpose of reaching understandings and to sign a comprehensive collective agreement, detailed and sweeping, to regulate the rights of the employees and the rights of the parties, in view of the aforementioned state of affairs, including the regulation of a safety net to secure the rights of the employees.
  - c) The employer is not holding collective negotiations and is ignoring the repeated demands of the employees' representatives.
- 2) On February 28, 2013, an application was filed with the Regional Labor Court to instruct the employees to cooperate in all that pertains to the implementation of the decisions of the Electricity Authority in the issue of aggregators within the arrangement of "Smart Consumption", which enables an aggregator consumer, representing a bulk of electricity consumers, to divest during peak hours as will be so defined by the system management. In a hearing held on July 15, 2013, the hearing of the claim was postponed without a date being scheduled. And in the decision of August 8, 2013, it was determined that until utilization of the date allotted by the government for the ending of the Yogev Committee discussions, it does not seem fit to conduct a hearing of the application.
- 3) 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.

On November 5, 2015, a judgment was passed, within which the Court partially accepted the Company's application, on the one hand not accepting the position according to which the Company is entitled to withdraw all the trust funds for itself and also ruled that funds cannot be transferred from the trust account to the Central Pension Fund, but on the other hand accepting the Company's position according to which the funds in excess of the coverage of the non-budgetary liability towards generation A employees and generation B employees are surplus and should be returned to the Company. It was further determined that the Company can carry out payments to employees with respect to the non budgetary components from the trust account, and the Electric Company is not obliged to maintain an actuarial balance in the trust account.

Regarding the dispute which arose between the parties later on, regarding the interpretation of the judgment, and the District Court's ruling therein, see Note 12.c.(7) above.

- 4) The employees' organization has instructed not to cooperate in all that pertains to the decisions of the Public Services Authority – Electricity in the following subjects: aggregator consumers (a claim in this matter was filed with the Labor Tribunal – see section 2 above), historic distributors, consumers changing to consumers of private electricity producers, preparing final accounts and providing invoice data to the private electricity producers. On July 29, 2013, the Company applied to the Labor Court with an application for temporary relief in these matters. On September 17, 2013, the Court ruled that that there is no justification to issue an injunction against the sanctions regarding the expansion of the arrangement regarding historic distributors and settling the account with customers of private producers, and that there is no justification to insert changes whose significance is actual implementation of the reform as long as the public committee headed by Uri Yogev is discussing the structure of the electricity sector.

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**NOTE 35:- AGREEMENTS, CLAIMS, CONTINGENT LIABILITIES AND LABOR DISPUTES (continued)**

**c. Labor disputes (continued)**

- 5) On October 10, 2013, the Company received the decision of the Commissioner of Wages regarding 4 wage deviations by the Company: payment for overtime not according to actual performance for external employees, board and lodging payments, command increment and paying pension global overtime to management members. According to the decision of the Court of Labor, the stated decision of the Supervisor of Wages will not enter into force until a decision is reached in the principal case in this matter, and the employee representatives will not take organizational steps. Following the completion of the hearing proceeding pursuant to the decision of the Court of Labor, the Supervisor of Wages published an updated decision on December 11, 2014. At present, the Court hearing of the proceeding is continuing.
- 6) 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.
- 7) On March 25, 2014, the Company submitted an application for an injunction against sanctions taken by employees following the publication of the draft of the Steering Team's recommendations and the CEO decisions, with regard to halting automatic promotion and freezing professional courses, due to the indicated economic position of the Company. On April 3, 2014, the Court gave its decision, providing relief against the sanctions, while determining that during the period that negotiations are being held between the parties regarding the implementation of the recommendations concerning the structural change, unilateral steps that may lead to a fait accompli in the field will not be taken by the Electric Company and the State Authorities. The State submitted an application for leave to appeal the decision and the National Court ruled on July 16, 2014 that as long as the order preventing the employees from taking sanctions is in effect, the State and the Company are obligated to conduct intensive negotiations with the employee representatives, in a manner that will not create a fait accompli in the field that unilaterally and irrevocably prejudice the rights of the employees, their working conditions and employment security.

On July 28, 2014, the National Federation of Labor and the Employees' Organization applied to the Haifa Regional Labor Tribunal with an urgent party application within the collective dispute requesting to permit them to exercise the right to strike.

On September 16, 2014, the Court determined that considering that the position of the State and the National Labor Federation is that the negotiations regarding the structural change have been exhausted, it is reasonable to allow the employees' representatives to take sanctions. It was further determined that until another decision is reached, the decision of the Court preventing the employees from taking sanctions against private producers will remain in effect, as follows:

- a) To refrain from sanctions whose significance is non-cooperation with instructions of the authorized entities in the Company regarding action against private producers that are up to the stage of a conditional license, including execution of feasibility studies, and private producers that have already received a conditional license in the past.
- b) Additional private producers will not be connected to the electricity grid and the State will not grant a conditional license to a producer who is not yet holding such a license.

The State and the employee representatives submitted to the National Court of Labor an application for leave to appeal the stated decision.

On October 19, 2014, the National Court of Labor determined that there is no reason that the State of Israel, including its various entities, will not be allowed to use its authority to grant the new conditional licenses and connect private producers to the electricity grid, and therefore previous decisions of the Regional Court of Labor do not prevent the State of Israel from acting as stated.

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**NOTE 35:- AGREEMENTS, CLAIMS, CONTINGENT LIABILITIES AND LABOR DISPUTES (continued)**

**c. Labor disputes (continued)**

Following reminder hearings at the National Court of Labor, the parties reached agreement in various matters that were formulated into a special collective agreement (see Note 11.f.1 above).

The National Court of Labor has not yet ruled on the appeals over the stated decision of the Regional Court of Labor of September 16, 2014.

A hearing was held at the National Court of Labor on January 14, 2016, at which the parties reached a consent, under which the outline of the reform in the Company will be promoted by April 30, 2016, and at the same time intensive negotiations will be conducted between the parties, during which they will discuss all the issues related to implementation of the reform and its implications on the working conditions of the employees and their occupational security. The negotiations will be held under the auspices of the Court.

- 8) On October 7, 2014, the Chairman of the Trade Union Division of the New National Labor Federation announced a labor dispute over the following issues:
- a) A unilateral decision regarding the privatization of the Electric Company.
  - b) Despite the significant implications that this decision has on the working conditions of the employees, their status, rights, salary and occupational security, it was reached without conducting negotiations and formulating agreements with the employee representatives, in an attempt to unilaterally dictate dramatic changes while ignoring the employee representatives.
  - c) This conduct constitutes breaking the rules and trampling accepted norms customary for decades within the framework of collective labor relations, in violation of the representative organization, the employee representatives and their standing.
  - d) Demand by the employee representatives to conduct negotiations regarding the implications of the above mentioned decision.
  - e) Acting in bad faith and in a manner unacceptable in labor relations in general and in collective labor relations in particular.

- 9) On October 7, 2014, the Chairman of the Trade Union Division of the New National Labor Federation announced a labor dispute regarding the following issues:

Employer's intention to establish a large scale organizational change and efficiency plan with significant and critical implications for the employees in all aspects, including but not limited to: employment and salary conditions, rights, status, job security. Within the organizational change and efficiency plan, the employer intends to massively increase efficiency, including, inter alia, dismissals and early retirements of thousands of employees. The employer is acting in bad faith as it tries to oppress the employees' organization and present it with a fait accompli.

- 10) On January 11, 2015, the Chairman of the Trade Union Division of the New National Federation of Labor announced two labor disputes regarding the following:
- a) The employee union's demand to conduct negotiations regarding the salary agreement for 2015.
  - b) The demand of the employees' representatives to conduct negotiations and to sign a collective agreement for increasing the Company's provisions for cumulative pension for employees who began their employment commencing from January 1, 2004.

- 11) On September 27, 2015, the Chairman of the Professional Union Division of the New National Labor Federation announced a labor dispute regarding serious shortage of manpower in various units of the Company which leads to exceptional work load and work under unreasonable conditions and the employees' representatives' demand to arrange the issue immediately.

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**NOTE 35:- AGREEMENTS, CLAIMS, CONTINGENT LIABILITIES AND LABOR DISPUTES (continued)**

**c. Labor disputes (continued)**

12) On October 25, 2015, the Chairman of the Professional Union Division of the New National Labor Federation announced three labor disputes on the following subjects:

- a) Unilateral actions by the employer at the gas turbine power station: not recruiting manpower for the station, not manning positions, lack of professional promotion of employees in the station, cancelling tenders and transferring officials to other units, and all of this in order to cause a structural change in practice without conducting negotiations with the employees' union regarding the change itself and the implications for the employees. These actions lead to serious harm to the employees at the power stations.
- b) Extended unilateral steps by the management to transfer functions and manpower to outsourcing on an ever increasing scale. A unilateral management decision to deliver projects, which are at the execution division including at the Hadera and Ashkelon power stations, to a contractor, while dismissing hundreds of employees.
- c) A unilateral decision regarding the transfer of senior officers employed by a collective agreement to an employment format by personal contract, which constitutes a unilateral modification of conduct existing at the Company for dozens of years, and constitutes a severe blow to the organizational power of the employees, the status of the employees' representatives and the employees' union.

13) On November 25, 2015, the Chairman of the Professional Union Division of the New National Labor Federation announced a labor dispute on the following subject:

The National Labor Federation's demand for a wage update in the public sector and an impasse in negotiations for signing the new wage agreement in the public sector.

14) On December 13, 2015, the Chairman of the Professional Union Division of the New National Labor Federation announced a labor dispute, as follows:

The employer's intention, within the Company's 2016 budget, to establish organizational changes and large scale economic streamlining plans with significant and critical implications for the employees in all aspects, including but not limited to: working terms and wages, rights, position, occupational security. As part of the organizational changes and streamlining plans, the employer intends to carry out massive streamlining which includes, inter alia, dismissals, early retirement of thousands of employees and extensive cutbacks in the number of positions. The employer is acting in bad faith while trying to force out the employees' union and present it with accomplished facts.

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**NOTE 36:- SEGMENTAL REPORTING**

**a. General**

The Company implements the International Financial Reporting Standard 8 (hereinafter: "IFRS 8") from January 1, 2009.

**b. Detailed Reportable Operation Segments**

The operations of the Company are comprised of three main operational segments making up the entire electricity chain. These operations are:

- Generation Segment - includes the operations at 17 sites of the electricity generating power stations, derives its revenues according to its share in the electricity rate, as determined by the regulator (Electricity Authority).
- Transmission Segment - includes the transmission and transformation system of the ultra-high, long distance electricity, generates its revenues according to its share in the electricity rate, as determined by the Electricity Authority.
- Distribution Segment – includes the electricity grids system and the transformation stations which supply the electricity to the end consumers, except a limited number of customers that purchase high voltage electricity directly from the transmission systems, as well as the customers service and collection system of the Company, the segment generates its revenues according to its share in the electricity rate, as determined by the Electricity Authority.

**c. Income and Results according to Operational Segments**

Segmental revenues are calculated on the basis of the electricity rate for the segment, published by the Electricity Authority, multiplied by the sold quantity (kW/h) of that segment. Segmental expenses that can be specifically identified are charged directly to the appropriate items. In addition, certain indirect expenses are recorded according to an allocation, which serves as a reasonable estimate for attributing these expenses, while adjusting to the electricity rate base. The CODM (Company CEO) receives the operational results of each segment up to the yearly profit (loss) level. See detailed information in Note 39 below.

	<b>For the Year ended December 31, 2015</b>			
	<b>Generation segment</b>	<b>Transmission segment</b>	<b>Distribution segment</b>	<b>Total Company</b>
	<b>NIS in millions</b>			
Revenues(*) .....	15,879	3,697	3,482	23,058
Operating income from ordinary operations .....	1,272	1,081	221	2,574
Profit (Loss) before income tax .....	483	678	(365)	796
Profit (Loss) for the year before regulatory deferral accounts .....	351	493	(277)	567
Transactions in balances of regulatory deferral accounts, net of tax	182	(482)	(44)	(344)
Profit (loss) for the period and net transactions in balances of regulatory deferral accounts	533	11	(321)	223
 <b>Additional Details</b>				
Depreciation and amortization .....	2,278	967	1,333	4,578
Financing expenses .....	789	403	586	1,778

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**NOTE 36:- SEGMENTAL REPORTING (continued)**

**c. Income and Results according to Operational Segments (continued)**

	<b>For the Year ended December 31, 2014</b>			
	<b>Generation segment</b>	<b>Transmission segment</b>	<b>Distribution segment</b>	<b>Total Company</b>
	<b>NIS in millions</b>			
Revenues(*) .....	19,625	2,781	2,899	25,305
Operating income from ordinary operations .....	6,013	339	(57)	6,295
Profit (Loss) before income tax .....	4,727	(282)	(988)	3,457
Profit (Loss) for the year before regulatory deferral accounts .....	3,474	(208)	(737)	2,529
Transactions in balances of regulatory deferral accounts, net of tax	(2,335)	88	183	(2,064)
Profit (loss) for the period and net transactions in balances of regulatory deferral accounts	1,139	(120)	(554)	465
<b><u>Additional Details</u></b>				
Depreciation and amortization .....	2,209	946	1,221	4,376
Financing expenses .....	1,286	621	931	2,838

**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.

	<b>As of December 31, 2015</b>			
	<b>Generation segment</b>	<b>Transmission segment</b>	<b>Distribution segment</b>	<b>Total Company</b>
	<b>NIS in millions</b>			
Assets .....	41,815	16,277	25,308	83,400
Investments in the year .....	1,663	769	1,225	3,657
Liabilities and credit balances of regulatory deferral accounts .....	34,558	12,516	19,632	66,706
	<b>As of December 31, 2014</b>			
	<b>Generation segment</b>	<b>Transmission segment</b>	<b>Distribution segment</b>	<b>Total Company</b>
	<b>NIS in millions</b>			
Assets .....	45,903	17,558	27,172	90,633
Investments in the year.....	*1,723	735	1,082	3,540
Liabilities and credit balances of regulatory deferral accounts .....	38,540	14,106	21,634	74,280

\* Including investments with respect to the emission reduction project (also see Note 13 above).

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**NOTE 37:- EXPLANATION OF THE IMPACT OF THE TRANSITION TO IMPLEMENTATION OF FULL INTERNATIONAL STANDARDS (IFRS)**

**a. General**

The accounting policies detailed in Note 2 were implemented in the preparation of the condensed consolidated financial statements for the year which ended on December 31, 2015, the comparative information for the year which ended on December 31, 2014, and the opening balance sheet in accordance with the IFRS of January 1, 2014 (hereinafter: the "Transition Date").

This Note is prepared on the basis of the IFRS, which have been published or can be adopted early at the date of the first annual reporting by the Company according to IFRS, December 31, 2015 on the basis of which the accounting policies of the Company were determined.

The explanation regarding the impact of the transition from reporting rules pursuant to the "Government Companies Regulations" to the IFRS rules on the financial position of the Company and the results of its operation is provided in the tables below.

**Implementation of the provisions of Standard 1 of the IFRS with respect to the first-time adoption of the IFRS standards and selection of relief provided by the standard on the Transition Date.**

IFRS Standard 1 determines that implementation of the IFRS standards in the opening balances as of the Transition Date will be executed retrospectively (always).

The Company chose the relief pursuant to IFRS Standard 1 for determination of the "Deemed Cost" of the fixed assets and intangible assets as cost which was presented in the financial statements of December 31, 2013.

The Company implements for the first-time, by early implementation, IFRS 14 with respect to regulatory deferral accounts (hereinafter: "IFRS 14"), the meaning of which is continuing to implement the existing practice for the issue of recognition in regulatory deferral accounts. The Company recognizes in its financial statements in regulatory deferral accounts, which are identical in essence to regulatory deferral accounts which existed in the financial statements of the Company until December 31, 2014, including their recognition and measurement rules. (See Note 2 y above).

**b. The gaps between the financial reporting principles implemented in these Financial Statements (IFRS) and the financial reporting standards pursuant to the Government Companies Regulations, which were implemented by the Company until December 31, 2014.**  
**(Regarding the Transition Date which was set to January 1, 2014, see Note 2 a above).**

Following are the main points of the gaps between the financial reporting principles which apply to the Company as of January 1, 2014, as detailed in Note 2 above, and the standards which were customary in the Company pursuant to the Government Companies Regulations until December 31, 2013, including in light of the decision of the Company to implement IFRS 14, as detailed below:

**1) Asset Impairment**

The international standards do not include a standard which is parallel to SFAS 90 and when testing asset impairment there is no differentiation between assets completed recently and the other assets. Before transition to international standards, the Company tested a provision for impairment of assets completed recently pursuant to the SFAS 90 rules, and in addition, implements the provisions of the IAS 36.

According to the IFRS, the test of attributing the provision for assets impairment is tested according to the provisions of IAS 36 only, i.e. the Company examines all its fixed assets items, including assets whose construction has been completed recently, as a total impairment in accordance with the provisions of IAS 36 since they constitute one cash yielding unit.

According to the annual rate update for 2014 (see Note 3 above), the Company cancelled part of the impairment it executed in the past under the rules of SFAS 90. According to the IFRS, this rate update is included as part of the regulatory deferral accounts of the Company. (See section c 4 e below).



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**NOTE 37:- EXPLANATION OF THE IMPACT OF THE TRANSITION TO IMPLEMENTATION OF FULL INTERNATIONAL STANDARDS (IFRS) (continued)**

- b. The gaps between the financial reporting principles implemented in these Financial Statements (IFRS) and the financial reporting standards pursuant to the Government Companies Regulations, which were implemented by the Company until December 31, 2014.**  
**(Regarding the Transition Date which was set to January 1, 2014, see Note 2 a above) (continued)**

2) Investments in Operational Power Stations (including Renovations)

Following the update of the generation rate base, as of February 15, 2010, the Electricity Authority determined that the cost of investments in operational power stations includes significant renovations (except for investments that cause an increase of output and/or improved availability and/or life span extension or for purposes of meeting environmental quality standards), will not be recognized as an addition to fixed assets and will be recognized instead as operational expense occurring once a year according to a formula determined in the rate.

Consequently, until the date of transition to international standards (IFRS), the Company depreciated its investments in operational power stations including significant renovations, upon their formation, in accordance with the principles of SFAS 90.

Under the IFRS, the investment cost in operational power stations is capitalized to the cost of the fixed assets, since under the international standards principles there is no parallel standard to the SFAS90 and these investments are depreciated in accordance with their useful life span.

3) Capitalization of Credit Costs and Return of Capital

According to the previous accounting principles implemented by the Company, the Company capitalized for assets under construction financing and return on capital costs recognized in the rate.

According to the IFRS standards, it is possible to capitalize borrowing costs (financing costs) that can be directly attributed to an asset under construction, in case it constitutes a qualifying asset. The stated standard does not enable to capitalize the return to capital component to an asset under construction.

Additionally, in view of the provisions of IFRS 14, the Company recognizes a regulatory deferral account balance with respect to a component of deemed interest that includes sums recognized for financing the construction, and that provide the entity with return on foreign capital. Therefore, the gap between the sum of the borrowing costs that can be capitalized with respect to the qualified assets under the provisions of IFRS, and the sum of the deemed interest that is recognized for the Company within the rate, is recognized as balances of regulatory deferral accounts instead of presenting sums as stated as part of the fixed assets costs pursuant to the Government Companies Regulations.

It is noted that as part of the relief by virtue of IFRS 1, the Company has used the relief for regulated companies to set the "deemed cost" of the fixed assets and intangible assets including the capitalization of financing costs, as an adjusted cost that was presented in the Financial Statements as of December 31, 2013, and implemented the IAS 23 from the date of the transition and onwards.

4) Preparing Adjusted Financial Statements

Under the Company's financial reporting principles as based on the Government Companies Regulations, the Company applies the provisions of Opinion No. 36 with regard to the preparation of Financial Statements adjusted by changes to the general purchasing power of the Israeli currency, including such provisions as are covered under Opinions Nos. 40, 50 and 56 of the Institute of Certified Public Accountants in Israel, which are similar in substance to the provisions of International Accounting Standard No. 29.

According to the IFRS, the Financial Statements may not be prepared according to the changes to the general purchasing power of the currency except under conditions of high inflation (hyperinflation) (in Israel up to December 31, 2003). It is emphasized that in light of the "deemed cost" relief set in IFRS 1, as aforesaid, the fixed assets balance in the Company books before the date of transition to international standards was adjusted with respect to changes in the general purchasing power of the Israeli currency. After the date of transition, the fixed assets balance is no longer linked with respect to changes as stated.

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**NOTE 37:- EXPLANATION OF THE IMPACT OF THE TRANSITION TO IMPLEMENTATION OF FULL INTERNATIONAL STANDARDS (IFRS) (continued)**

- b. The gaps between the financial reporting principles implemented in these Financial Statements (IFRS) and the financial reporting standards pursuant to the Government Companies Regulations, which were implemented by the Company until December 31, 2014.**  
**(Regarding the Transition Date which was set to January 1, 2014, see Note 2 a above) (continued)**

5) Regulatory Deferral Accounts

According to IFRS 14, the presentation of regulatory deferral accounts and the transaction in them is different in the Financial Statements under the IFRS compared with the manner of their presentation until the Transition Date. For details see Note 2.y. above.

6) Cash Flow Statement

Under the financial reporting principles of the Company according to the Government Companies Regulations, the Company reports interest paid as part of its current operations in the cash flow statement  
According to the IFRS, the Company classifies the interest paid as part of its financing activity and interest received as part of its investment activity.

**c. The impact of the transition to IFRS - quantitative disclosure**

As stated, the Company adopted the IFRS standards and has examined the material impacts that are caused to the Company as a result of adopting the IFRS. Following are the material financial impacts of the transition from the financial reporting principles of the Company under the Government Companies Regulations to the IFRS, to the financial position of the Company, December 31, 2014, and January 1, 2014 (the Transition Date), and the results of its operation and the changes in its equity for the year which ended on December 31, 2014, from the transition date until December 31, 2014.

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**NOTE 37:- EXPLANATION OF THE IMPACT OF THE TRANSITION TO IMPLEMENTATION OF FULL INTERNATIONAL STANDARDS (IFRS) (continued)**

**c. The impact of the transition to IFRS - quantitative disclosure (continued)**

**1) Following are details regarding the items in the Consolidated Statement of Financial Position and the impact of the transition to reporting under the IFRS standards on them:**

	Notes	As of January 1, 2014			As of December 31, 2014		
		Reporting under the Government Companies Regulations in 1.1.2014 NIS	Impact of the adoption of IFRS	Data reported under IFRS	Reporting under the Government Companies Regulations in 31.12.2014 NIS	Impact of the adoption of IFRS	Data reported under IFRS
4) in NIS millions							
<b>Current Assets:</b>							
Cash and cash equivalents .....		3,401	-	3,401	4,504	-	4,504
Short-term investments .....		493	-	493	2,559	-	2,559
Trade receivables for sales of electricity .....		4,392	-	4,392	4,546	-	4,546
Accounts receivable .....		328	2	330	537	-	537
Inventory fuels .....	a)	1,067	(5)	1,062	1,057	(4)	1,053
Inventory stores .....	b),c)	144	-	144	146	-	146
Regulatory assets .....	e)	2,973	(2,973)	-	-	-	-
<b>Total current assets .....</b>		<b>12,798</b>	<b>(2,976)</b>	<b>9,822</b>	<b>13,349</b>	<b>(4)</b>	<b>13,345</b>
<b>Non-current Assets:</b>							
Inventory – fuel .....	a)	1,736	(40)	1,696	1,539	(30)	1,509
Long term receivables .....		1,178	-	1,178	1,833	-	1,833
Investment in an associate company .....		98	-	98	86	-	86
Regulatory assets .....	e)	696	(696)	-	-	-	-
<b>Assets with respect to post-employment benefits:</b>							
Surplus pension fund assets to pension liability .....		2,020	-	2,020	4,310	-	4,310
Funds in trust .....		1,728	-	1,728	1,909	-	1,909
		<b>3,748</b>	<b>-</b>	<b>3,748</b>	<b>6,219</b>	<b>-</b>	<b>6,219</b>
<b>Fixed Assets, net:</b>							
Operated fixed assets, net .....	b),c)	58,241	-	58,241	56,622	290	56,912
Fixed assets under construction .....	b),c)	6,075	-	6,075	6,488	(19)	6,469
<b>Total fixed assets .....</b>		<b>64,316</b>	<b>-</b>	<b>64,316</b>	<b>63,110</b>	<b>271</b>	<b>63,381</b>
Intangible assets, net .....	b),c)	1,352	-	1,352	1,381	3	1,384
<b>Total non-current assets .....</b>		<b>73,124</b>	<b>(736)</b>	<b>72,388</b>	<b>74,168</b>	<b>244</b>	<b>74,412</b>
<b>Total assets .....</b>		<b>85,922</b>	<b>(3,712)</b>	<b>82,210</b>	<b>87,517</b>	<b>240</b>	<b>87,757</b>
Debt balance of regulatory deferral accounts .....	e)	-	3,668	3,668	-	2,876	2,876
<b>Total assets and debt balance of regulatory deferral accounts .....</b>		<b>85,922</b>	<b>(44)</b>	<b>85,878</b>	<b>87,517</b>	<b>3,116</b>	<b>90,633</b>

**THE ISRAEL ELECTRIC CORPORATION LIMITED**  
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**NOTE 37:- EXPLANATION OF THE IMPACT OF THE TRANSITION TO IMPLEMENTATION OF FULL INTERNATIONAL STANDARDS (IFRS) (continued)**

**c. The impact of the transition to IFRS - quantitative disclosure (continued)**

**1) Following are details regarding the items in the Consolidated Statement of Financial Position and the impact of the transition to reporting under the IFRS standards on them: (continued)**

	Notes	As of January 1, 2014			As of December 31, 2014		
		Reporting under the Government Companies Regulations in 1.1.2014 NIS	Impact of the adoption of IFRS	Data reported under IFRS	Reporting under the Government Companies Regulations in 31.12.2014 NIS	Impact of the adoption of IFRS	Data reported under IFRS
4) <b>in NIS millions</b>							
<b>Current Liabilities:</b>							
Credit from banks and other credit providers.....	a)	7,118	5	7,123	8,351	4	8,355
Suppliers and service providers.....		1,764	-	1,764	1,925	-	1,925
Accounts payable.....		1,702	-	1,702	1,631	-	1,631
Short term regulatory liabilities.....	e)	-	-	-	400	(400)	-
Advances from work orders less work in progress.....		398	-	398	453	-	453
Provisions.....		730	-	730	719	-	719
<b>Total current liabilities....</b>		<b>11,712</b>	<b>5</b>	<b>11,717</b>	<b>13,479</b>	<b>(396)</b>	<b>13,083</b>
<b>Non-Current Liabilities</b>							
Debentures.....	a)	32,770	10	32,780	35,695	8	35,703
Liabilities to banks.....	a)	8,572	11	8,583	4,737	5	4,742
Liabilities with respect to other post-employment benefits.....		2,924	-	2,924	2,930	-	2,930
Regulatory liabilities.....	e)	1,398	(1,398)	-	261	(261)	-
Provisions for returning sums to customers.....		2,565	-	2,565	2,675	-	2,675
Deferred taxes, net.....	a)	5,087	(10)	5,077	5,537	126	5,663
Debentures to the State of Israel.....		2,536	-	2,536	2,534	-	2,534
Liabilities to the State of Israel.....	a)	2,856	1	2,857	2,902	3	2,905
Other liabilities.....		691	-	691	683	-	683
<b>Total non-current liabilities.....</b>		<b>59,399</b>	<b>(1,386)</b>	<b>58,013</b>	<b>57,954</b>	<b>(119)</b>	<b>57,835</b>
<b>Total liabilities.....</b>		<b>71,111</b>	<b>(1,381)</b>	<b>69,730</b>	<b>71,433</b>	<b>(515)</b>	<b>70,918</b>
<b>Equity.....</b>		<b>14,811</b>	<b>(60)</b>	<b>14,751</b>	<b>16,084</b>	<b>269</b>	<b>16,353</b>
<b>Total liabilities and equity.....</b>		<b>85,922</b>	<b>(1,441)</b>	<b>84,481</b>	<b>87,517</b>	<b>(246)</b>	<b>87,271</b>
Credit balances of regulatory deferral accounts.....		-	1,397	1,397	-	3,362	3,362
<b>Total liabilities, equity and credit balances of regulatory deferral accounts.....</b>		<b>85,922</b>	<b>(44)</b>	<b>85,878</b>	<b>87,517</b>	<b>3,116</b>	<b>90,633</b>

THE ISRAEL ELECTRIC CORPORATION LIMITED  
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NOTE 37:- EXPLANATION OF THE IMPACT OF THE TRANSITION TO IMPLEMENTATION OF FULL INTERNATIONAL STANDARDS (IFRS) (continued)

c. The impact of the transition to IFRS - quantitative disclosure (continued)

2) The following is an estimate of the impact on the equity of the Company:

	As of January 1, 2014, in 1.1.2014 NIS	As of December 31, 2014
	(in NIS millions)	
Equity according to financial statements prepared in accordance with the Government Companies Regulations .....	14,811	16,084
Impact as of January 1, 2014 due to cessation of adjustment of the statements to changes in the CPI.....	(60)	(30)
Impact on the comprehensive income for the period .....	-	299
<b>Equity after implementation of the IFRS .....</b>	<b>14,751</b>	<b>16,353</b>

3) Impact in the consolidated statement of profit and other comprehensive income for the year ended on December 31, 2014, in the transition to reporting under IFRS:

	Reporting under the Government Companies Regulations	Impact of implementing IFRS 14 due to classification of deferred account balances (e)	Additional impact of the adoption of IFRS (a)	Data reported under IFRS
	in NIS millions			
<b>Revenues .....</b>	25,195	128	(18)	25,305
<b>Cost of operating the electricity system .....</b>	20,144	(2,858)	(331)	16,955
<b>Profit from operating the electricity system .....</b>	5,051	2,986	313	8,350
Sales and marketing expenses .....	902	-	(1)	901
Administrative and general expenses .....	1,136	21	-	1,157
Expenses (income) from liabilities to pensioners, net .....	2	-	(5)	(3)
	2,040	21	(6)	2,055
<b>Profit from ordinary operations.....</b>	3,011	2,965	319	6,295
<b>Financing expenses.....</b>	2,787	157	(106)	2,838
<b>Profit before income tax .....</b>	224	2,808	425	3,457
<b>Income tax .....</b>	61	744	111	916
<b>Profit after income tax .....</b>	163	2,064	314	2,541
Company's share of the loss of included company, net .....	(12)	-	-	(12)
<b>Profit before regulatory deferred accounts .....</b>	151	2,064	314	2,529
Transactions in balances of regulatory deferral accounts, net of tax.....	-	(2,064)	-	(2,064)
<b>Profit for the year and transactions, net, in regulatory deferral accounts.....</b>	151	-	314	465
<b>Other comprehensive income for the year, net of tax.....</b>	1,152	-	(15)	1,137
<b>Comprehensive income for the year .....</b>	1,303	-	299	1,602

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**NOTE 37:- EXPLANATION OF THE IMPACT OF THE TRANSITION TO IMPLEMENTATION OF FULL INTERNATIONAL STANDARDS (IFRS) (continued)**

**c. The impact of the transition to IFRS - quantitative disclosure (continued)**

**4) Notes and explanations concerning the abovementioned information:**

a) Impacts due to adoption of IFRS

- Adjusting the statements to the general purchasing power of the Israeli currency - see section b 4) above. In 2014, as a result of cancellation of the adjustment to this purchasing power, the Company recorded a decrease in financing expenses of NIS 62 million, net, after tax.
- Cancelling the implementation of SFAS 90 - as a result, the expense with respect to operating the electricity system has decreased in the amount of NIS 237 million, net, after tax.

b) Fixed assets and intangible assets, balance as of January 1, 2014 - as stated above, upon transition to the IFRS, the Company decided to use the relief of the IFRS 1 concerning regulated companies for determining the "deemed cost" of the fixed assets and other assets as the adjusted cost that was presented in the Financial Statements as of January 1, 2014.

Additionally, in light of the provisions of IFRS 1, on the date of transition to international standards (IFRS), the Company positively examined impairment of all the fixed assets items for which the abovementioned relief was used, according to the provisions of IAS 36. In light of the stated examination, it was found that the recoverable amount of the fixed assets and other assets items is higher than their book value and therefore reduction for impairment was not required.

As a result of the aforesaid, the fixed assets balance as of January 1, 2014 (the Transition Date) did not change.

c) Fixed assets and intangible assets, balance as of December 31, 2014 - upon transitioning to IFRS, the accounting treatment of fixed assets includes, inter alia, the following principles:

- Ceasing to adjust data in the financial statements to changes in inflation: as a result, the fixed assets and the intangible assets balance as of December 31, 2014 increased by approximately NIS 127 million.
- Capitalization of financing costs under IAS 23: capitalizing all the exchange rate and interest differentials with respect to foreign currency loans as long as these costs do not exceed the alternative cost in local currency. As a result, the fixed assets balance as of December 31, 2014 decreased by approximately NIS 53 million. See section b 3) above. Regarding capitalization of credit costs that were used for construction of fixed assets and intangible assets in the report period in the Company books, see Note 2 I above.
- Assets impairment: there is no parallel standard to SFAS 90 in international standards and examination of asset impairment is tested in accordance with IAS 36. As a result of cancellation of the implementation of SFAS 90, the fixed assets balance as of December 31, 2014 has decreased by approximately NIS 122 million. See section b 1) above.
- Investments in operational power stations including investment renovations: under the previous standards, costs that the Company does expect to be recovered within the rate were immediately charged to profit and loss. Under the existing standards, costs as stated were capitalized to the fixed assets. These costs were examined for impairment as part of the examination of all the fixed assets under IAS 36. As a result, the fixed assets balance as of December 31, 2014 has increased by approximately NIS 322 million. See section b 2) above.
- According to a valuation executed in the Company as of December 31, 2014, reduction for impairment was not required for the reporting under IFRS as well.

As a result of the aforesaid, the fixed assets and intangible assets balance as of December 31, 2014 increased in an amount of approximately NIS 274 million.

d) In 2014, as a result of the above mentioned, the Company recorded a decrease of the amortization and depreciation expenses (see section a above) in the amount of approximately NIS 149 million, net, after tax (of this, the Company classified approximately NIS 90 million, net after tax, to regulatory deferral accounts).

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**NOTE 37:- EXPLANATION OF THE IMPACT OF THE TRANSITION TO IMPLEMENTATION OF FULL INTERNATIONAL STANDARDS (IFRS) (continued)**

**c. The impact of the transition to IFRS - quantitative disclosure (continued)**

**4) Notes and explanations concerning the abovementioned information: (continued)**

- e) Regulatory Deferral Accounts - according to the IFRS 14, the presentation of regulatory deferral accounts and the change in them is different in the Financial Statements under the IFRS compared with the manner of their presentation under the Government Companies Regulations until the Transition Date. Regulatory assets/liabilities will henceforth be defined as "regulatory deferral accounts". The total regulatory deferral accounts in debit and the total regulatory deferral accounts in credit will be presented as separate items in the statement of financial position and will be separated as a separate category. The change, net of tax, in regulatory deferral accounts belonging to the statement of comprehensive income, was presented as a separate item after the income for the year.

<u>Notes</u>	<u>January 1 2014</u>	<u>December 31 2014</u>
	<u>(in NIS millions)</u>	
<b><u>Account classification following disclosure according to IFRS 14:</u></b>		
<b><u>Current assets:</u></b>		
Regulatory assets .....	2,973	-
<b><u>Non-current assets:</u></b>		
Regulatory assets .....	696	-
<b><u>Current liabilities:</u></b>		
Regulatory liabilities.....	-	(400)
<b><u>Non-current liabilities:</u></b>		
Regulatory liabilities.....	(1,398)	(261)
<b><u>Total account classification</u></b>	<b>2,271</b>	<b>(661)</b>
Deemed interest .....	-	53
Recognition of investments reduced in the past due to SFAS 90 .....	-	122
	-	175
<b>Total</b>	<b>2,271</b>	<b>(486)</b>
<b><u>Presented:</u></b>		
Debit balances of regulatory deferral accounts	4,718	2,876
Credit balances of regulatory deferral accounts	(2,447)	(3,362)
<b>Total</b>	<b>2,271</b>	<b>(486)</b>

- (1) If the Company recognized the deemed interest component that includes sums recognized for financing construction and providing an entity with return on capital, as well as return on the foreign capital component.
- (2) The Company recognized sums reduced in the past under SFAS 90, and are currently recognized in the rate according to the asset lifespan.
- f) Regarding the adjustment of the rate to the implications on the financial reporting under the IFRS, see Note 3 d above.
- g) Regarding the transition to implementation of the IFRS and its impact on the operating results of the Company see Note 3 d) above. The transition to implementation of IFRS standards is not expected to have a direct impact on the current cash flow of the Company.

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**NOTE 38:- SUBSEQUENT EVENTS AFTER THE STATEMENT OF FINANCIAL POSITION DATE, IN ADDITION TO THE DETAILS IN THE AFOREMENTIONED NOTES**

Following are details of subsequent events after the statement of financial position date - in addition to the information included in the aforementioned Notes:

**a. Appointment of directors and officeholders of the Company**

- 1) On January 1, 2016, Mr. Avi Doitchman was appointed Senior Vice President Finance and Economics.
- 2) On February 9, 2016, Mr. Yoav Druker was appointed as a Director.
- 3) On February 9, 2016, Mr. Mordechai (Muki) Ben Ami was appointed as a Director.
- 4) On February 19, 2016, Ms. Rochelle Don Yehiye ended her term as a Director.
- 5) On February 21, 2016, Mr. Ram Erlichman was appointed Senior Vice President Generation and Energy.
- 6) On February 21, 2016, Mr. Shimon Fisher ended his term as Acting Senior Vice President Generation and Energy.

**b. Legal proceedings**

- 1) On January 14, 2016, the Company received the decision of the National Court of Labor, under which the outline of the reform in the Company will be advanced until April 30, 2016. On March 2, 2016, a hearing was held at the National Court of Labor, in which it was decided that the parties will hold at least four meetings until the Passover Holiday in order to advance the negotiations regarding the reform. For additional details see Note 35 c. 7) above.
- 2) On March 2, 2016, the District Court ordered the Trustee to immediately transfer NIS 280 million from the Trust account to the Company. For additional details see Note 12 c. above.
- 3) E.M.G arbitration - On February 11, 2016, the Company received an application to appeal the arbitration award which was granted, which was submitted to the Superior Court in Switzerland by the Egyptian National Gas Companies. For additional details see Note 35b.5)b. above.

**c. Environmental protection laws**

- 1) On January 1, 2016, the Company received the Minister's directive, which determines that the coal powered generation units will be operated such that the electricity generation rate in these units will decrease by 15% in an annual calculation relative to the electricity generation volume in these units in 2015. For additional details see Note 1 g above.
- 2) On February 7, 2016, the Company received letters from the Ministry of Environmental Protection, within which the Company is required, inter alia, to present by February 25, 2016 a plan for the manner of meeting the emission values in units 1-4 at the Orot Rabin and Rutenberg power stations. For additional details see Note 1 g above.

**d.** On February 2, 2016, the Company received a letter from the Antitrust Authority, within which it was claimed that the General Director of the Antitrust Authority is considering determining that the Company abused its position as a monopoly in transmitting electricity and distributing it, and to impose a financial fine on the Company in the amount of NIS 13 million. For additional details see Note 1 h above.

**e.** Regarding execution of buyback and issue of debentures, see Note 20 d above.



**THE ISRAEL ELECTRIC CORPORATION LIMITED**  
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**NOTE 38:- SUBSEQUENT EVENTS AFTER THE STATEMENT OF FINANCIAL POSITION DATE, IN ADDITION TO THE DETAILS IN THE AFOREMENTIONED NOTES**

- f. Regarding the notification of the “Midroog” and “S & P Ma’alot” rating companies of February 16, 2016, for additional details, see Note 20 g above.
- g. According to the notice of the Companies Authority of March 3, 2016, the completion of appointment of the new auditors in Government Companies is subject to approval from the State Comptroller, under which there is no obstacle to continue the appointment proceeding, and under these circumstances the present auditors auditing the Government Companies will continue in their position until completion of appointment of the new auditors as aforesaid.
- h. On March 10, 2016, the Electricity Authority announced a later hearing regarding the issue of recognition of costs of the installations for reducing emissions at the coal fired stations. For additional details see Note 3 f above

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**NOTE 39:- 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.

**a. Statement of operations for the year ended December 31, 2015:**

	<u>Total Company</u>	<u>Generation segment</u>	<u>Transmission segment</u>	<u>Distribution segment</u>
	<u>NIS in millions</u>			
Required revenues.....	23,483	16,169	3,230	4,084
Adjustment for segment revenues .....	(639)	(356)	457	(740)
<b>Revenues from electricity .....</b>	<b>22,844</b>	<b>15,813</b>	<b>3,687</b>	<b>3,344</b>
Other revenues.....	214	66	10	138
<b>Total revenues .....</b>	<b>23,058</b>	<b>15,879</b>	<b>3,697</b>	<b>3,482</b>
Cost for operating the electricity system .....	18,286	13,994	2,439	1,853
<b>Income from operating the electricity system .....</b>	<b>4,772</b>	<b>1,885</b>	<b>1,258</b>	<b>1,629</b>
Sales and marketing expenses.....	904	-	-	904
Administrative and general expenses .....	763	336	139	288
Expenses from liabilities to pensioners .....	531	277	38	216
	<u>2,198</u>	<u>613</u>	<u>177</u>	<u>1,408</u>
<b>Income from current operations .....</b>	<b>2,574</b>	<b>1,272</b>	<b>1,081</b>	<b>221</b>
Financial expenses .....	1,778	789	403	586
<b>Income (loss) before income taxes.....</b>	<b>796</b>	<b>483</b>	<b>678</b>	<b>(365)</b>
Income taxes.....	217	132	184	(99)
<b>Income (loss) after income tax .....</b>	<b>579</b>	<b>351</b>	<b>494</b>	<b>(266)</b>
Company's share of the loss of an associate company.....	(12)	-	(1)	(11)
<b>Income (loss) for the period before regulatory deferral accounts.....</b>	<b>567</b>	<b>351</b>	<b>493</b>	<b>(277)</b>
Movements in regulatory deferral accounts balances, net of tax .....	(344)	182	(482)	(44)
<b>Profit (loss) for the period and net movements in regulatory deferral accounts balances.....</b>	<b>223</b>	<b>533</b>	<b>11</b>	<b>(321)</b>

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**NOTE 39:- 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 ABOVE) (Continued)**

**b. Details of the generation sites statement of operations for the year ended December 31, 2015:**

	Total generation segment	PEP and others	Rutenberg	Orot Rabin	Haifa	Reading	Eshkol	Gezer	Hagit	Alon Tavor	Ramat Hovav	Zafit	Other gas turbines
	NIS in millions												
Required revenues.....	16,169	1,514	3,440	2,866	1,211	592	1,477	1,310	1,517	730	848	545	119
Adjustment for segment revenues ....	(356)	-	(83)	(70)	(29)	(14)	(36)	(32)	(37)	(18)	(21)	(13)	(3)
<b>Revenues from electricity .....</b>	<b>15,813</b>	<b>1,514</b>	<b>3,357</b>	<b>2,796</b>	<b>1,182</b>	<b>578</b>	<b>1,441</b>	<b>1,278</b>	<b>1,480</b>	<b>712</b>	<b>827</b>	<b>532</b>	<b>116</b>
Other revenues.....	66	-	14	14	5	4	9	5	5	4	3	2	1
<b>Total revenues.....</b>	<b>15,879</b>	<b>1,514</b>	<b>3,371</b>	<b>2,810</b>	<b>1,187</b>	<b>582</b>	<b>1,450</b>	<b>1,283</b>	<b>1,485</b>	<b>716</b>	<b>830</b>	<b>534</b>	<b>117</b>
Cost for operating the electricity system.....	13,994	1,510	2,864	2,496	1,038	527	1,251	1,076	1,311	635	739	479	68
<b>Income from operating the electricity system .....</b>	<b>1,885</b>	<b>4</b>	<b>507</b>	<b>314</b>	<b>149</b>	<b>55</b>	<b>199</b>	<b>207</b>	<b>174</b>	<b>81</b>	<b>91</b>	<b>55</b>	<b>49</b>
Sales and marketing expenses.....	-	-	-	-	-	-	-	-	-	-	-	-	-
Administrative and general expenses .....	336	-	70	76	23	22	48	23	25	17	15	12	5
Expenses from liabilities to pensioners .....	277	-	60	68	22	20	39	16	19	10	11	8	4
	613	-	130	144	45	42	87	39	44	27	26	20	9
<b>Income from current operations .....</b>	<b>1,272</b>	<b>4</b>	<b>377</b>	<b>170</b>	<b>104</b>	<b>13</b>	<b>112</b>	<b>168</b>	<b>130</b>	<b>54</b>	<b>65</b>	<b>35</b>	<b>40</b>
Financial expenses .....	789	2	220	117	65	13	72	97	81	35	42	24	21
<b>Income before income taxes .....</b>	<b>483</b>	<b>2</b>	<b>157</b>	<b>53</b>	<b>39</b>	<b>-</b>	<b>40</b>	<b>71</b>	<b>49</b>	<b>19</b>	<b>23</b>	<b>11</b>	<b>19</b>
Income taxes.....	132	-	42	17	11	-	11	19	13	5	6	3	5
<b>Profit after income taxes</b>	<b>351</b>	<b>2</b>	<b>115</b>	<b>36</b>	<b>28</b>	<b>-</b>	<b>29</b>	<b>52</b>	<b>36</b>	<b>14</b>	<b>17</b>	<b>8</b>	<b>14</b>
Company's share of the loss of an associate company .....	-	-	-	-	-	-	-	-	-	-	-	-	-
<b>Income for the period before regulatory deferral accounts .....</b>	<b>351</b>	<b>2</b>	<b>115</b>	<b>36</b>	<b>28</b>	<b>-</b>	<b>29</b>	<b>52</b>	<b>36</b>	<b>14</b>	<b>17</b>	<b>8</b>	<b>14</b>
Movements in regulatory deferral accounts balances, net of tax .....	182	-	42	47	11	11	19	5	8	5	5	4	25
<b>Profit for the period and net movements in regulatory deferral accounts balances .....</b>	<b>533</b>	<b>2</b>	<b>157</b>	<b>83</b>	<b>39</b>	<b>11</b>	<b>48</b>	<b>57</b>	<b>44</b>	<b>19</b>	<b>22</b>	<b>12</b>	<b>39</b>

**THE ISRAEL ELECTRIC CORPORATION LIMITED**  
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**NOTE 39:- 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 ABOVE) (Continued)**

**c. Details of the distribution sites statement of operations for the year ended December 31, 2015**

	Total distribution segment	Northern District	Haifa District	Jerusalem District	Dan District	Southern District
	NIS in millions					
Required revenues.....	4,084	839	488	540	787	1,430
Adjustment for segment revenues ....	(740)	(152)	(89)	(98)	(142)	(259)
<b>Revenues from electricity .....</b>	<b>3,344</b>	<b>687</b>	<b>399</b>	<b>442</b>	<b>645</b>	<b>1,171</b>
Other revenues .....	138	38	18	18	26	38
<b>Total revenues .....</b>	<b>3,482</b>	<b>725</b>	<b>417</b>	<b>460</b>	<b>671</b>	<b>1,209</b>
Cost for operating the electricity system.....	1,853	372	232	261	350	638
<b>Income from operating the electricity system .....</b>	<b>1,629</b>	<b>353</b>	<b>185</b>	<b>199</b>	<b>321</b>	<b>571</b>
Sales and marketing expenses.....	904	197	103	108	185	311
Administrative and general expenses .....	288	59	38	39	53	99
Expenses from liabilities to pensioners .....	216	44	28	29	41	74
	1,408	300	169	176	279	484
<b>Income from current operations .....</b>	<b>221</b>	<b>53</b>	<b>16</b>	<b>23</b>	<b>42</b>	<b>87</b>
Financial expenses .....	586	124	65	74	112	211
<b>Loss before income taxes.....</b>	<b>(365)</b>	<b>(71)</b>	<b>(49)</b>	<b>(51)</b>	<b>(70)</b>	<b>(124)</b>
Income taxes.....	(99)	(19)	(13)	(14)	(19)	(34)
<b>Loss after income tax .....</b>	<b>(266)</b>	<b>(52)</b>	<b>(36)</b>	<b>(37)</b>	<b>(51)</b>	<b>(90)</b>
Company's share of the loss of an associate company .....	(11)	(2)	(1)	(1)	(3)	(4)
<b>Loss for the period before regulatory deferral accounts .....</b>	<b>(277)</b>	<b>(54)</b>	<b>(37)</b>	<b>(38)</b>	<b>(54)</b>	<b>(94)</b>
Movements in regulatory deferral accounts balances, net of tax .....	(44)	(9)	(5)	(6)	(8)	(16)
<b>Loss for the period and net movements in regulatory deferral accounts balances .....</b>	<b>(321)</b>	<b>(63)</b>	<b>(42)</b>	<b>(44)</b>	<b>(62)</b>	<b>(110)</b>

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d. Statement of Financial Position as of December 31, 2015:

	Total Company	Generation segment	Transmission segment	Distribution segment
	NIS in millions			
Current assets .....	8,762	5,467	1,437	1,858
Long-term receivables .....	10,064	6,165	655	3,244
Fixed assets, net .....	62,442	29,325	13,839	19,278
Intangible assets, net .....	1,295	279	188	828
Debit balances of regulatory deferral accounts	837	579	158	100
	<b>83,400</b>	<b>41,815</b>	<b>16,277</b>	<b>25,308</b>
Current liabilities .....	7,608	3,943	1,047	2,618
Non-current liabilities .....	57,307	29,064	11,229	17,014
Capital	16,694	7,257	3,761	5,676
Credit balances of regulatory deferral accounts	1,791	1,551	240	-
	<b>83,400</b>	<b>41,815</b>	<b>16,277</b>	<b>25,308</b>

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**e. Details of the generation segment Statement of Financial Position as of December 31, 2015:**

	Total generation segment	PEP and others	Rutenberg	Orot Rabin	Haifa	Reading	Eshkol	Gezer	Hagit	Alon Tavor	Ramat Hovav	Zafit	Other gas turbines
	NIS in millions												
Current assets .....	5,467	287	1,240	965	447	181	532	480	531	240	304	196	64
Long-term receivables.....	6,165	691	1,191	1,317	431	335	715	355	431	212	254	176	57
Fixed assets, net .....	29,325	165	7,949	5,784	2,534	399	2,680	2,779	2,708	971	1,631	1,020	705
Intangible assets, net .....	279	1	71	35	29	4	30	31	31	11	19	11	6
Debit balances of regulatory deferral accounts	579	-	136	151	35	34	60	16	25	16	15	13	78
	<b>41,815</b>	<b>1,144</b>	<b>10,587</b>	<b>8,252</b>	<b>3,476</b>	<b>953</b>	<b>4,017</b>	<b>3,661</b>	<b>3,726</b>	<b>1,450</b>	<b>2,223</b>	<b>1,416</b>	<b>910</b>
Current liabilities .....	3,943	84	1,030	987	266	119	365	280	282	150	189	122	69
Non-current liabilities .....	29,064	1,027	7,370	5,938	2,358	627	2,710	2,527	2,579	977	1,504	964	483
Capital	7,257	33	1,823	923	757	115	782	811	799	281	488	296	149
Credit balances of regulatory deferral accounts	1,551	-	364	404	95	92	160	43	66	42	42	34	209
	<b>41,815</b>	<b>1,144</b>	<b>10,587</b>	<b>8,252</b>	<b>3,476</b>	<b>953</b>	<b>4,017</b>	<b>3,661</b>	<b>3,726</b>	<b>1,450</b>	<b>2,223</b>	<b>1,416</b>	<b>910</b>

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**f. Details of the distribution segment Statement of Financial Position as of December 31, 2015:**

	<b>Total distribution segment</b>	<b>Northern District</b>	<b>Haifa District</b>	<b>Jerusalem District</b>	<b>Dan District</b>	<b>Southern District</b>
	<b>NIS in millions</b>					
Current assets.....	1,858	388	209	243	351	667
Long-term receivables .....	3,244	664	423	429	609	1,119
Fixed assets, net .....	19,278	4,087	2,059	2,477	3,583	7,072
Intangible assets, net.....	828	152	114	120	141	301
Debit balances of regulatory deferral accounts	<u>100</u>	<u>21</u>	<u>11</u>	<u>13</u>	<u>19</u>	<u>36</u>
	<b><u>25,308</u></b>	<b><u>5,312</u></b>	<b><u>2,816</u></b>	<b><u>3,282</u></b>	<b><u>4,703</u></b>	<b><u>9,195</u></b>
Current liabilities .....	2,618	548	293	362	468	947
Non-current liabilities .....	17,014	3,559	1,917	2,191	3,180	6,167
Capital	5,676	1,205	606	729	1,055	2,081
Credit balances of regulatory deferral accounts	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
	<b><u>25,308</u></b>	<b><u>5,312</u></b>	<b><u>2,816</u></b>	<b><u>3,282</u></b>	<b><u>4,703</u></b>	<b><u>9,195</u></b>

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**g. Statement of operations for the year ended December 31, 2014:**

	Total Company	Generation segment	Transmission segment	Distribution segment
	NIS in millions			
Required revenues.....	21,977	15,137	3,059	3,781
Adjustment for segment revenues.....	2,916	4,277	(298)	(1,063)
<b>Revenues from electricity.....</b>	<b>24,893</b>	<b>19,414</b>	<b>2,761</b>	<b>2,718</b>
Other revenues.....	412	211	20	181
<b>Total revenues.....</b>	<b>25,305</b>	<b>19,625</b>	<b>2,781</b>	<b>2,899</b>
Cost for operating the electricity system.....	16,955	12,975	2,293	1,687
<b>Profit from operating the electricity system.....</b>	<b>8,350</b>	<b>6,650</b>	<b>488</b>	<b>1,212</b>
Sales and marketing expenses.....	901	-	-	901
Administrative and general expenses.....	1,157	639	149	369
Revenues from liabilities to pensioners.....	(3)	(2)	-	(1)
	2,055	637	149	1,269
<b>Profit (loss) from current operations.....</b>	<b>6,295</b>	<b>6,013</b>	<b>339</b>	<b>(57)</b>
Financial expenses.....	2,838	1,286	621	931
<b>Profit (loss) before income taxes.....</b>	<b>3,457</b>	<b>4,727</b>	<b>(282)</b>	<b>(988)</b>
Income taxes.....	916	1,253	(75)	(262)
<b>Profit (loss) after income taxes.....</b>	<b>2,541</b>	<b>3,474</b>	<b>(207)</b>	<b>(726)</b>
Company's share of the loss of an associate company.....	(12)	-	(1)	(11)
<b>Profit (loss) for the year before regulatory deferral accounts.....</b>	<b>2,529</b>	<b>3,474</b>	<b>(208)</b>	<b>(737)</b>
Movement in regulatory deferral accounts balances, net of tax.....	(2,064)	(2,335)	88	183
<b>Profit (loss) for the year and net movement in regulatory deferral accounts balances.....</b>	<b>465</b>	<b>1,139</b>	<b>(120)</b>	<b>(554)</b>



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**h. Details of the generation segment statement of income for the year ended December 31, 2014:**

	Total generation segment	PEP and others	Rutenberg	Orot Rabin	Haifa	Reading	Eshkol	Gezer	Hagit	Alon Tavor	Ramat Hovav	Zafit	Other gas turbines
	NIS in millions												
Required revenues.....	15,137	686	3,498	3,386	1,144	446	1,221	1,307	1,372	614	715	580	168
Adjustment for segment revenues .....	4,277	-	1,035	1,002	338	132	361	387	406	182	212	172	50
<b>Revenues from electricity .....</b>	<b>19,414</b>	<b>686</b>	<b>4,533</b>	<b>4,388</b>	<b>1,482</b>	<b>578</b>	<b>1,582</b>	<b>1,694</b>	<b>1,778</b>	<b>796</b>	<b>927</b>	<b>752</b>	<b>218</b>
Other revenues.....	211	-	48	47	14	12	26	20	17	8	9	6	4
<b>Total revenues.....</b>	<b>19,625</b>	<b>686</b>	<b>4,581</b>	<b>4,435</b>	<b>1,496</b>	<b>590</b>	<b>1,608</b>	<b>1,714</b>	<b>1,795</b>	<b>804</b>	<b>936</b>	<b>758</b>	<b>222</b>
Cost for operating the electricity system.....	12,975	682	2,914	3,028	973	391	1,013	1,060	1,155	521	605	513	120
<b>Profit from operating the electricity system .....</b>	<b>6,650</b>	<b>4</b>	<b>1,667</b>	<b>1,407</b>	<b>523</b>	<b>199</b>	<b>595</b>	<b>654</b>	<b>640</b>	<b>283</b>	<b>331</b>	<b>245</b>	<b>102</b>
Sales and marketing expenses .....	-	-	-	-	-	-	-	-	-	-	-	-	-
Administrative and general expenses..	639	-	140	148	44	37	76	55	53	24	30	21	11
Revenues from liabilities to pensioners .....	(2)	-	(1)	(1)	-	-	-	-	-	-	-	-	-
	637	-	139	147	44	37	76	55	53	24	30	21	11
<b>Profit from current operations .....</b>	<b>6,013</b>	<b>4</b>	<b>1,528</b>	<b>1,260</b>	<b>479</b>	<b>162</b>	<b>519</b>	<b>599</b>	<b>587</b>	<b>259</b>	<b>301</b>	<b>224</b>	<b>91</b>
Financial expenses .....	1,286	3	365	189	104	22	118	158	134	57	66	39	31
<b>Profit before income taxes .....</b>	<b>4,727</b>	<b>1</b>	<b>1,163</b>	<b>1,071</b>	<b>375</b>	<b>140</b>	<b>401</b>	<b>441</b>	<b>453</b>	<b>202</b>	<b>235</b>	<b>185</b>	<b>60</b>
Income taxes.....	1,253	-	308	285	99	37	107	117	120	53	62	49	16
<b>Profit after income taxes .....</b>	<b>3,474</b>	<b>1</b>	<b>855</b>	<b>786</b>	<b>276</b>	<b>103</b>	<b>294</b>	<b>324</b>	<b>333</b>	<b>149</b>	<b>173</b>	<b>136</b>	<b>44</b>
Company's share of the loss of an associate company .....	-	-	-	-	-	-	-	-	-	-	-	-	-
<b>Profit for the year before regulatory deferral accounts .....</b>	<b>3,474</b>	<b>1</b>	<b>855</b>	<b>786</b>	<b>276</b>	<b>103</b>	<b>294</b>	<b>324</b>	<b>333</b>	<b>149</b>	<b>173</b>	<b>136</b>	<b>44</b>
Movement in regulatory deferral accounts balances, net of tax .....	(2,335)	(10)	(596)	(297)	(237)	(41)	(253)	(261)	(263)	(92)	(149)	(96)	(40)
<b>Profit (loss) for the year and net movement in regulatory deferral accounts balances .....</b>	<b>1,139</b>	<b>(9)</b>	<b>259</b>	<b>489</b>	<b>39</b>	<b>62</b>	<b>41</b>	<b>63</b>	<b>70</b>	<b>57</b>	<b>24</b>	<b>40</b>	<b>4</b>

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i. Details of the distribution segment statement of operations for the year ended December 31, 2014:

	Total distribution segment	Northern District	Haifa District	Jerusalem District	Dan District	Southern District
	NIS in millions					
Required revenues.....	3,781	781	457	500	740	1,303
Adjustment for segment revenues.....	(1,063)	(220)	(129)	(141)	(207)	(366)
<b>Revenues from electricity.....</b>	<b>2,718</b>	<b>561</b>	<b>328</b>	<b>359</b>	<b>533</b>	<b>937</b>
Other revenues.....	181	39	21	20	32	69
<b>Total revenues.....</b>	<b>2,899</b>	<b>600</b>	<b>349</b>	<b>379</b>	<b>565</b>	<b>1,006</b>
Cost for operating the electricity system.....	1,687	340	215	237	329	566
<b>Profit from operating the electricity system.....</b>	<b>1,212</b>	<b>260</b>	<b>134</b>	<b>142</b>	<b>236</b>	<b>440</b>
Sales and marketing expenses.....	901	192	104	106	181	318
Administrative and general expenses..	369	76	49	49	68	127
Revenues from liabilities to pensioners	(1)	-	-	-	-	(1)
	1,269	268	153	155	249	444
<b>Loss from current operations.....</b>	<b>(57)</b>	<b>(8)</b>	<b>(19)</b>	<b>(13)</b>	<b>(13)</b>	<b>(4)</b>
Financial expenses.....	931	197	103	118	180	333
<b>Loss before income taxes.....</b>	<b>(988)</b>	<b>(205)</b>	<b>(122)</b>	<b>(131)</b>	<b>(193)</b>	<b>(337)</b>
Income taxes.....	(262)	(54)	(32)	(35)	(51)	(90)
<b>Loss after income taxes.....</b>	<b>(726)</b>	<b>(151)</b>	<b>(90)</b>	<b>(96)</b>	<b>(142)</b>	<b>(247)</b>
Company's share of the loss of an associate company.....	(11)	(2)	(1)	(2)	(2)	(4)
<b>Loss for the year before regulatory deferral accounts.....</b>	<b>(737)</b>	<b>(153)</b>	<b>(91)</b>	<b>(98)</b>	<b>(144)</b>	<b>(251)</b>
Movement in regulatory deferral accounts balances, net of tax.....	183	39	20	23	34	67
<b>Loss for the year and net movement in regulatory deferral accounts balances.....</b>	<b>(554)</b>	<b>(114)</b>	<b>(71)</b>	<b>(75)</b>	<b>(110)</b>	<b>(184)</b>

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- j. 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:

Separate Financial Statements

In January 2005, the Company decided to make the necessary preparations to enable preparation of separate Financial Statements of each activity, as required by the stipulation of the Government Companies Authority, ("Separate Financial Statements"), where the work plan includes, inter alia, preparation of methodology, work procedures, internal audit procedures and a computerized solution. Implementation of these preparations was postponed due to sanctions opened by the employees, who prevented the implementation of the decision.

On March 26, 2006, the Company received a letter from the manager of the Government Companies Authority, announcing that implementation of the first milestones, required to be completed by March 26, 2006, was postponed by one quarter at least. There has been no development in this issue up to the signing date of the Financial Statements.

Implementation of the Government Companies Authority stipulations on disclosure of Company activities is a condition in the Government Companies Regulations adopted by the Minister of Finance on the subject of preparing adjusted Financial Statements starting from January 1, 2004 and up to December 31, 2007, including an amendment to the Government Companies Regulations dated June 30, 2008, which are in force (after several extensions) up to December 31, 2014 (see Note 2 a(1) above). In addition, failure to include information required by law in the Financial Statements may impair the ability of the Company to publish Financial Statements. The data presented in the Financial Statements and in the supplementary information' is the responsibility of the Company and do not obligate the State of Israel.

**k. 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, 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.
- 2) The Company's activities are composed of three principal segments:
  - a) Generation - activities of the power plants producing electricity.
  - b) Transmission - the transmission and transformation system for high-voltage electricity over long distances.
  - c) Distribution - the electricity grid and the transformer stations system that brings electricity to the end consumer (except for a small number of customers who purchase high-voltage electricity and are directly connected to the transmission system), as well as the customer service and collection system of the Company.These segments are called the electricity chain ("the electricity chain").
- 3) The rate base that came into force in July 2002 initially included various rates for four segments in the electricity chain: generation, transmission, distribution and supply. The different rates were intended to enable the private producers and customers to trade in electricity through a partial usage of the Company's system.
- 4) The Company manages one accounting system that includes all of the activities of the electricity chain. The internal controls principles that exist for everything concerning the internal trade between the activities of the electricity chain are not compatible with those required for separate audited financial statements.

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**I. 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.
- c) The methodology used by the Company to distribute the income and expenses to the generation, transmission and distribution segments is consistent with the decision of the Electricity Authority for the 2014 update of January 21, 2014.  
The abovementioned does not correspond to the decision of the Electricity Authority for the 2015 update which was published on September 7, 2015, as in this decision it was determined that some of the costs will be attributed to system costs and as such no longer constitute a part of the generation/transmission segment. As there is no separate segment for system costs. Costs with respect to system components will be presented in the generation/transmission segments as the Company has presented thus far.

**2) Below are the principles for attributing the revenues between the various segments**

**a) Revenues from the sale of electricity:**

The gross revenues for the segment are calculated based on the rate model that was used by the Electricity Authority to determine the rates for the Company.

In this model, the rate for each segment is calculated separately for every consumer.

The final rate published by the Authority for every consumer is a scheme of rates that were calculated in every segment.

The revenues per segment are calculated by the product of the segment rate multiplied by the sales (kWh) for the end consumer.

**(1) Amount sold per segment**

The amount sold by each segment is calculated based on data of the amount of sales to the end customers according to the type of the customer and rates according to load and time ("LTR").

**(2) Rate for the segment**

The electricity rates that were determined by the Electricity Authority are divided into two categories:

- (a) Rates according to load and time ("LTR") - rate that varies according to the season of the year and the time of day, where it is split to each of the segments of the electricity chain (a total of nine rates at the segment level).
- (b) A uniform rate according to type of consumer that is supposed to reflect over an entire year, the LTR rate according to the expected level of demand by those paying that same rate during the various seasons and time of day (a total of five types of uniform rates at the segment level).  
The uniform rate, in accordance with the various types of consumers, is calculated for the various segments, in accordance with the model that was used by the Electricity Authority in determining the rates for the Company.

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NOTE 39:- 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)

I. The principles used in preparing these statements of revenues are as follows (continued)

2) Below are the principles for attributing the revenues between the various segments (continued)

a) Revenues from the sale of electricity: (continued)

(3) Calculation of the revenues for the electricity chain segments

The calculation of the revenue for the segment is calculated by multiplying the amount of sales calculated for each segment by the various types of consumers at the appropriate rates.

The difference, which derives from the Company's actual revenue and the calculated revenue obtained, is distributed among the segments according to the amount of their calculated revenue.

(4) In addition, in view of the matter discussed in section n. 3 above, as of July 1, 2006, revenues from usage fees are calculated for substations and connections. These revenues are collected through the generation and distribution segment rates and transferred to the transmission segment for the usage fees for the segment's properties. Revenues from usage fees of substations and connections are calculated at a rate per kWh multiplied by the sales to the end consumer.

(5) Additionally, it is clarified that various adjustments are carried out for the revenues calculated in each segment, such as: addition of the fixed component in the electricity bill, giving various discounts, decrease of revenues with respect to non recognition of the revenues of the East Jerusalem Electricity Company and the Palestinian Authority etc.

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 are fully attributed to the generation segment. Costs with respect to purchase of electricity from private electricity producers are charged to the generation sector. Costs with respect to purchase of electricity from owners of photo-voltaic installations are charged to the transmission segment in accordance with the decisions of the Electricity Authority that deal with rate regulation for renewable energy producers.

b) Selling and marketing expenses - include the expenses for services to consumers that are attributed to the distribution segment.

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I. 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 (without expenses from works on account of others as detailed in section 2 below), the Finance 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 from works on account of others which can be specifically identified were attributed to the appropriate segment. General works are presented according to the ratio of distribution of the operating expenses in the electricity chain in the reported period.
- (3) 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.
- (4) 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.
- (5) 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.

f) Income Taxes

The tax expenses attributed to the segments according to the rate of taxes on income from profit (loss) before taxes on income at the Company level.

g) Movements and net balances in regulatory deferral accounts net balances after tax effect - movements and balances of regulatory deferral accounts are attributed to the segments in relation to the nature of the income or expense, in accordance with the guiding principles for determining the electricity rate in the segment. The division into stations in the generation segment and into districts in the transmission segment was executed according to the ratio of active fixed assets.

**THE ISRAEL ELECTRIC CORPORATION LIMITED**  
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**m. The principles used in attributing the aforesaid statement of financial position items are as follows:**

- 1)** The Company is one legal entity and, in effect, the statement of financial position balances are not separated according to the Company's activities segments in its accounts (except for direct fixed assets). Therefore, the Company is reallocating the balance sheet balances for the purpose of this note, in every reporting year, based on allocation keys, as described below.
- 2)** The statement of financial position as they are presented in this note do not necessarily reflect the financial position of the various segments, if they would have been managed as separate economic entities, as signified by generally accepted accounting principles.
- 3) Below are the principles for attributing the statement of financial position balances to the various segments:**

**a) Working capital items:**

The working capital items were attributed to the segments in accordance with those principles that the Electricity Authority used in determining the electricity rates (principally for the purpose of determining the coverage of the working capital's financial expenses) where the principal allocation keys are:

Fuels inventories and balance for fuels suppliers - were fully attributed to the generation segment. The trade receivables balance was allocated according to the distribution ratio for revenues.

Trade payables and other items were allocated primarily according to the ratio of the operating expenses and salary for the segments.

Fuel payables- allocated to the operating segment, divided between the units according to actual fuel costs.

**b) Fixed assets:**

Fixed assets that are specifically identifiable are included in the appropriate segment. Joint assets (about 3% of the entire assets) were distributed according to distribution keys that, in management's opinion, constitute a reasonable estimate for attributing these assets.

**c) Other assets**

Other assets which can be specifically identified were included in the appropriate segment. Other assets which could not be specifically identified were allocated according to the ratio of active fixed assets.

**d) 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 profit/loss before tax in its absolute value.

**e) 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.

- f)** The remaining statement of financial position items were distributed according to distribution keys that, in the Company's estimation, constitute a reasonable estimate for attributing these items.

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n. **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 m.1 above, the Company was required to provide disclosure in the form of a note that is to include condensed statements of operations and a statement of financial position, in reference to 18 activities that are included in the three electricity chain segments, as follows:

Generation segment	11 generation sites: Rutenberg, Orot Rabin, Haifa, Reading, Eshkol, Gezer, Hagit, Alon Tavor, Ramat Hovav, Zafit and the other gas turbines. In addition, it also reports on activities for acquiring electricity from private producers.
Transmission segment	The electricity transmission and transformation system.
Distribution segment	The Company's five districts: Northern, Haifa, Jerusalem, Dan, Southern.

Below, the 18 operations segments will be called: "reporting units".

2) **Below are the primary principles for attributing the revenue**

The revenue at the level of the reporting unit is calculated by stages since presently there is no electricity rate at the reporting unit level, and the Authority's current rates, at the level of the electricity chain's segments, do not allow for their attribution to a level that is lower than the segment level.

The revenue is calculated based on the following principles:

- a) Calculation of the revenue from electricity at the level of the electricity chain segments, which is based on the electricity rates and agrees with the total of all revenues from electricity at the total Company level.
- b) Determination of the required revenues at the reporting unit level for each reporting year. Required revenue - coverage of the actual costs during the reported year (operating costs including fuel and depreciation) neutralized by the various other revenue and expenses, and with the addition of normative financing costs of assets recorded in the books and the normative rate of return on capital.

The required revenues are structured based on the principal elements of the rules and principles that served the Electricity Authority for determining the electricity rate for the various segments.

- c) The difference between the total required revenues for the reporting unit in the segment and the revenues of the appropriate segment was distributed among the reporting units according to the ratio of required revenue of the segment.
- d) The revenues from electricity at the reporting unit level were not designated in order to estimate the revenues that will be obtained from the electricity if and when electricity rates are determined at the reporting unit level and, therefore, statements of operations according to the 18 reporting units do not necessarily reflect the results of their operations if they were managed as separate economic entities, as signified by generally accepted accounting principles.



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n. **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 l. 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 n. 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 m., while providing additional details for the 18 reporting units.

**THE ISRAEL ELECTRIC CORPORATION LIMITED**  
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**NOTE 40:- ADDITIONAL INFORMATION REQUIRED UNDER THE PROVISIONS OF THE GOVERNMENT COMPANIES AUTHORITY**

a. For information about attributing the statement of profit and loss and comprehensive income according to the generation transmission and distribution segments, see Note 39 above.

b. Disclosure about Reports on Internal Controls

1) According to Government Companies Regulations (additional report on actions taken and representations given to assure additional reports on the effectiveness of internal controls over the financial reporting) – 2007, all Government companies, including the Company, were obligated to attach to their annual and Interim Financial Statements an additional report of the actions taken in order to assure effectiveness of Internal controls over the Financial Reporting, including setting up an entire array of internal controls.

The Company established Administration, Control and Work, integrated a mechanized dedicated system and units and elected a consultant to assist in the implementation of the said regulations. The system allows documentation of risks and controls in any process, documentation of the performed tests and their results. The system also provides the ability to monitor faults corrections and to generate various control and administration reports, in order to enable the office holders signing the Financial Statements and the Report of the Board of Directors to declare in the additional report that the Financial Statements and the Report of the Board of Directors do not contain false representation of a material fact and that they properly reflect, in all material aspects, the financial position, results of operations, changes in equity and cash flows of the Company for the days and periods presented in the reports. . The Company established a procedure to verify: absence of weaknesses which may affect the correctness of the report, implementation of all disclosure controls enacted, including implementation of a methodical mechanism from managing and monitoring information gathering from position holders and statements of intermediate managers on the implementation of the disclosure controls in their spheres of responsibility and also applying suitable controls over amended work processes.

2) The Companies Authority required the Company to conduct audits according to the Government Companies Regulations (Additional Reports on the Effectiveness of Internal Control over Financial Statements) – 2007 and according to the Government Company Regulations (Additional Report on Actions Taken and Representations Given to Ensure the Correctness of the Financial Reports and the Board of Directors' Report) – 2005, and according to the circular of the Companies Authority on the subject of risk management in Government companies, of June 11, 2009, and present disclosure of them in the notes to the financial statements on the internal controls over the financial reporting related to assets/ liabilities/ activities/ trusts/ projects and services managed through service providers assets/ liabilities/ activities/ trusts/ projects and services, as these are defined in SAS 70 (Statements on Auditing Standards 70). In the framework of the controls tested as listed above, also tested were controls relating to service providers assets/ liabilities/ activities/ trusts/ projects and services, as these are defined in SAS 70.

The Companies Authority wished to ensure that within the framework of the chain of signings and backing the declarations carried out for the purpose of implementing the above stated regulations regarding SOX 302 and SOX 404 and the Government Companies Risk Management Circular, all the key advisors and other service providers relevant to the internal controls over the financial reporting in the Company in the stated spheres will provide a statement regarding the audits they executed and their findings with respect to the existence or non-existence of weaknesses or faults in accordance with the stated Regulations regarding SOX and the Risk Management Circular, SAS 70 including its amendments, including SSAE 16 ("Statements on Standards For Attestation Engagements 16"), as well as regarding the issue of conflict of interests, this in addition to the chain of signings and backing the declarations of those responsible for the processes, sub-processes and additional controls relevant to the internal controls over the financial reporting of the Company.

The position of the Company:

SAS 70 deals with an opinion of an auditor on the reliability of the controls that exist in service bureaus.

The key advisors and other service providers relevant to the internal controls over the financial reporting of the Company are experts and not service bureaus and therefore they are not comprised in SAS 70.

For the purpose of relying on the work of the expert, the Company examines his professional qualifications, his professional authorization by an appropriate professional entity, his experience and reputation, and also carries out tests in order to verify the use he makes of the data, assumptions and the methods he uses, and examines the outcome of his work.

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**NOTE 40:- ADDITIONAL INFORMATION REQUIRED UNDER THE PROVISIONS OF THE GOVERNMENT COMPANIES AUTHORITY (continued)**

b. Disclosure about Reports on the Internal Audit (continued)

The position of the Company: (continued)

The Authority is not accepting the Company's position and is of the opinion that in the absence of declarations as aforesaid, weaknesses or defects may exist according to the SOX Regulations and the Risk Management Circular or they will not be disclosed as required. So, for example, as stated in the non-implementation of the instructions of the Authority on execution of a risk survey in accordance with the Risk Management Circular. Moreover, under the SSAE 16 the interpretation included in the position of the Company is overly limited and the term "Service organization" is defined as: "An organization or segment of an organization that provides service to user entities, which are likely to be relevant to those user entities' internal controls over financial reporting".

A similar definition is also included in the ISAE 3402 (International Standard on Assurance Engagements 3402).

c. Government Companies are required to ensure that a misleading item will not be included in the Financial Statements and the accompanying information they submit, including information that might mislead a reasonable reader of the Financial Statements and their accompanying information.

d. The Company will provide proper disclosure in the Financial Statements of significant assets for which it believes there is a material gap between their fair value and their carrying amount in the Financial Statements, which are not recorded at their full amounts in the Company's books, including on the basis of appraisals or evaluations performed, or insurance appraisals, if performed.

The Company does not have valuations of specific assets (except Rogozin land, where the book value is higher than the fair value of the land).

The Company annually reviews the need for provision for impairment of its assets according to IAS 36 and if needed performs a valuation of all its assets, which is attached as an annex to the financial statements.

See also Note 2 k and 13 b above, and the position of the Companies Authority in section 13 i above.

e. In June, 2015, the Companies Authority notified the Company that it is performing an examination of all the issues related to calculation of the actuarial liability of the Company and deposits to the pension fund, and requested and received data from the Company for this purpose.

f. The Government Companies Authority required the Company to ascertain and provide disclosure, that the rights recorded in the financial statements related to liabilities with respect to employee-employer relations did not deviate from the current binding rights from aspects of Labor laws and that these liabilities were recorded accurately.

The Company's position is:

The Company tightened the controls over the salary and pension payments and established a procedure, approved by the Company's Board of Directors, on the subject of the manner of updating changes in employee rights and benefits. The Company estimates that these steps strengthened the internal controls over the financial reports for subjects related to handling the employees' wages rights section from now onwards. Regarding rights of wages deriving from the past, the Company received an opinion of its legal advisers, and in 2011 applied to the Commissioner of Wages to receive his approval for validity of wage rights that had not yet received approval. The Commissioner of Wages stated that he cannot provide an approval as requested, and that he intends to conduct an examination of the salary components of the Company. A decision by the Commissioner of Wages regarding salary exceptions in the Company of October 10, 2013 is pending at the Haifa Regional Court of Labor, and at present it is not in effect until a decision is reached in the proceeding. For additional details see Note 11 g above.

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**NOTE 40:- ADDITIONAL INFORMATION REQUIRED UNDER THE PROVISIONS OF THE GOVERNMENT COMPANIES AUTHORITY (continued)**

- g. The Government Companies Authority requested to disclose the implications of the Law to Promote Competition and Reduce Centralization - 2013 (hereinafter: the "Centralization Law"), as was published in the Official Gazette on December 11, 2013, insofar as they are relevant to the operation of the Company within the electricity sector and the communications sector.

Chapter B of the Centralization Law deals with weighing pan-economy centralization considerations and sectorial competition considerations when allocating rights. As part of the law, a "Committee for Reducing Centralization" (hereinafter: the "Committee") has been established, and its members are the General Director of the Antitrust Authority (as Chairman of the committee), the Director General of the Ministry of Finance acting as Head of the Economics Division (if the Minister of Finance appointed him as a member of the committee) and the Head of the National Economic Council acting pursuant to the Government's decision or one of his deputies (if the Prime Minister appointed him as a member of the committee).

The Committee determined that the Company is a "Centralized Entity" as is defined in the Centralization Law, due to it being a real significant corporation, under the definition appearing in section 4 of the law, and because its accumulated extent of activity in the field of essential infrastructure (as this term is defined in the law) exceeds half of all the activity in that field.

Defining the Company as a Centralized Entity may impact the Company as detailed below:

- 1) Allocating rights and renewing or extending rights given to the Company - according to the provisions of the Centralization Law, every entity that is authorized to allocate a right, renew or extend it (a right means license, contract or significant holding as they are defined in the law) in the field of essential infrastructure should weigh pan-economic centralization considerations when allocating the right. The regulator allocating the right is permitted not to allocate it to a Centralized Entity. If it wishes to allocate it to a Centralized Entity or to enable a Centralized Entity to participate in the process of allocation, it must first conduct consultation with the Committee for Reducing Centralization. Additionally, Part C of Chapter B of the Centralization Law requires the regulator to consider considerations of promoting sectorial competition when allocating certain rights. In addition, if the allocated right will be included in a list that will be published by the General Director of the Israel Antitrust Authority, he will have to consult with him before the allocation. Regarding Part C, the definition of "right" also includes, in addition to the aforesaid, a license in a field of activity which is not an essential infrastructure if the number of those operating in that field is naturally limited.
- 2) Expanding the operation of the Company to an additional field of essential infrastructure in a process pursuant to the Government Companies Law - the Centralization Law requires the consideration of pan-economy centralization considerations when making a government decision which enables a Government company which is a Centralized Entity to operate in an additional field of essential infrastructure. Additionally, according to the law, the Government Companies Authority has to consult with the Committee for Reducing Centralization prior to formulating its opinion for the Government in this matter.

Furthermore, as the Company is a Government company, the Centralization Law affects the Company as detailed below:

- 3) Allocating a right in essential infrastructure by the Company - according to the provisions of the Centralization Law, insofar as a government company will wish to enter a contractual engagement with a third party to execute the activity that is one of the fields of essential infrastructures, then it is a proceeding of allocation of a right by the Company. In this situation, the tender committee of the government company, as an allocating entity, is required weigh pan-economy centralization considerations during the allocation proceeding. Accordingly, the government company is permitted not to allocate the right to a Centralized Entity. If the government company wishes to allocate the right to a Centralized Entity, it must first consult with the Committee for Reducing Centralization. Additionally, according to Part C of Chapter B of the Centralization Law, the tender committee of the Company will be required, in addition to any other consideration it must consider pursuant to the law regarding the allocation, to consider considerations of promoting sectorial competition when allocating such rights. Additionally, if the allocated right is included in a list published by the General Director of the Antitrust Authority, it will have to consult with him prior to the allocation.

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**NOTE 40:- ADDITIONAL INFORMATION REQUIRED UNDER THE PROVISIONS OF THE GOVERNMENT COMPANIES AUTHORITY (continued)**

- 4) Extending the validity of a right - according to Part D of Chapter B of the Centralization Law, extending the validity of a right is regarded as the same as allocating a right and the provisions of Part C of Chapter B of the Centralization Law will apply to it, upon the fulfillment of these two: (a) the holder of the right for which the extension of validity is requested holds it for a period exceeding ten years, whether determined in a single allocation or accrued in a number of allocations; and (b) the allocation of the right or a previous extension of its validity were not reviewed pursuant to the provisions of Chapter B of the Centralization Law during the ten years which preceded the requested extension of validity. During a hearing regarding the extension of the validity of a right, the Tender Committee of the Company will be required to consider, among the gamut of considerations, the characteristics of the process for extending the validity of the right discussed and its circumstances.
- 5) Privatization of a government company - when formulating a decision to privatize a government company (as defined in section 1 of the Government Companies Law), the Government Companies Authority will consult with the Committee for Reducing Centralization before formulating an opinion or a memorandum on its behalf, under section 59(b) of the Government Companies Law, regarding the possibility of allocating rights in a government company to a Centralized Entity and the terms for this, as well as regarding the definition of the centralization considerations as an essential interest. Additionally, as part of the stated opinion, the Government Companies Authority will consider considerations of promoting sectorial competition. In addition, if the allocated right will be included in a list that will be published by the General Director of the Israel Antitrust Authority, it will have to consult with him before the allocation.

In addition, according to the Centralization Law, competition and industry centralization consideration should also be considered in relation to the operations of the Company in the electricity sector and the communications sector.

In general, the provisions of the Centralization Law that deal with pan-economic centralization considerations and sectorial competition considerations in allocating rights entered into force on December 11, 2014. However, the provisions pertaining to extension of validity or renewing a license (including the licenses of the Electric Company) are expected to enter into force on December 11, 2018.

- h. The Companies Authority requested that 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.

- i. 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. As of the date of signing the report, approximately 360 big customers that purchase electricity from approximately 2,750 consumption locations have transferred to purchase electricity from private suppliers. The Company estimates that the decrease in the scope of the Company's production due to the transfer of these customers to private producers is approximately 9 billion kWh in a full year (less electricity sales to private electricity producers). In addition, the Company estimates that this process is expected to continue in 2016, although the Company has no certainty at this stage as to the number of customers which will transfer to the private producers and the stated implications as stated on the kWh produced and sold and the revenues of the Company. For additional details see Note 35 a 4) above.

**THE ISRAEL ELECTRIC CORPORATION LIMITED**  
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**NOTE 40:- ADDITIONAL INFORMATION REQUIRED UNDER THE PROVISIONS OF THE GOVERNMENT COMPANIES AUTHORITY (continued)**

- j. The Companies Authority requested to provide disclosure regarding the effectiveness of the procedures included in the declaration given by the Vice President for Human Resources of the Company, which, based on his knowledge, the reports delivered to the fund do not include misrepresentation of material or misleading facts regarding the period of the account.

The position of the Company:

As noted in the declaration given by the Senior Vice President Human Resources of the Company to this report to the CEO of Infinity Ltd., the controls in the processes included in the declaration are effective.

- k. The Companies Authority requested the Company to attach audited financial statements of the Jordan Assets Incorporated Company.

Financial statements of the company have not been prepared or signed since 2005 until the present due to issues from the past of classification of a number of assets between the Jordan Assets Company and the Company. Additionally, directors have not yet been appointed to the Jordan Assets Company.

The Company is also working, inter alia, 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 2015

## **Prominent Disclaimer**

This English translation of the **“Additional Particulars about the Corporation”** for the year ended December 31, 2015 ("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, 2015  
**Date of the Report:** March 21, 2016

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 comprehensive income (loss) in the quarters**

Following is the summary of the reports:

	Quarter 1	Quarter 2	Quarter 3	Quarter 4	2015
Revenues	5,735	4,912	7,192	5,219	23,058
Cost of operating the electricity system	4,385	4,186	5,214	4,501	18,286
<b>Profit from operating the electricity system</b>	<b>1,350</b>	<b>726</b>	<b>1,978</b>	<b>718</b>	<b>4,772</b>
Sales and marketing expenses	235	242	214	213	904
Administrative and general expenses	236	167	170	190	763
Expenses (income) for liabilities to pensioners	(12)	544	(17)	16	531
<b>Profit (loss) from current operations</b>	<b>891</b>	<b>(227)</b>	<b>1,611</b>	<b>299</b>	<b>2,574</b>
Financial expenses, net	572	537	403	266	1,778
<b>Profit (loss) before income taxes</b>	<b>319</b>	<b>(764)</b>	<b>1,208</b>	<b>33</b>	<b>796</b>
Expenses (income) of taxes on income	79	(196)	320	14	217
<b>Net profit (loss)</b>	<b>240</b>	<b>(568)</b>	<b>888</b>	<b>19</b>	<b>579</b>
Profit (loss) with respect to an associated company	(3)	1	(5)	(5)	(12)
<b>Profit (loss) before regulatory deferral accounts, net of tax</b>	<b>237</b>	<b>(567)</b>	<b>883</b>	<b>14</b>	<b>567</b>
Movement in regulatory deferral account balances	(185)	(271)	159	(47)	(344)
<b>Profit (loss) for the period and net movement in regulatory deferral account balances</b>	<b>52</b>	<b>(838)</b>	<b>1,042</b>	<b>(33)</b>	<b>223</b>
Other comprehensive income (loss), net of tax	(735)	1,224	(321)	(50)	118
<b>Comprehensive income (loss) for the period</b>	<b>(683)</b>	<b>386</b>	<b>721</b>	<b>(83)</b>	<b>341</b>

**Regulation 11: A list of investments in subsidiaries and related companies, as of the statement of financial position date (31.12.2015)**

Subsidiaries and related companies held by the Company<sup>1</sup> on December 31, 2015, 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:

Name of Subsidiary	Share Type	Number of Held Shares and Nominal Value	Proportion of the Company's Holding (%)				Millions of NIS
			In Securities	In Capital	In Voting Rights	In Appointment of Directors	
Jordan Investment Company Ltd.	Ordinary	300,000 of NIS 0.0005 each	100.00	12.00	73.17	73.17	-
	Ordinary A	(*)110,000 of NIS 0.0001 each	99.98	87.99	26.82	26.82	-
Migrashei Hakablanim Ltd.	Preferred	2,000,630(**) of NIS 0.0001 each	100.00	76.05	100.00	100.00	-
	Deferred		<u>100.00</u>	<u>23.95</u>	<u>0.00</u>	<u>0.00</u>	
National Coal Supply Company Ltd.	Ordinary A	910,000 of NIS 1 each	100.00	100.00	100.00	100.00	55
Advanced Training Fund of Israel Electric Corporation Ltd.(***)	Management A	6 of NIS 1 each	50.00 of the Management shares	-	50.00	50.00	-
PAMA Energy Resources Development Company Ltd.	Ordinary	3,467,790 of NIS 0.10 each	49.99	49.99	49.99	30.77	-
I.B.C. Israel Broadband Company (2013) Ltd.	Ordinary	400 of NIS 1each	40.00	40.00	40.00	****	74

(\*) 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.

(\*\*\*\*) In accordance with the founders' agreement and the articles of association of I.B.C Israel Broadband Company (2013) Ltd., the number of directors of 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 the Israel Electric Corporation 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 appointed by the controlling shareholder at any time will not be less than 3 directors; 2) the Israel Electric Corporation will have the right to appoint between 2-4 directors to the Board of Directors of the Company, subject to the number of directors appointed by the Israel Electric Corporation 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 1i, 2f and 10 to the Financial Statements of the Company of December 31, 2014 ("Financial Statements").

<sup>1</sup> All the subsidiaries and related companies detailed in this regulation are not traded in the stock exchange.

**Regulation 12: Changes in investments in subsidiaries and related companies during 2015**

There were no changes in investments in subsidiaries and related companies during 2015.

**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, 2015), 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, 2015:

Name of Company	Net Profit (loss)	Comprehensive Profit (loss)	Proposed Dividend	Management Fees	Interest
National Coal Supply Company Ltd.	16	12	7.5	-	-
Issuance of series NIS Electric 2013I.B.C. Israel Broadband Company (2013) Ltd.	(30)	(30)	-	-	-

**Regulation 20 Trading on the Stock Exchange - Securities that were Listed for Trading - Trading Halt Dates and Reasons**

During 2015 and until the reporting date, Company debentures from the issue of the negotiable series "26 Electric" and "27 Electric", and their expansions, were listed in the Retzef trading system of the Tel Aviv Stock Exchange, as detailed:

Name of Series	Security no.	Nominal value issued June 7, 2015	Nominal value issued February 22, 2016	Listed at
26 Electric	6000202	436,978,000	571,988,000	Retzef
27 Electric	6000210	403,595,000	756,166,000	Retzef

There were no breaks in the trading of the Company's securities in 2015 and in the period after December 31, 2015 and until the reporting date.

**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 2015 as recognized in the financial statements for 2015 (in current prices) is detailed below:

2015														
Details of Rewards Recipient				Rewards* for Services							Other Rewards			
Name	Position	Position Scope	Equity holding rate	Salary**	Bonus	Shares Based Payment	Management Fees	Consulting Fees	Commission	Other	Interest	Rent	Other	Total
Yiftah Ron-Tal (1)	Chairman of the Board of Directors	100%	-	1,253,099	-	-	-	-	-	-	-	-	-	1,253,099
Oren Helman	Senior VP Regulation, Government Relations and Communications	100%		1,184,733	-	-	-	-	-	-	-	-	-	1,184,733
Adrian Bianu	Senior VP Corporate Sustainability and Risk Management	100%	-	1,117,240	-	-	-	-		-	-	-	-	1,117,240
Amit Oberkowitz	Senior VP of Human Resources and Organization	100%	-	1,092,065	-	-	-	-	-	-	-	-	-	1,092,065
David Elmakias	Senior VP Planning, Development and Technology	100%	-	1,083,685	-	-	-	-	-	-	-	-	-	1,083,685

(\*) 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, 2015 (in current prices).

(\*\*) The amounts specified above include salary in terms of cost incurred by the Company expenses refund with respect to subsistence allowance, telephone, vehicle and payments to professional societies ("Expenses Refund") and charging tax with respect to vehicle, insurance, electricity, advanced studies, fixed and mobile phone, gift and meals ("Charged to Tax")

## Notes to the Table:

### Terms of employment for employees employed by personal contract<sup>2</sup>:

The employment agreement of an officeholder is a personal employment agreement, in a uniform version, dictated and required by the Companies Authority, in accordance with the Government Companies Authority's Circular no. 2001/1 of November 7, 2001 ("The Authority's Circular Regarding Senior Employees"). The salary of an officeholder is determined in accordance with the classification of the Company, which is determined by the Committee for Classifying Government Companies that was established by virtue of the Government resolution (the "**Committee for Classifying Government Companies**"), and is updated once a year in accordance with the increase of the CPI and subject to the approval of the Board of Directors of the Company. As part of the employment of an officeholder and in accordance with his employment agreement, and after receiving approval for it from the Board of Directors of the Company and from the Government Companies Authority, the officeholder is entitled to for purpose of his function, to a vehicle supplied by the employer and the Company bears the costs of its use. Within the framework of his work, he is also entitled to expenses of maintaining a landline and cellular telephone, board and lodging expenses, clothing allowance, advance study fund, annual leave and convalescence pay. The officeholder shall cease to serve in office and his term in office shall expire in accordance with the causes which are set forth in the Government Companies Law and on the dates set forth therein. According to the Authority's Circular Regarding Senior Employees, an advance notice of three months must be issued to a senior employee who is dismissed from employment or by senior employee who resigns voluntarily. The terms of office and employment of the officeholders are compatible with the compensation policy of the Company.

On February 9, 2015, after receiving prior approval from the Compensation Committee and Board of Directors of the Company, the general meeting of the Company approved an amendment to the compensation policy of the Company. Accordingly, the Company executed provision of NIS 1.5 million for a bonus for seven senior officers with a personal contract. This sum is not included in the above table. See Note 33 d (4) to the Financial Statements.

**Yiftah Ron-Tal** - started his term as chairman of the Board of Directors of the Company on September 16, 2010 and his tenure as Chairman of the Board of Directors was renewed on October 2, 2013 until the date of expiry of his term. The amount presented in the "Salary" column for 2015 includes an annual salary of NIS 830,491 (which includes, *inter alia*, a combined salary in the amount of NIS 779,539, annual payments of NIS 8,936 and Expenses Refund in the amount of NIS 42,016), plus employer's costs in the amount of NIS 265,757 plus Charges to Tax in the amount of NIS 156,852.

**Eli Glickman** - started work as Company CEO on April 14, 2011. He ended his work at the Company on April 30, 2015. The salary is paid according to an agreement from April 2011 which was in force until the end of his work as aforesaid. The amount presented in the "Salary" column for 2015 includes an annual salary and payments with respect to retirement of NIS 936,376 (which includes, *inter alia*, combined salary in the amount of NIS 268,340.39, retirement grants in the amount of NIS 449,944.21, annual payments of NIS 197,720, including personal compensation of NIS 191,630, and Expenses Refund in the amount of NIS 20,371), plus employer's costs in the amount of NIS 299,640 plus Charges to Tax in the amount of NIS 28,925.

**Ofer Bloch** - started work in the Company as Company CEO on June 11, 2015. The salary is paid according to the contractual engagement of June 2015, which shall be in effect until the expiry of his term. The amount presented in the "Salary" column for 2015 includes an annual salary of NIS 446,983 (which includes, *inter alia*, combined salary in the amount of NIS 421,144, and Expenses Refund in the amount of NIS 25,838), plus employer's costs in the amount of NIS 143,034 plus Charges to Tax in the amount of NIS 91,325.

**Amit Oberkowitz** - started work as Senior Vice President of Human Resources and Organization on January 1, 2015 and transferred to a personal contract. The salary is paid according to the engagement from January 2015 which will be in force until the date of termination of his office. The amount presented in the "Salary" column for 2015 includes an annual salary of NIS 743,322 (which includes, *inter alia*, a combined salary in the amount of NIS 689,544, annual payments of NIS 10,782, and Expenses Refund in the amount of NIS 42,996), plus employer's costs in the amount of NIS 245,296 plus Charges to Tax in the amount of NIS 103,447.

**Oren Helman** - started work as Senior Vice President of Regulations and Government Relations on December 15, 2011. The salary is paid according to an agreement from December 2011 which will be in force until the end of his work. The amount presented in the "Salary" column for 2015 includes an annual salary of NIS 824,657 (which includes, *inter alia*, a combined salary in the amount of NIS 554,464, annual payments of NIS 210,626, which include personal compensation of NIS 201,690, and Expenses Refund in the amount of NIS 59,567), plus employer's costs in the amount of NIS 272,137 plus Charges to Tax in the amount of NIS 87,939.

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<sup>2</sup> Regarding those employed by a personal contract that received personal compensation for previous years, an accounting provision was executed in 2014.

Terms of employment for employees under a collective agreement:

The salary is paid according to collective agreements and arrangements applied to the majority of Company employees. The salary is updated according to collective agreements entered for all employees. Employment termination by the Company is according to the collective agreements and arrangements of the Company. Employment termination by the employee is according to the law and Company procedures, or upon reaching retirement age. The terms of office and employment of the officeholders are compatible with the compensation policy of the Company. For details of the collective agreements and arrangements that apply to the employees of the Company see section 13 to the Report of Description of the Business Affairs of the Corporation.

**David Elmakias** - started work in the Company on October 20, 1974. The amount presented in the "Salary" column for 2015 includes an annual salary of NIS 720,563 (which includes, *inter alia*, combined salary in the amount of NIS 383,910, salary increments of NIS 195,449, annual payments of NIS 76,279 and Expenses Refund in the amount of NIS 64,865), plus employer's costs in the amount of NIS 259,403 plus Charges to Tax in the amount of NIS 103,730.

**Adrian Bianu** - started work in 1978. The amount presented in the "Salary" column for 2015 includes an annual salary of NIS 757,674 (which includes, *inter alia*, combined salary in the amount of NIS 408,070, salary increments of NIS 212,794, annual payments of 79,572 and Expenses Refund in the amount of NIS 57,237), plus employer's costs in the amount of NIS 257,609 plus Charges to Tax in the amount of NIS 101,958.

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<sup>3</sup>

The compensation given to directors (except the Chairman of the Board of Directors) in 2015, which does not deviate from that which is customary<sup>4</sup>, amounted to NIS 762,747 (the amount does not include VAT and is in current prices). 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.

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<sup>3</sup> Circular 2013-5-1 of the Government Companies Authority "Accounting and Finances - Financial Statements"/

<sup>4</sup> 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.

Regulation 22:      Transactions with a Stakeholder

The State holds about 99.85% of the shares of the Company and is the controlling stakeholder in it. For details, to the best of the knowledge of the Company, concerning any transaction with the controlling shareholder or in whose approval the controlling shareholder has a personal interest, which the Company has executed during the reporting year or at a later date than the end of the reporting year, or which is still valid on the date of the report, including with respect to letters of guarantee that were provided by the State of Israel to secure the liabilities of the Company and loans provided by the State of Israel to the Company, see Note 33 to the financial statements

The Company received several loans directly from the State of Israel. In addition, the Company has received the State of Israel's guarantee for certain of its borrowings and debentures issued by the Company, as follows (supplement to Note 20 e to the Financial Statements):

a. **Loans Guaranteed by the State of Israel**

The State has provided guarantees to the benefit of third parties for the obligations of the Company to banking corporations in Israel and abroad. The total balance of these obligations as on December 31, 2015, amounted to approximately NIS 1,608.8 million, as detailed below:

1. A State guarantee to the benefit of Bank Hapoalim Ltd., in September 1996 with respect to an amount of up to NIS 600 million, according to the loan agreement entered in September 1996 between the Company and Bank Hapoalim Ltd., the Company received a credit line in six payments, during September through November 1996. The guarantee was approved on May 9, 1996, by the Board of Directors of the Company. The balance of the loan as on December 31, 2015, is approximately NIS 47.3 million. The guarantee is with respect to the unpaid balance. The Company is paying a commission at an annual rate of 0.2%, paid according to an amortization table.
2. A State guarantee to the benefit of CITIBANK in December 2005 with respect to an amount of up to USD 250 million, according to the loan agreement entered in December 2005 between the Company and CITIBANK in the U.S.A., insured by OPIC (an agency of the U.S.A. Government) for receiving credit of up to USD 250 million. The Company utilized approximately USD 222.8 million out of this amount during 2006 through 2007. The guarantee was approved on 25 November 2014 by the board of directors of the Company. The balance of the loan as on December 31, 2015, is approximately NIS 550.6 million. The guarantee is with respect to the unpaid balance. The Company paid, in advance, a guarantee commission of approximately USD 4.5 million.
3. A State guarantee for the debentures (series 25) that were issued under the Company prospectus of June 26, 2012, as amended on July 2, 2012. The nominal value of the debentures (series 25), revalued under the linkage terms as of December 31, 2015, is approximately NIS 1,010.9 million. For details see section 22.3 in the Report of the Business Affairs of the Corporation.

b. **Loans borrowed directly from the State of Israel**

Bank	Loan	Loan Currency	Repayment Period		Outstanding Balance of Principal and Interest payable as of December 31, 2015	
			First repayment	Last repayment	Source currency, USD	NIS
State of Israel <sup>5</sup>	\$800 mil.	USD	05/28/2002	05/25/2023	417,698,173.19	1,629,858,271.80
	\$ 250 mil.	USD	09/10/2000	09/10/2020	98,436,268.89	384,098,321.20
	\$ 180 mil.	USD	09/10/2003	09/10/2024	110,148,045.69	429,797,674.29
	\$ 270 mil.	USD	08/10/2005	08/10/2025	135,512,926.29	528,771,438.38
<b>Total</b>					<b>761,795,414.06</b>	<b>2,972,525,705.67</b>

The Company fulfills the payment terms of the aforementioned loans.

c. **Perpetual debentures issued to the State of Israel**

Pursuant to an arrangement with the Ministry of Finance, during the period from 1983 through 1985, the Company issued 9 series of perpetual debentures to the State of Israel for an aggregate consideration of NIS 15.5 million, which as on December 31, 2015 (nominal value plus interest payable and linkage to the CPI differences up to December 31, 2015), amounts to approximately NIS 2,538.9 million, as detailed in the following table ("Perpetual Debentures"). The perpetual debentures bear interest at a rate of 5% and 5.75% per annum, fully linked to the CPI. The principal amount of the perpetual debentures is not linked to the CPI. The perpetual debentures are secured by fixed charges on certain deposits of the Company, at a total nominal value of NIS 92 (Old Shekel 92,000), payable to the State of Israel. The perpetual debentures have priority only over non-guaranteed loans or loans guaranteed by a floating lien only in the amounts deposited in those charged deposits of the Company. As a result of their terms, the perpetual debentures were treated until December 31, 2005 as equity. Following the implementation of the IAS 22, commencing January 1, 2006, the classification of the perpetual debentures was changed to extended-term liability and the interest with respect to these perpetual debentures is charged as financing expenses in the statement of operations. For details, see Note 23 in the financial statements.

	Issued amount (in NIS)	Coupon	Outstanding Balance as of December 31, 2015
Series 1.....	342,940.69	5 %	220,366,756.89
Series 2.....	2,348,640.00	5.75 %	148,292,314.15
Series 3.....	702,538.71	5 %	345,833,683.95
Series 4.....	558,981.66	5 %	232,881,707.11
Series 5.....	834,185.81	5 %	349,040,140.99
Series 6.....	710,312.09	5 %	197,010,723.72
Series 7.....	759,335.64	5 %	208,874,399.57
Series 8.....	1,146,203.97	5 %	315,292,280.47
Series 9.....	8,064,000.00	5.75 %	521,356,741.11
<b>Total.....</b>	<b>15,467,138.57</b>		<b>2,538,948,747.96</b>

<sup>5</sup> These loans were granted to the Company through the Israel Industrial Bank Ltd. In the 1990<sup>th</sup> 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

Name of Company	"Party at Interest" / Senior office holder	Type of Share	Nominal Value in NIS	No. of Shares	Proportion of Holding (%)		
					In Capital	In Voting Rights	In Appointment of Directors
<u>In the corporation</u>							
Israel Electric Corporation Ltd.	State of Israel	Ordinary	0.1	79,980,010	99.77	99.77	100.00
		Ordinary B	0.1	40,053,252	100.00	100.00	100.00
	Yiftah Ron-Tal	Ordinary	0.1	1	0	0	0
	Adv. Nissim Hilu*	Ordinary	0.1	1	0	0	0
National Coal Supply Company Ltd.	Israel Electric Corporation	Ordinary A		909,999	100	100	100**
I.B.C. Israel Broadband Company (2013) Ltd.	Electric Corporation	Ordinary	-	400	40	40	5-9***

\* On January 1, 2015, Advocate Hilu was appointed substitute General Counsel and secretary of the Company, until the appointment of a permanent General Counsel. On April 15, 2015, Advocate Hilu ended his term as substitute General Counsel and secretary of the Company, and on the same date Ms. Yael Nevo was appointed General Counsel of the Company.

\*\* According to the articles of the national Coal Supply Company, 3 directors are appointed from the public and 6 are appointed from among the employees of the Electric Company.

\*\*\* In accordance with the founders' agreement and the articles of association of I.B.C Israel Broadband Company (2013) Ltd., the number of directors of 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 the Israel Electric Corporation 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 appointed by the controlling shareholder at any time will not be less than 3 directors; 2) the Israel Electric Corporation will have the right to appoint between 2-4 directors to the Board of Directors of the Company, subject to the number of directors appointed by the Israel Electric Corporation at any time being less than the number of directors appointed by the controlling shareholder.

The Company has several other subsidiaries and second-tier subsidiaries in which office holders in the Company hold shares, in trust for the Electric Company, however, since the activities of these companies are immaterial to the operation of the corporation, no information about these holdings are presented.

**Regulation 24A:** Registered Capital, issued capital and convertible securities on the report date, see Note 24 to the Financial Statements.

Additionally, the company has no convertible securities.

**Regulation 24B:** Register of Shareholders of the Company

For an updated list of shareholders see the Company's immediate report of February 24, 2016, at the Magna site (reference 2016-01-033967) regarding the status of corporation's capital and securities registers and changes therein (T087).

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.iec.co.il](http://www.iec.co.il)  
e-mail : [ub772@iec.co.il](mailto:ub772@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 (Chairman of the Board of Directors)**

**Name:** Yiftah Ron-Tal

**Identity card no.:** 054067939

**Date of birth:** April 15, 1956

**Address:** 22/3 Asher St., Modiin

**Citizenship:** Israel

**Membership on board committees:** Chairman of the Board of Directors, Chairman of the Strategy, Structural Change and Image Committee, Sub-committee for Regional Cooperation and Business Development, Marketing and Service Committee, Human Resources and Organization Committee, Budget, Financial and Risks Management Committee, Agreements and Assets Committee, Corporate Liability and Regulation Committee.

**External director:** No.

**Has accounting or financial expertise:** No.

**Independent Director:** No.

**Is he an employee of the company, of a subsidiary, of an Affiliated Company, of a stakeholder?** No

**Date of appointment:** Appointed as a director on September 15, 2010 and appointed as the Chairman of the Board of Directors on October 7, 2010. The term of office of Mr. Ron-Tal as director was renewed on September 30, 2013, and his term of office as Chairman of the Board of Directors of the Company was renewed on October 2, 2013.

**Education:** L.L.B in Law from the Hebrew University, E.M.B.A. (certified) from Bar Ilan University.

**Other Education and Professional Certificates:** Graduate of an Advanced Systems Course in the National Security College.

**Is he a relative of another stakeholder in the company?** No

**Does the company regard him as an accounting and financial expert for purposes of meeting the minimum number determined by the board of directors:** No.

**His employment over the past five (5) years:** 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, served in the Committee of Friends of the "AleI Siach" non-profit organization, served as a member of the Committee for Appointing Legal Advisors to the Companies Authority, served as a member of the Referees Organization of the Football Association, Chairman of the Steering Committee of the Forum of Leading Companies of the Economy in the field of infrastructure, with emphasis on energy and water - Academic College, Netanya, Chairman of the presidium of the "Special in Uniform" project of the "Lend a Hand to a Special Child" non-profit organization, member of the Board of Trustees of the Museum of the Righteous Among the Nations and the Educational Heritage Center to commemorate their actions. Member of the presidium of the CEO forum.

**List of corporations in which he serves as a director:** None.

2. **Rochelle Don-Yechiya (Gurevich)**

**Name:** Rochelle Don-Yechiya (Gurevich)

**Identity card no.:** 012603403

**Date of birth:** February 4, 1952

**Address:** 24 Yoni Netanyahu Street, Givat Shmuel

**Citizenship:** Israel, U.S.A.

**Membership on board committees:** Chairperson of Agreements and Assets Committee, Corporate Liability and Regulation Committee; Strategy Organizational Restructuring and Image Committee; Human Resources and Organization Committee, Committee for Regional Cooperation and Business Development.

**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; in Israel, member of management of the late Yaakov and Ida Limar Foundation.

**List of corporations in which she serves as a director:** Channel 2 News Company of the Israeli Television.

3. **Yaffa Vigodsky**

**Name:** Yaffa Vigodsky

**Identity card no.:** 007428253

**Year of birth:** June 17, 1946

**Address:** 3 Sinai St., Ramat Hasharon

**Citizenship:** Israel

**Membership on board committees:** Chairperson Human Resources and Organization committee; Agreements and Assets committee; Strategy, Structural Change and Image Committee, Compensation Committee; Audit 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, on September 15, 2011 and on October 29, 2014).

**Education:** BA General and Educational Administration, MA Educational Administration, Tel Aviv University.

**Is she a relative of another party at interest in the company?** No.

**Does the company regard her as an accounting and financial expert for purposes of meeting the minimum number determined by the board of directors:** No.

**Her employment over the past five years:** General Manager of Educational Television, member of the National Technological Committee, and Chairperson of the Fund for Persons with Eroding Professions, Chairperson of the "Ma'agalim" Fund.

**List of corporations in which she serves as a director:** AMAL network.

4. **Yehuda Adler**

**Name:** Yehuda Adler

**Identity card no.:** 057962011

**Date of birth:** November 21, 1962

**Address:** 17 Hashehafim St., Ra'anana.

**Citizenship:** Israel

**Membership on board committees:** Chairman of the Committee for Regional Cooperation and Business Development; Strategy, Restructuring and Image Committee; 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, Master's Degree in Health Systems Administration from the University of Tel Aviv.

**Is he a relative of another party at interest in the company?** No.

**Does the company regard him as an accounting and financial expert for purposes of meeting the minimum number determined by the board of directors:** No.

**His employment over the past five (5) years:** Chairman of Practice Committee - Sheba Tel Hashomer, Head of Sheba Tel-Hashomer Talpiot; Head of Misgav Ledech Hospital, Jerusalem; Chairman of the Administration for Promoting Academy and Research in the Galilee Hospitals..

**List of corporations in which he serves as a director:** Aposense Ltd.

5. **Arie Yehuda Rapoport**

**Name:** Arie Rapoport

**Identity card no.:** 052603081

**Date of birth:** June 29, 1954

**Address:** 17 Yitzhak Sade St., Tel Aviv

**Citizenship:** Israel

**Membership on board committees:** Chairman of the Rewards Committee; Chairman of the Audit Committee; Chairman of the Committee for Reviewing the Financial Statements; Strategy, Organizational Restructuring and Image Committee; Budget, Risk Management and Financial Management Committee; Corporate Governance and Regulation 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, and reappointed on August 14, 2014.

**Education:** B.A. in Economics and Accounting, Tel Aviv University.

**Is he a relative of another party at interest in the company?** No.

**Does the company regard him as an accounting and financial expert for purposes of meeting the minimum number determined by the board of directors:** Yes.

**His employment over the past five (5) years:** Accountant at Rapoport & Co., Accountants

**List of corporations in which he serves as a director:** Rapoport & Co., Auditors, Arie Rapoport Investments and Management Ltd., Arie Rapoport Trust Company Ltd., First Global Finance (2008) Ltd., TMG Trade Finance (2008) Ltd., Plasma Ltd., ATP Trade Finance Ltd., Raja Finance Ltd., Ragua VeYafe Ltd., Allium Medical Inc., KSR Properties Ltd., Variety Jerusalem Club Fund Ltd., Variety Israel (registered society), Chairman of Moadon Yaakov Society (registered society), Arthur Rubinstein society.

6. **Raik Abu-Reish**

**Name:** Raik Abu-Reish

**Identity card no.:** 024784225.

**Date of birth:** February 23, 1970.

**Address:** P.O.B. 804, Yarka 24967.

**Citizenship:** Israel.

**Membership on board committees:** Chairman of the Budget, Risk Management and Financial Management Committee; Human Resources and Organization Committee; Agreements and Assets Committee; Committee for Regional Cooperation and Business Development.

**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:** May 3, 2010 until May 2, 2013. Reappointed on March 13, 2014.

**Education:** B.A. (graduate) Economics Accounting from the Hebrew University; L.L.B. (graduate) Law, Sha'arei Mishpat College.

**Is he a relative of another party at interest in the company?** No.

**Does the company regard him as an accounting and financial expert for purposes of meeting the minimum number determined by the board of directors:** Yes.

**His employment over the past five (5) years:** Owner of an accounting firm.

**List of corporations in which he serves as a director:** Zim.

7. **Aryeh (Arik) Forer**

**Name:** Aryeh (Arik) Forer

**Identity card no.:** 54269535

**Date of birth:** September 14, 1956

**Address:** 45 Hanasi Harishon, Rehovot

**Citizenship:** Israel

**Membership on board committees:** Rewards Committee; Strategy Committee; Audit Committee; Committee for Reviewing the Financial Statements; Budget and Financial Management Committee; Risk Management Committee; Agreements and Assets Committee .

**External director:** Yes.

**Independent director:** Yes.

**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 8, 2015.

**Education:** B.A. in Economics from the Ben Gurion University, MBA majoring in finance from the Bar Ilan University, LL.B. from the College of Law and Business.

**Is he a relative of another party of 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:** CEO Realek Company, public company in the field of real estate and hotels, Director in the public company Dash Securities and Investments; Deputy CEO Finances of private companies in the field of construction and real estate, Business Division - providing credit for the construction sector at the head office of the Bank Leumi; member of committees of receiverships and liquidations, committee of planning and construction, the Israel Bar Association; private attorney; member of the Israel bar Association; Owner of a private company for business management, consulting and initiation.

**List of corporations in which he serves as a director:** Chairman of the Management of the Rehovot cinemas and member of the management of the film industry association of Israel.

8. **Mordechai (Muki) Ben Ami**

**Name:** Mordechai (Muki) Ben Ami

**Identity card no.:** 058832320

**Date of birth:** July 27, 1964

**Address:** 45 Gilboa, Nofit

**Citizenship:** Israel

**Membership on board committees:** Chairman of Corporate Governance and Regulation Committee; Budget, Risk Management and Financial Management Committee; Human Resources and Organization Committee; Agreements and Assets 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.

**Date of appointment:** February 9, 2016.

**Education:** B.A. in Economics from the Business Administration track at Haifa University; two-year program of Business Administration for Knowledge Intensive Plants at Haifa University.

**Is he a relative of another party of 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 Finance and Accounting Department at the Broadband Communications Branch, Budget Department of the Electric Company, Coordinator of the Operating Budget of the Company, director of the Mahog provident fund, and member of the fund's Investments Committee.

9. **Yoav Druker**

**Name:** Yoav Druker

**Identity card no.:** 056125701

**Date of birth:** December 27, 1959

**Address:** 15 Avraham Schlonski, Ra'anana

**Citizenship:** Israel

**Membership on board committees:** Strategy, Organizational Restructuring and Image Committee; Corporate Governance and Regulation Committee; Agreements and Assets Committee; Committee for Regional Cooperation and Business Development; Committee for Examination of the Company's Operation during a Storm.

**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?** Yes.

**Date of appointment:** February 9, 2016.

**Education:** BA in Electrical and electronic Engineering – the Academic College of Judea and Samaria; MBA Business Administration – the Ono Academic College.

**Is he a relative of another party of 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 Head of the Electric Company's Southern Region Operating Department; Head of the Electric Company's Dan Region Operating and Supervision Department.



Regulation 26A: Senior position holders in the corporation

The following are particulars of the current senior officeholders:

1. **Ofer Bloch**

**Name:** Ofer Bloch

**Identity card no. :** 056002546.

**Date of birth:** September 17, 1959.

**Date on which he began his term:** June 10, 2015.

**Position in the company:** CEO.

**Is he a relative of another senior officeholder or a party at interest?** No.

**Education:** B.A. Economics from the Tel Aviv University, M.B.A from the Recanati School of Business Administration - Tel Aviv University.

**Business experience over the past five (5) years:** CEO "Hadera Paper" Group.

**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 way of his position as the CEO.

2. **Adrian Bianu**

**Name:** Adrian Bianu

**Identity card no.** 016830648

**Date of birth:** August 29, 1948.

**Date on which he began his term:** December 1, 2003.

**Position in the company:** Senior Vice President Corporate Sustainability and Risk Management.

**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:** Senior Vice President Strategic Resources.

**Position in a subsidiary of the company, its affiliated company, or in a stakeholder in the company:** Director in enterprises of the Company as part of the Technological Hothouse (see details in section 12 in the Description of the Company's Business Affairs).

Pursuant to the definition of a "stakeholder" as stated in section 1 of the Securities Law, the officer is not a stakeholder in the Company.

3. **Yael Nevo**

**Name:** Yael Nevo

**Identity card no.** 012319398

**Date of birth:** July 23, 1968.

**Date on which she began her term:** April 15, 2015.

**Position in the corporation:** Legal advisor and secretary of the company.

**Is she a relative of another senior officeholder or a party at interest?** No.

**Education:** L.L.B in Law, from the University of Tel Aviv.

**Business experience over the past five (5) years:** Served as legal advisor and secretary of the Hadera Paper Group for about 4 years, served in the past as company secretary at "Zim", and as legal advisor and company secretary of the Mey Eden Group.

**Position in a subsidiary of the company, its affiliated company, or in a stakeholder in the company:** None

4. **Oren Helman**

**Name:** Oren Helman

**Identity card no.** 024163875

**Date of birth:** November 3, 1968.

**Date on which he began his term:** December 15, 2011.

**Position in the corporation:** Senior Vice President Regulation, Government Relations and Communications.

**Is he a relative of another senior officeholder or a party at interest?** No.

**Education:** BA in Political Science, and MA in Public Policy, Tel Aviv University.

**Business experience over the past five (5) years:** Manager of the Government Press Office in the Prime Minister's Office; Strategy Consultant, "Goren Amir".

**Position in a subsidiary of the company, its affiliated company, or in a stakeholder in the company:** Director of the Coal Company.

Pursuant to the definition of a "stakeholder" as stated in section 1 of the Securities Law, the officer is not a stakeholder in the Company.

5. **Amir Livne**

**Name:** Amir Livne

**Identity card no.:** 23725740

**Date of birth:** April 19, 1968

**Date on which he began his term:** April 14, 2011

**Position in the corporation:** Head of the Organizational Restructuring Administration of the Company and Senior Aide to the CEO (in the status of a Division Manager).

**Is he a relative of another senior officeholder or a party at interest?** No.

**Education:** L.L.B Law, L.L.M Law, Haifa University.

**Business experience over the past five (5) years:** Assistant to the CEO of the Company.

**Position in a subsidiary of the company, its affiliated company, or in a stakeholder in the company:** None.

Pursuant to the definition of a stakeholder as stated in section 1 of the Securities Law, the officer is not a "stakeholder" in the Company.

6. **Mr. Yitzhak Balmas**

**Name:** Yitzhak Balmas

**Identity card no.:** 058874496

**Date of birth:** July 25, 1964

**Date on which he began his term:** February 1, 2013

**Position in the corporation:** Appointed on January 1, 2015 as Senior Vice President Customers instead of his position as Senior Vice President Generation and Transmission.

**Is he a relative of another senior officeholder or a party at interest?** No.

**Education:** B.Sc. Electrical Engineering and Computers Ben Gurion University, M.E Mechanical Engineering and Business Management, Technion, Haifa.

**Business experience over the past five (5) years:** Engineering Planning Division Manager (from June 2007 to May 2012), Acting VP Engineering projects (from May 2012 to February 2013), VP Generation and Transmission (March 2013 to December 2014).

**Position in a subsidiary of the company, its affiliated company, or in a stakeholder in the company:** None.

Pursuant to the definition of a stakeholder as stated in section 1 of the Securities Law, the officer is not a "stakeholder" in the Company.

7. **Ron Weiss**

**Name:** Ron Weiss

**Identity card no.:** 059611756.

**Date of birth:** April 3, 1965.

**Date on which he began his term:** February 1, 2013.

**Position in the corporation:** Senior Vice President Engineering Projects.

**Is he a relative of another senior officeholder or a party at interest?** No.

**Education:** B.Sc. Electrical Engineering, Ben-Gurion University, the Negev; M.Sc. Electrical Engineering, the Technion, Haifa.

**Business experience over the past five (5) years:** VP technical issues in the Transmission and Transformer Division (from July 2001 to November 2010); Head of Transmission and Transformer Division (from November 2010 to February 2013).

**Position in a subsidiary of the company, its affiliated company, or in a stakeholder in the company:** None.

Pursuant to the definition of a stakeholder as stated in section 1 of the Securities Law, the officer is not a "stakeholder" in the Company.

8. **David Elmakias**

**Name:** David Elmakias

**Identity card no.:** 63565139

**Date of birth:** August 1, 1950

**Date on which he began his term:** December 16, 2013

**Position in the company:** Senior Vice President Planning, Development and Technology

**Is he a relative of another senior officeholder or a party at interest?** No.

**Education:** bachelors and Master's Degree in Electrical Engineering, the Technion Institute of Technology, and PhD in Electrical Engineering, Tel Aviv University.

**Business experience over the past five years:** Head of Division for Planning, Development and Technology (from April 2003 to December 2013).

**Position in a subsidiary of the company, its affiliated company, or in a stakeholder in the company:** None.

Pursuant to the definition of a stakeholder as stated in section 1 of the Securities Law, the officer is not a "stakeholder" in the Company.

9. **Itzhak Mandelman**

**Name:** Itzhak Mandelman

**Identity card no.:** 23720295

**Date of birth:** June 23, 1968.

**Date on which he began his term:** May 7, 2015.

**Position in the company:** Acting Senior Vice President Finance and Economics and Head of the Finances Division.

**Is he a relative of another senior officeholder or a party at interest?** No.

**Education:** B.A. (graduate) Economics and Accounting from the University of Tel Aviv.

**Business experience over the past five years:** Chief Financial Officer ICPOWER and INKIA ENERGY.

**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.

Mr. Yitzhak Mandelman's term in office ended on December 31, 2015. On January 1, 2016, Mr. Avi Doitchman was appointed Senior Vice President Finance and Economics, and his details are as follows:

**Avi Doitchman**

**Name:** Avi Doitchman

**Identity card no.:** 057297723

**Date of birth:** September 18, 1961.

**Date on which he began his term:** January 1, 2016.

**Position in the company:** Senior Vice President Finance and Economics.

**Is he a relative of another senior officeholder or a party at interest?** No.

**Education:** B.A. (graduate) Economics and Accounting from the University of Bar Ilan. Certified Accountant.

**Business experience over the past five years:** Deputy CEO, Deputy CEO Finances and Strategy at the Israel Chemicals Ltd, and Director in subsidiaries 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.

10. **Yosef Shnek**

**Name:** Yosef Shnek

**Identity card no.:** 69363208

**Date of birth:** October 24, 1951.

**Date on which he began his term:** August 1, 2013

**Position in the company:** Senior Vice President Information and Communication.

**Is he a relative of another senior officeholder or a party at interest?** No.

**Education:** Bachelor of practical Computer Engineering at the Technion and Bachelor of Computer Sciences at the Israeli branch of the American Champlain College and M.B.A. at the Derby College.

**Business experience over the past five years:** Head of Information Systems and Teleprocessing Division (from April 2009 to August 2013).

**Position in a subsidiary of the company, its affiliated company, or in a stakeholder in the company:** None.

Pursuant to the definition of a stakeholder as stated in section 1 of the Securities Law, the officer is not a "stakeholder" in the Company.

**11. Amit Oberkowitz**

**Name:** Amit Oberkowitz

**Identity card no.:** 059030015

**Date of birth:** August 19, 1964.

**Date on which he began his term:** July 10, 2014

**Position in the company:** Head of Human Resources Division.

**Is he a relative of another senior officeholder or a party at interest?** No.

**Education:** Certified, Business Administration, University of Derby; Certified, Political Science, Tel Aviv University.

**Business experience over the past five years:** Deputy Head of Human Resources Division for 3 years; Head of Department of Administration of the Gas Turbine Power Stations in the Generation Division of the Company for 9 years.

**Position in a subsidiary of the company, its affiliated company, or in a stakeholder in the company:** None.

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. Shimon Fischer**

**Name:** Shimon Fischer

**Identity card no.:** 056412463

**Date of birth:** March 27, 1960.

**Date on which he began his term:** January 1, 2015

**Position in the company:** Acting Senior Vice President Generation and Energy.

**Is he a relative of another senior officeholder or a party at interest?** No.

**Education:** Graduate of Electrical Engineering at the Technion, M.B.A. in Business Administration at the Netanya College.

**Business experience over the past five years:** Head of Generation Division; Head of the Haifa Power Station; Electrical Engineer and Deputy Head of the Haifa Power Station.

**Position in a subsidiary of the company, its affiliated company, or in a stakeholder in the company:** None.

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.

Mr. Shimon Fischer's term in office ended on February 21, 2016, and Mr. Ram Ehrlichman was appointed Senior Vice President Generation and Energy. His details are as follows:

**13. Ram Ehrlichman**

**Name:** Ram Ehrlichman

**Identity card no.:** 022521553

**Date of birth:** July 14, 1966.

**Date on which he began his term:** February 21, 2016.

**Position in the company:** Senior Vice President Generation and Energy.

**Is he a relative of another senior officeholder or a party at interest?** No.

**Education:** Graduate of Mechanical Engineering, the Technion; qualified in Electrical and Electronic Engineering, the Tel Aviv University.

**Business experience over the past five years:** Acting Head of Generation Division; Head of the Rutenberg Power Station; Director from among the employees, Head of Electricity Sector at the Rutenberg power station.

**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.

**14. Nitza Rogozinski**

**Name:** Nitza Rogozinski

**Identity card no. :** 025487950.

**Date of birth:** June 10, 1973.

**Date on which she began her term:** April 27, 2014.

**Position in the company:** Internal Auditor.

**Is she a relative of another senior officeholder or a party at interest?** No.

**Education:** L.L.M. (certified) Law from the Bar-Ilan University; Graduate of Business Administration - the College of Management Academic Studies; Accountant; Certified Internal Auditor (CIA).

**Business experience over the past five years:** Chief Internal Auditor - Amitim Senior Pension Funds; Head of Internal Auditing Division - Amitim Senior Pension Funds.

**Position in a subsidiary of the company, its affiliated company, or in a stakeholder in the company:** None.

**Regulations 26(b): Independent Authorized Signatories as Appointed by the Company:**

Pursuant to the decision of the Board of Directors on the subject of signature authorities and in accordance with the Company's procedure on the subject, the Company does not have independent approved signatories, as this term is defined in the Securities Law - 1968.

**Regulation 27: Accountant of the corporation**

Brightman Almagor Zohar and Co., Accountants - 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 May 25, 2015 see immediate report of May 25, 2015 (reference No. 2015-01-027399).

For decisions made by the special general shareholders meeting on December 8, 2015 see immediate report of December 8, 2015 (reference No. 2015-01-175833).

For decisions made by the special general shareholders meeting on December 21, 2015 see immediate report of December 21, 2015 (reference No. 2015-01-185127 and 2015-01-185139).

**Regulation 29A (4): Exemption, insurance, or liability for indemnity in respect of officeholders in effect on the date of this report**

**a. Insurance for Directors and Office Holders**

According to the compensation policy approved by the compensation committee on December 19, 2013, by the Board of Directors of the Company on December 26, 2013, and by the general meeting on January 9, 2014, the Company purchased the following insurance policies:

1. Liability insurance for directors and office holders for a period of three years starting from January 16, 2015 and until January 15, 2018, inclusive.
2. Third party liability insurance - as customary in the Company (the directors and office holders are part of the insured under this policy).
3. Personal accident insurance for the directors.

For details of the terms of the policies mentioned above see the immediate report of the Company of January 9, 2014 (reference no.: 2014-01-011125).

**b. Indemnification of Members of the Board of Directors and Officers**

For details on issuing indemnification letters to officers who served in the Company on the publication date of the financial statements as on June 30, 2009, regarding a liability or expense related to the restatement of these financial statements, and for details on indemnification letters to directors, CEO of the Company, CFO and the legal advisor and Company secretary, whose issue was approved by the general meeting of shareholders on November 22, 2012, see Note 34 f to the financial statements.

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Ofer Bloch  
Chief Executive Officer

Yiftah Ron-Tal  
Chairman of the Board of Directors

**Date of approval of the report: March 21, 2016.**



## CORPORATE GOVERNANCE QUESTIONNAIRE<sup>1</sup>

INDEPENDENCE OF THE BOARD OF DIRECTORS				
			<b>Correct</b>	<b>Not Correct</b>
1.		<p>Throughout the reporting year two or more external directors served in the corporation.  <i>A response of "correct" may be given on this question if the period of time during which two external directors did not serve does not exceed 90 days, as provided in Section 363A.(b)(10) of the Companies Law. However, whatever the response (correct/not correct), the period (in days) during which two or more external directors did not serve in the reporting year (including also a period of service that was approved retroactively) must be indicated, separating between the different external directors:</i>                      Director A: <u>Mr. Arie Rapoport</u>                      Director B: <u>Mr. Ziv Reich / Arik Forer</u>                      Number of external directors serving in the corporation as of the date of publication of this questionnaire: <b>2</b></p>	✓	
2.		<p>- The proportion<sup>2</sup> of independent directors<sup>3</sup> serving in the corporation as of the date of publication of this questionnaire: 2/8                      The proportion of independent directors set in the articles<sup>4</sup> of the corporation<sup>5</sup>: 0  <input type="checkbox"/> Not relevant (there is no article set in the articles)</p>	—	—

<sup>1</sup> Published as part of proposed legislation to improve the statements on March 16, 2014.

<sup>2</sup> "Proportion" in this questionnaire - a certain number out of the total., 3/8 .

<sup>3</sup> Including "external directors" as defined in the Companies Law.

<sup>4</sup> Regarding this question - "Articles" including under a specific provision of law that applies to the corporation (for example, in a banking corporation - the directives of the supervisor of banks).

<sup>5</sup> A debenture company is not required to answer this section.

## INDEPENDENCE OF THE BOARD OF DIRECTORS

			Correct	Not Correct
3.		During the reporting year an examination was conducted with the external directors (and the independent directors) and it was found that they had complied in the reporting year with the provision of Section 240(b) and (f) of the Companies Law regarding the absence of a relation of the external (and independent) directors serving in the corporation and that they satisfy the conditions for service as an external (or independent) director.	✓	
4.		All the directors who served in the corporation in the course of the reporting year are <u>not</u> subordinate <sup>6</sup> to the CEO, directly or indirectly (other than a director representative of employees, if the corporation has an employees' representative body). If your response is "not correct" (i.e. any director is subordinate to the CEO, as stated) – indicate the proportion of directors who did <u>not</u> satisfy this restriction: _____	✓	
5.		All the directors that announced the existence of a personal interest they have in an approval of a transaction on the agenda of the meeting, were not present at the meeting and did not vote as stated (other than a discussion and/or vote in circumstances as provided in Section 278(b) of the Companies Law): If your answer is "Not correct"- Was it for the purpose of presenting a certain subject by him pursuant to the provisions of the end of section 278 (a): <input type="checkbox"/> Yes. <input type="checkbox"/> No. (Mark an X in the appropriate box). The proportion of meetings in which directors as stated participated in the discussion and/or participated in the vote except under circumstances as stated in subsection :a _____.	✓	

<sup>6</sup> Regarding this question - the service of a director in a held corporation that is controlled by the corporation will not be considered "subordination", however, the service of a director in a corporation who is serving as an office holder (except as director) and/or is working in a corporation controlled by the corporation will be considered as "subordination" for purposes of this question.

**INDEPENDENCE OF THE BOARD OF DIRECTORS**

		<b>Correct</b>	<b>Not Correct</b>
6.	<p>A controlling shareholder (including his relative and/or anyone acting on his behalf), who is <u>not</u> a director or other senior officer in the corporation, <u>was not present</u> at meetings of the board of directors that were held in the reporting year.</p> <p>If your response is "not correct" (i.e. the controlling shareholder and/or his relative and/or anyone acting on his behalf who is not a board member and/or senior officer in the corporation, was present at meetings of the board of directors as stated) – indicate the following details regarding the presence of each additional person at such meetings of the board of directors:</p> <p>Identity: _____.</p> <p>Position in the corporation (if exists): _____.</p> <p>Details of the relation to the controlling shareholder (if the person present was not the controlling shareholder himself): _____.</p> <p>Was it for the purpose of presenting a particular subject by him:</p> <p><input checked="" type="checkbox"/> Yes</p> <p><input checked="" type="checkbox"/> No</p> <p><i>(Mark an X in the appropriate box).</i></p> <p>Rate of his presence<sup>7</sup> at meetings of the board of directors held in the reporting year for presenting a certain subject by him: _____, Other presence: _____.</p> <p><input type="checkbox"/> Not relevant (the corporation has no controlling shareholder).</p>	✓	

<sup>7</sup> While separating between the controlling shareholder and his relative and/or anyone on his behalf.

**DIRECTORS' COMPETENCE AND QUALIFICATIONS**

		Correct	Not Correct
7.	<p>The corporation's articles do <b>not</b> include a provision that restricts the possibility of immediate termination of the service of all the directors in the corporation who are not external directors (<i>in this regard – a determination by a simple majority is <b>not</b> considered a restriction</i>)<sup>8</sup>.</p> <p>If your response is "not correct" (i.e. such a restriction exists), indicate –</p>	✓	
	a. The period of time set in the articles for the service of a director: _____.		
	b. The required majority set in the articles for the termination of service of the directors: _____.		
	c. The quorum set in the articles for a general meeting for terminating the service of the directors: _____.		
	d. The required majority for changing these provisions in the articles: _____.		
8.	<p>The corporation conducted a training program for new directors in the area of the corporation's business and in the area of the law applying to the corporation and the directors, and also conducted a continuation program for training serving directors, that is adapted, <i>inter alia</i>, to the position held by the director in the corporation.</p> <p>If your response is "correct" – indicate whether the program was operated in the reporting year:</p> <p>Yes</p>	✓	

<sup>8</sup> A debenture company is not required to answer this section.

## DIRECTORS' COMPETENCE AND QUALIFICATIONS

			Correct	Not Correct
9.	a.	<p>The corporation has set a minimum number of board members who are required to have accounting and financial expertise.</p> <p>If your response is "correct," indicate the minimum number that was set: <u>5</u></p>	✓	_____
	b.	<p>The number of directors who served in the corporation in the course of the reporting year: <b>7</b>.</p> <p>Having accounting and professional expertise<sup>9</sup>: <b>5</b></p> <p>Having professional competence<sup>10</sup>: <b>2</b></p> <p><i>In the event of changes in the number of such directors in the reporting year, the lowest number of directors of each type who served in the reporting year (except during a period of 60 days immediately after the change) will be provided: _____</i></p>		
10.	a.	<p>Throughout the reporting year the board of directors was composed of members of both genders.</p> <p>If your response is "not correct" – indicate the period of time (in days) during which the above was not fulfilled: _____</p> <p><i>A response of "correct" may be given on this question if the period of time during which directors of both genders did not serve does not exceed 60 days. However, whatever the response (correct/not correct), the period of time (in days) during which directors of both genders did not serve in the corporation must be indicated: 0 (Directors of both genders served throughout the period).</i></p>	✓	
	b.	<p>The number of directors of each gender serving on the corporation's board of directors as of the date of publication of this questionnaire:</p> <p>Men: <u>6</u> Women: <u>2</u></p>	_____	_____

<sup>9</sup> After appraisal by the Board of Directors, according to the provisions of the Companies Regulations (Conditions and Criteria for a Director Who Possesses Accounting and Financial Expertise and a Director Who Possesses Professional Competence), 2005.

<sup>10</sup> See footnote 9.

MEETINGS OF THE BOARD OF DIRECTORS (CONVENING A GENERAL MEETING)

							Correct	Not Correct	
11.		a.	Number of meetings of the board of directors held in each quarter of the reporting year:						
			First quarter (2015 year): <u>33</u>						
			Second quarter: <u>29</u>						
Third quarter: <u>16</u>									
Fourth quarter: <u>25</u>									
		b.	Indicate next to the name of each of the directors who served in the corporation during the reporting year the rate <sup>11</sup> 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):						
			<i>(Add lines according to the number of directors)</i>						
			Director's name	Rate of his attendance at meetings of the board of directors	Rate of his attendance at meetings of the audit committee <sup>12</sup>	Rate of his attendance at meetings of the committee for examining the financial statements <sup>13</sup>	Rate of his attendance at meetings of the compensation committee <sup>14</sup>		
	Ziv Reich	96%	100%	100%	100%	Engagements and Assets - 90%			

<sup>11</sup> See footnote 2.

<sup>12</sup> For a director who is a member of this committee.

<sup>13</sup> For a director who is a member of this committee.

<sup>14</sup> For a director who is a member of this committee.

MEETINGS OF THE BOARD OF DIRECTORS (CONVENING A GENERAL MEETING)

								Correct	Not Correct
			Arieh Rapoport	100%	100%	100%	100%	<p>Strategy, Structural Change and Image - 100%</p> <p>Examination of the Company's actions during the October 2015 storm - 0%</p> <p>Locating CEO - 100%</p> <p>Business Development, and Regional Cooperation-100%</p> <p>Budget, Financial Management and Risk Management - 100%</p>	
			Ofir Bashan	95 %		100%		<p>Corporate Responsibility and Regulation - 100%</p> <p>Strategy, Structural Change and Image - 100%</p> <p>Engagements and Assets - 100%</p> <p>Budget, Financial Management and Risk management - 100%</p>	
			Yafa Vigodski	88%	9% Alternate director		100%	<p>Strategy, Structural Change and Image - 100%</p> <p>Examination of the Company's actions during the October 2015 storm -</p>	

MEETINGS OF THE BOARD OF DIRECTORS (CONVENING A GENERAL MEETING)

								Correct	Not Correct
							100% Locating CEO - 100% Engagements and Assets - 100% Human Resources - 100%		
		Arik Forer	100%	100%			Strategy, Structural Change and Image - 0% Examination of the Company's actions during the October 2015 storm - 0% Budget, Financial Management and Risk Management - 0%		
		Raik Abu Reish	94%		100% Alternate director		Engagements and Assets - 91% Human Resources - 100% Business Development and Regional Cooperation - 100% Budget, Financial Management and Risk Management - 90%		



MEETINGS OF THE BOARD OF DIRECTORS (CONVENING A GENERAL MEETING)

							Correct	Not Correct
			Muki Ben Ami	100%			<p>Budget, Financial Management and Risk Management - 100%</p> <p>Business Development and Regional Cooperation - 100%</p>	
			Varda Samet	67%			She did not participate in committee meetings during her term in office.	
			Gideon Frank	84%			<p>Corporate Responsibility and Regulation - 100%</p> <p>Strategy, Structural Change and Image - 100%</p> <p>Examination of the Company's actions during the October 2015 storm - 100%</p> <p>Locating CEO - 100%</p> <p>Business Development and Regional Cooperation - 86%</p>	
			Rochelle Don Yehye	97%			<p>Corporate Responsibility and Regulation - 100%</p> <p>Strategy, Structural Change</p>	

MEETINGS OF THE BOARD OF DIRECTORS (CONVENING A GENERAL MEETING)

							Correct	Not Correct
						and Image - 100% Examination of the Company's actions during the October 2015 storm - 100% Locating CEO - 100% Business Development and Regional Cooperation - 100% Human Resources and Organization - 100% Engagements and Assets - 100% Committee accompanying selection of Nisha Law Firm - 100%		
		Yehuda Adler	91%			Corporate Responsibility and Regulation - 100% Strategy, Structural Change and Image - 100% Examination of the Company's actions during the October 2015 storm - 100% Locating CEO - 88% Business Development and Regional Cooperation - 100%		

MEETINGS OF THE BOARD OF DIRECTORS (CONVENING A GENERAL MEETING)

								Correct	Not Correct
							Human Resources - 80%		
		Yiftah Ron Tal	100%				Corporate Responsibility and Regulation - 50% Strategy, Structural Change and Image -100% Examination of the Company's actions during the October 2015 storm - 100% Locating CEO - 100% Business Development and Regional Cooperation - 100% Human Resources - 100% Engagements and Assets - 36% Budget, Financial Management and Risk Management - 100%		
12.		In the reporting year, the board of directors held at least one meeting regarding the management of the corporation's business by the CEO and the officers subordinate to him, without their presence, and they were given the opportunity to state their position.						✓	

**SEPARATION BETWEEN THE FUNCTIONS OF CEO AND CHAIRMAN OF THE BOARD OF DIRECTORS**

		Correct	Not Correct
13.	<p>Throughout the reporting year a chairman of the board of directors served in the corporation.</p> <p><i>A response of "correct" may be given on this question if the period of time during which a chairman of the board of directors did not serve in the corporation does not exceed 60 days, as provided in Section 363A.(2) of the Companies Law. However, whatever the response (correct/not correct), the period of time (in days) during which a chairman of the board of directors did not serve in the corporation must be indicated: 0.</i></p>	✓	
14.	<p>Throughout the reporting year a CEO served in the corporation.</p> <p><i>A response of "correct" may be given on this question if the period of time during which a CEO did not serve in the corporation does not exceed 90 days, as provided in Section 363A.(6) of the Companies Law. However, whatever the response (correct/not correct), the period of time (in days) during which a CEO did not serve in the corporation must be indicated: 0.</i></p>	✓	
15.	<p>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<sup>15</sup>. <input checked="" type="checkbox"/> <i>Not applicable (if no such dual office exists in the corporation).</i></p>		
16.	<p>The CEO is <u>not</u> a relative of the chairman of the board of directors.</p> <p>If your response is "not correct" (i.e. the CEO is a relative of the chairman of the board of directors) –</p>	✓	
	<p>a. Indicate the family relationship between the parties: _____.</p>	_____	_____

<sup>15</sup> For a debenture company - approval in accordance with section 121(d) of the Companies Law.

**SEPARATION BETWEEN THE FUNCTIONS OF CEO AND CHAIRMAN OF THE BOARD OF DIRECTORS**

			<b>Correct</b>	<b>Not Correct</b>
	b.	<p>The service of the CEO was approved in accordance with Section 121(c) of the Companies Law<sup>16</sup>.</p> <p><input type="checkbox"/> Yes</p> <p><input type="checkbox"/> No</p> <p><i>(Mark an X in the appropriate box)</i></p>	_____	_____
17.		<p>The controlling shareholder or his relative does <u>not</u> serve as CEO or as a senior officer in the corporation other than a director.</p> <p><input type="checkbox"/> <i>Not applicable (there is no controlling shareholder in the corporation).</i></p>	✓	

<sup>16</sup> For a debenture company - approval in accordance with section 121(d) of the Companies Law.

**AUDIT COMMITTEE**

		Correct	Not Correct
18	The following <u>did not serve</u> on the audit committee in the reporting year:	—	—
a.	The controlling shareholder or his relative. <input type="checkbox"/> <i>Not applicable (there is no controlling shareholder in the corporation).</i>	✓	
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. <input type="checkbox"/> <i>Not applicable (there is no controlling shareholder in the corporation).</i>	✓	
19.	A person not permitted to be a member of the audit committee, including a controlling shareholder or his relative, was not present in the reporting year at meetings of the audit committee, other than in accordance with Section 115(e) of the Companies Law.	✓	
20.	A quorum for transacting business and passing resolutions at all meetings of the audit committee that were held in the reporting year was a majority of the members of the committee, a majority of those present being independent directors and at least one being an external director.  If your response is "not correct" – indicate the rate of meetings at which this requirement was not fulfilled: _____.	✓	
21.	The audit committee held in the reporting year at least one meeting attended by the internal auditor and the independent auditor and without the presence of officers in the corporation who are not members of the committee, regarding defects in the business management of the corporation.	✓	

**AUDIT COMMITTEE**

			<b>Correct</b>	<b>Not Correct</b>
22.		At all meetings of the audit committee at which a person who is not permitted to be a member of the committee was present, this was with the approval of the chairman of the committee and/or at the request of the committee (regarding the general counsel and secretary of the corporation who is not a controlling shareholder or his relative).	✓	
23.		Arrangements set by the audit committee regarding the manner of handling complaints by the corporation's employees concerning defects in its business management and the protection provided for employees that complained as stated were in force during the reporting year.	✓	
24.		The audit committee (and/or the committee for reviewing the financial statements) was satisfied that the volume of work of the independent auditor and his fees with respect to the financial statements in the reporting year were adequate for executing appropriate control and review.	✓	

**FUNCTIONS OF THE COMMITTEE FOR EXAMINING THE FINANCIAL STATEMENTS (HEREINAFTER – THE COMMITTEE) IN ITS WORK PRIOR TO APPROVAL OF THE FINANCIAL STATEMENTS**

		<b>Correct</b>	<b>Not Correct</b>
25.			
a.	Indicate the period of time (in days) set by the board of directors as a reasonable time for submitting the recommendations of the committee ahead of the discussion by the board of directors for approval of the financial statements: <u>2</u>	_____	_____
b.	The number of days that actually elapsed between the date of submission of the recommendations to the board of directors and the date of the discussion by the board of directors for approval of the financial statements:  First quarter report (2015 year): <u>7</u> Second quarter report: <u>2</u> Third quarter report: <u>5</u> Annual report: <u>4</u>	_____	_____
c.	The number of days that elapsed between the date of transfer of the draft of the financial statements to the directors and the date of the discussion by the board of directors for approval of the financial statements:  First quarter report (2015 year): <u>12</u> Second quarter report: <u>11</u> Third quarter report: <u>9</u> Annual report: <u>11</u>		
26.	The corporation's independent auditor participated in all the meetings of the committee and the board of directors at which the corporation's financial statements for the periods included in the reporting year were discussed. (if your answer is "not correct", the proportion of its participation will be noted) : _____.	✓	



**FUNCTIONS OF THE COMMITTEE FOR EXAMINING THE FINANCIAL STATEMENTS (HEREINAFTER – THE COMMITTEE) IN ITS WORK PRIOR TO APPROVAL OF THE FINANCIAL STATEMENTS**

		<b>Correct</b>	<b>Not Correct</b>
27.	Throughout the reporting year and until publication of the annual report, the committee complied with all the conditions set out below:	_____	_____
a.	The number of its members was no less than three (at the time of the meeting of the committee and the approval of the financial statements as stated).	✓	
b.	It complied with all the conditions prescribed in Section 115(b) and (c) of the Companies Law (regarding the service of members of the audit committee).	✓	
c.	The chairman of the committee is an external director.	✓	
d.	All its members are directors and a majority of its members are independent directors.	✓	
e.	All its members are able to read and understand financial statements, and at least one of the independent directors possesses accounting and financial expertise.	✓	
f.	The members of the committee submitted a declaration prior to their appointment.	✓	
g.	The quorum of the committee for meeting and for passing resolutions was a majority of its members, provided that a majority of those present were independent directors including at least one external director.	✓	
	If your response is "not correct" on one or more of the subparagraphs of this question, specify with respect to which report (periodic/quarterly) the stated condition was not complied with and the condition that was not complied with: _____.	_____	_____

**COMPENSATION COMMITTEE**

		<b>Correct</b>	<b>Not Correct</b>
28.	<p>The number of members of the committee in the reporting year was at least three, and its external directors constituted the majority (at the time of discussion by the committee).</p> <p><input type="checkbox"/> Not relevant (a discussion was not held).</p>	✓	
29.	<p>The terms of office and employment of all the members of the compensation committee in the reporting year are in accordance with the Companies Regulations (Rules regarding compensation and expense reimbursement of external directors), 2000.</p>	✓	
30.	<p>The following did not serve on the compensation committee during the reporting year:</p>	—	—
a.	<p>The controlling shareholder or his relative.</p> <p><input type="checkbox"/> Not relevant (there is no controlling shareholder in the corporation).</p>	✓	
b.	<p>The chairman of the board of directors.</p>	✓	
c.	<p>A director who is employed by the corporation or by the controlling shareholder in the corporation or by a corporation under his control.</p>	✓	
d.	<p>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.</p>	✓	
e.	<p>A director whose main livelihood derives from the controlling shareholder.</p> <p><input type="checkbox"/> Not relevant (there is no controlling shareholder in the corporation).</p>	✓	
31.	<p>A controlling shareholder or his relative were not present at the meetings of the compensation committee during the reporting year, except if the chairman of the committee determined that any of them is required for the presentation of a certain matter.</p>	✓	

**COMPENSATION COMMITTEE**

	<b>Correct</b>	<b>Not Correct</b>
<p>32. The compensation committee and the board of directors did not use their authority under sections 267a(c), 272(c)(3) and 272(c1)(1)(c) to approve a transaction or a compensation policy, despite the objection of the general meeting.</p> <p>If your answer is “not correct”, indicate -</p> <p>The type of transaction approves as stated: _____</p> <p>The number of times their authority was used in the reporting year: _____</p>	✓	

INTERNAL AUDITOR			
		Correct	Not Correct
33.	The chairman of the board of directors or CEO of the corporation is the person in charge of the internal auditor of the corporation.	✓	
34.	The chairman of the board of directors or the audit committee approved the work plan in the reporting year.  In addition, the audit issues dealt with by the internal auditor in the reporting year will be detailed: Information security - remote access; engagement to execute cable ducts - continued engagement; security - "Orot Rabin Project"; implementation of recommendations of the State Comptroller (Report 65A) - recruitment and employment of relatives and close associates in corporations - Israel Electric Corporation; follow-up of State Comptroller's 2014 reports of review of local authority; sale of materials and equipment - "Orot Rabin Project"; follow-up (31/2013 report) - sale of services and business initiative; drawing conclusions arising from applications in the field of consumption - 2014; transfers (transferring between warehouses) - "Orot Rabin Project"; vehicles replacement model - Audit Committee requests; management of radiation events by the non destructive section of the project execution division; management and preparation of spare parts inventory; employing external legal advisors in the Company - circular of the Government Companies Authority; treating irregular events occurring in the Company; risk management; follow-up - the general administration; payments adequacy in the field of publication; health and safety; follow-up of implementation of decisions and recommendations of the teleprocessing division; implementation of recommendations by the Customers Division from 2014 reports and inspection documents; follow-up of implementation of decisions and recommendations in planning, development and technology; implementation of decision and recommendations of Engineering Projects Division; directors compensation for 2014; implementation of decisions and recommendations in the Energy Production Division.	✓	
35.	Scope of employment of the internal auditor in the reporting year (in hours <sup>17</sup> ): full-time position (180 hours).	—	—
	A discussion was held (by the audit committee or the board of directors) in the reporting year regarding the findings of the internal auditor.	✓	
36.	The internal auditor is not an interested party, a relative, an independent auditor of the corporation or anyone on its behalf, and does not have material business relations with the corporation, its controlling party, relative or corporations under their control.	✓	

<sup>17</sup> Includes work hours invested in held companies and in audit outside of Israel, as relevant.

**INTERESTED-PARTY TRANSACTIONS**

	<b>Correct</b>	<b>Not Correct</b>
<p>37. The controlling shareholder or his relative (including companies controlled by him) is not employed by the corporation and does not provide management services to it.</p> <p>If your response is "not correct" (i.e. the controlling shareholder or his relative is employed by or provides management services to the corporation), indicate –</p> <ul style="list-style-type: none"> <li>- The number of relatives (including the controlling shareholder) employed by the corporation (including companies controlled by them and/or through management companies): _____.</li> <li>- Were such employment agreements and/or management services approved by the organs stipulated by law: <ul style="list-style-type: none"> <li><input type="checkbox"/> Yes</li> <li><input type="checkbox"/> No</li> </ul> </li> </ul> <p><i>(Mark an X in the appropriate box)</i></p> <p><input type="checkbox"/> <i>Not applicable (the corporation has no controlling shareholder).</i></p>	✓	
<p>38. To the best of the corporation's knowledge, the controlling shareholder does not have any additional business in the corporation's area of operations (in one area or more).</p> <p>If your response is "not correct" – indicate whether an arrangement was established between the corporation and its controlling shareholder that delimits their activities:</p> <ul style="list-style-type: none"> <li><input type="checkbox"/> Yes</li> <li><input type="checkbox"/> No</li> </ul> <p><i>(Mark an X in the appropriate box)</i></p> <p><input type="checkbox"/> <i>Not applicable (the corporation has no controlling shareholder).</i></p>		✓

## End Notes:

Note to question number 1: The period (in days) in which two external directors did not hold a position in the corporation in the reporting year is 7 days.

Note to question number 2: Since the authority to appoint directors of the Company is in the hands of the Minister of Finance and the Minister of National Infrastructures, Energy and Water, and following consultation with the Appointment Review Committee, the Company on February 8, 2009 approached the Government Companies Authority to obtain their position and guidelines regarding the adoption of provisions and regulations of the Company regarding the Independent Director, the rate of Directors and their terms in office. The Government Companies Authority's position as of February 24, 2009 is that the binding stipulating regulation is that a public government company requires the appointment of a certain number of independent directors, as defined in Amendment No. 8 to the Companies Law may impose significant limitations on the appointment of directors of that company, due to the strict requirements which meet the "independent director" regarding his relationship with the state and the entities it controls. On the other hand, the position of the Government Companies Authority does not deem that such a provision will significantly improve the activity of the Company's directors and reinforce independent status, beyond current measures of protection in accordance with the provisions of the Government Companies Law and the principles of administrative law. Therefore, the company adopted the provisions regarding the number of independent directors.

Note to question number 6: By virtue of section 27(b) of the Government Companies Law - 1975, invitation to meetings of the board of directors will also be delivered to the Government Companies Authority, and it may send a representative to every meeting who will be allowed to participate in the meeting, and his standing will be as a director, but he will not be counted as part of the quorum and he will not have a right to vote. Beyond that, a representative of a controlling shareholder was not present in meetings of the board of directors.

Note to question number 7: The appointment of certain directors and termination according to the guidelines of the Government Companies law 1975. Furthermore, although the company regulations contain instructions according to which the company is entitled to relieve a member of the board of directors of his duties at the end of his term in an extracurricular decision considering that the State of Israel holds 99.85% of the Company's share capital, effectively there is nothing in the guidelines that limits the possibilities of immediate removal of directors from their position.

Note to question 19: Based on sections 27(b) and 29(b) of the Companies Law 1975, invitation to a meeting of the Audit Committee will be issued to the Authority of Government Companies and the latter is entitled to send a representative to each of the meetings at Director status; however he will not be considered of the legal quorum and will not have voting rights.

Note to question 24: The Electric Company as a government company has no influence over the appointment and the remuneration of the external Auditor and these are decided upon by the Authority for Government Companies, in accordance with Government Company regulations (appointing Accountants and their remuneration), 1994. Notwithstanding, the Committee for Reviewing the Financial Statements held a discussion on March 16, 2015 that focused on the scope of engagement of the External Auditor.

Note to question 31: See note to question 19 above.

Note to question 38: The Controlling shareholder established and owns two government companies, which are predicted to work in the electricity sector: The System Management Company Ltd. and new Power Generation Stations Ltd. As far as the Company knows, these companies are not operational.

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**Chairman of the Board of Directors**

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**Chairman of the Audit Committee and  
of the Committee for Reviewing the  
Financial Statements**

# **ANNEX 1**

## **Actuarial Liabilities of the Israel Electric Corporation**

**At**

**December 31, 2015**





Ernst & Young (Israel) Ltd  
3 Aminadav St.  
Tel-Aviv 6706703, Israel

Tel: +972-3-6232525  
Fax: +972-3-5622555  
ey.com

March 21, 2016

To  
Mr Avi Doitchman, Senior Vice-President of Finance and Economics  
Israel Electric Corporation Ltd.  
P.O. Box 10  
Haifa 31000, Israel

Dear Sir,

Re: **Actuarial liability as of December 31, 2015 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 Avi Doitchman, Senior Vice-President of 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.

On March 29, 2011, the Company granted us a letter of indemnity in respect of the services we will provide to the Company. On July 22, 2015, the Israel Securities Authority published guidance regarding the "disclosure of the existence of dependence between the appraiser of value and the corporation and disclosure regarding an appraiser of value whose valuations are highly material to the corporation", whereby the granting of a letter of indemnity to the appraiser (and included in this is the Company's actuary) creates a presumption that the appraiser is dependent on the Company.

However our position is that there is no dependency on the Company, since the granting of a letter of indemnity and valuations of this kind are accepted practice and do not create a specific dependency on the Company.

It is noted that we receive fees in respect of this engagement and other consulting services that we provide to the Company, and this does not change our position in relation to independence as stated. Likewise we confirm that the fees we receive from the Company are not dependent on the results of this valuation.

- 1.3 The valuation was performed solely for the purpose mentioned above and this report is not to be used, or to reach conclusions, for any other purpose such as determining the provisions required for funding the benefits, valuations of the Company etc. The actuarial results appropriate for any other purpose may materially differ from the results reported in this document.
- 1.4 This report is intended to present results and provide explanations relating to the valuation. This report is prepared for the purpose of its inclusion in the Company's financial statements.
- 1.5 The amounts reported herein were calculated according to the Company's interpretations of IAS 19 and its accounting policies regarding its implementation (see section 3 below). The Company is fully and exclusively responsible for these interpretations and policies.
- 1.6 According to this valuation, there is a surplus of assets over liabilities in the pension plan. Based on the Company's instructions, this surplus is presented as an asset of the Company in whole. According to legal regulations of the Fund, in specific situations where there is a surplus, it is returned to the Company, where the surplus is determined according to the actuarial valuation of the Fund. The actuarial valuation of the Fund is different from the Company's valuation contained in this report, primarily due to a different discount rate and different assumptions regarding future salary increases. According to the most recent actuarial valuation of the Fund (as of December 31, 2015), the liabilities were higher than those calculated in this valuation, and there were no surplus assets over liabilities.
- 1.7 In order to calculate the amounts included in this report, we relied on information concerning the employee benefit terms and conditions (including constructive obligations) and on historical and current employee data, as provided to us by the Company, that were not verified by us. The full responsibility for the completeness and reliability of the information and data as provided to us lies with the Company.
- 1.8 The valuation results are highly sensitive to the actuarial assumptions. The actual demographic and economic experiences are likely to differ from the assumptions, and assumptions are likely to change in future, which will impact on the valuation of the accrued benefits liability. Section 8 below provides additional information.

- 1.9 The valuation was performed by Mr Emanuel Berzack, a qualified actuary, and his actuarial team at Ernst & Young (Israel) Ltd. Mr Berzack has a B.Econ.Sc (Statistics and Actuarial Science) from the University of the Witwatersrand in South Africa and is a Fellow of the Israel Association of Actuaries (FILAA) and a Fellow of the Institute of Actuaries (FIA) in the UK. Our professional experience of the last 12 years includes actuarial valuations of employee benefits of a similar kind to those of the Company, of pension liabilities of pension funds and insurance liabilities of insurance companies, in the role of a valuation actuary or reviewing or audit actuary.
- 1.10 This report has been prepared in accordance<sup>1</sup> with the relevant standards in "Technical Actuarial Standard R – Reporting Actuarial Information" published in November 2009 and in the "Pensions Technical Actuarial Standard" published in November 2012 by the Board for Actuarial Standards of the Financial Reporting Council in the UK. We did not refer to "Technical Actuarial Standard D - Data" of said Board since in view of the agreement entered into between Ernst & Young and the Company, the responsibility for validating the completeness, reliability and suitability of the data lies with the Company.
- 1.11 Definitions:
- "salary" – Pensionable Salary
  - "the Fund" – the Central Pension Fund of the employees of the Israel Electric Corporation Ltd.
  - "pension plan" – the set of benefits paid by the Fund
  - "date of valuation" – December 31, 2015
  - "linked pensions agreement" – the collective agreement between the company and the Histadrut and the committee of Company employees, which inter alia changes the method of the pensions update (linking pensions to the CPI (the "Index") instead of updates by promotions and wage agreements)

## 2. **The benefits included in the valuation**

- 2.1 Our calculations are based on the details of the benefits and their terms, as obtained in a document from the Company, dated March 2, 2016, 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. In this valuation, the liability in respect of the severance pay benefit for senior managers employed by personal contracts of the Government Companies Authority was not taken in to account.

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<sup>1</sup> 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).

2.3 The benefits to which the valuation refers are as follows (see details in Appendix F):

2.3.1 In respect of employees and pensioners of the defined benefit pension plan, the benefits consist of the following:

- post-retirement pension in respect of pensionable salary, comprised of the following components, subject to each employee/pensioner's individual entitlement to each one: regular salary<sup>2</sup>, shift work, home service, Arava additions, convalescence pay (one 12<sup>th</sup> of salary), 13<sup>th</sup> salary (one 12<sup>th</sup> of salary) 14<sup>th</sup> salary (one 12<sup>th</sup> of salary) and "CPI increment";
- disability pension;
- survivors' pension in respect of employees who die during service<sup>3</sup> or following retirement (including employees who died after retirement on account of disability);
- retirement grant for service above 35 years' service and to survivors on the death of the spouse as above ("additional years grant") including apprenticeship period 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, the benefits consist of:

- supplementation of severance pay at 2.33% of regular salary (including 13<sup>th</sup> salary) for each year of service. In addition, in respect of 14<sup>th</sup> 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;

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<sup>2</sup> includes combined salary, management increment, seniority, personal addition, continual education addition and physical effort addition.

<sup>3</sup> 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.

- 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 years), whichever is soonest.

2.4 An update for pension amounts takes place in the month of January each year, in accordance with the rate of annual change in consumer price index (the ratio of the index for the most recent month of December to the index for the December previous to that).

2.5 Our valuation does not take into consideration the payment of other possible benefits or increase to existing benefits at the Company's discretion, other than the allowance for early retirements, which require Company approval, based on the assumed early retirement rates (see 5.4 below).

2.6 We were informed by the Company that, according to the position of the Commissioner of the Ministry of Finance, there are salary irregularities with a potential total impact on the actuarial liability of about NIS 450 million. Legal proceedings in the labor court regarding this issue are yet to be decided. The actuarial liability in this report does not include a reduction with respect to this issue.

### 3. **The valuation methodology and actuarial and accounting principles underlying the report**

3.1 In accordance with IAS 19, the liabilities were calculated using the projected unit credit method. Under this method the liability is calculated as the present value of projected payments to employees and pensioners in respect of the relevant benefits based on the accrued rights of employees and pensioners as of the valuation date (the "past obligation"). The calculation projects each employee and pensioner's expected benefit payment amounts and dates, while taking into account the projected salary growth rate, mortality, termination and disability rates of employees and pensioners, as well as the labor agreements and the Company's benefit payment policy.

3.2 The liabilities and additional disclosures in this report were calculated and presented in accordance with the Company's accounting policy as detailed in sections 3.3-3.10 below.

3.3 Accrued rights are calculated for each benefit in the following way<sup>4</sup>:

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<sup>4</sup> Namely, the manner of attributing the benefits to the period of employment

<b>The benefit</b>	<b>Method of calculating the past liability</b>
Post-employment pension (including disability pension) and social welfare activities	Based on the benefit formula in the pension plan, namely, at the rate of accruing the plan's pension percentages.
Grant of post employment discounted electricity rates and holiday gifts, including tax grossing up (and VAT on the electricity benefit)	The liability is fully recognized for anyone who has at least 10 years of service and has reached the age of 40 (60 for generation C employees). If those criteria are not met, the past liability is based on the ratio of accrued service to accumulated service until said service and age, multiplied by the full liability.
Death in service survivors' pension	The liability is recognized in full.
Severance pay upon leaving without entitlement to pension, and grant of "up to 35 years"	Based on eligibility on the valuation date. Eligibility is accrued based on accrued service. For the "up to 35 years of employment" grant, there is a 35-year accumulation maximum.
Grant for additional years	This liability is not recognized prior to 35 years of service. As for employees with over 35 years of service, the past liability is calculated according to the actual benefit terms, namely the number of additional years' (over 35 years) service as at the valuation date.
Grant for unutilized sick leave	According to the number of unutilized sick leave days as of the valuation date
Grant for disability retirement	According to eligibility on the valuation date. Eligibility is accrued according to service, subject to a maximum of 30 years (up to 15 times salary).
20-year grant	Based on the ratio of accrued service to 20 years. There is no liability in respect of employees with over 20 years of service (as they already received the grant).
Increased severance pay for non-permanent employees employed under special agreement	Using the straight-line method from commencement of work through the end of the maximum work period or retirement age (67), whichever is sooner.
Social welfare fund	Using the straight-line method from commencement of work until the date the employee reaches age 50/55 (male/female), or 30 years of service, whichever is later.
Life insurance benefits	The calculation of the liability in respect of the life insurance benefits was done on the basis of two-thirds of the sums insured in the event of death, after consideration of pensioner participation of one third of the cost of the benefit. It was assumed that the sums insured in the future will be linked monthly to the CPI. In regards to life insurance benefits, in respect of which there exists an insurance arrangement, a margin was added for the cost of the benefit. The calculation of the accrued obligation was done using the straight-line method from commencement of work until the average retirement age (66).

- 3.4 Actuarial losses and gains attributable to post-employment benefits are attributed to capital. Actuarial gains and losses attributable to benefits that are not post-employment benefits are attributed to profit and loss.

- 3.5 The results presented in Appendix A are on a nominal basis, and accordingly the interest cost and the expected return on assets are calculated according to the nominal interest rate at the start of the year.
- 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 nominal annual interest rate of 4.77% (the uniform discount rate inherent in the liability as of December 31, 2014).
- 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, 2015. 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<sup>5</sup> data – we received files on January 11, 2016 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<sup>6</sup>:

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<sup>5</sup> The possibility that pensioners died without the Company's knowledge was not taken into consideration in the valuation.

<sup>6</sup> To remove all doubt, the rates and manner of adjustment represent part of the Company's instructions and were not determined or examined by us.

4.2.1 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 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:

<b>Before the adjustments in section 4.2 above</b>				
Group	Number	Monthly salary/pension in NIS – regular salary, taken from data	Average age	Average service (years)
<b>Defined benefit pension plan *</b>				
Employees	7,094	107,697,486	54.3	27.9
Pensioners – former employees	4,094	53,244,477	72.6	
Pensioners – survivors (including children)	1,931	14,050,622	73.9	
<b>Generation C**</b>				
Employees	2,201	18,491,546	43.1	13.3
Pensioners – former employees	19	2,799	68.7	
Pensioners – survivors (including children)	10	1,473	49.0	
<b>Employees under special agreements (non-permanent employees) ***</b>				
Employees	668	3,663,782	37.9	3.7

<b>After the adjustments in section 4.2 above</b>				
Group	Number	Monthly salary/pension in NIS – regular salary, calculated by formula based on salary components	Average age	Average service (years)
<b>Defined benefit pension plan *</b>				
Employees	7,070	107,776,894	54.3	27.9
Pensioners – former employees	4,118	53,831,336	72.5	
Pensioners – survivors (including children)	1,931	14,186,579	73.9	
<b>Generation C**</b>				
Employees	2,201	18,586,968	43.1	13.3
Pensioners – former employees	19	2,853	68.7	
Pensioners – survivors (including children)	10	1,502	49.0	
<b>Employees under special agreements (non-permanent employees) ***</b>				
Employees	668	3,681,734	37.9	3.7



- \* 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<sup>7</sup>, shift work, home service, Arava additions, convalescence pay (the 12<sup>th</sup> portion), 13<sup>th</sup> salary (the 12<sup>th</sup> portion), 14<sup>th</sup> salary (the 12<sup>th</sup> portion) and value of holiday gifts (grossed up for tax). The amounts of the 13<sup>th</sup> and 14<sup>th</sup> salaries were calculated by dividing the regular salary by 12 in respect of all those qualifying based on service data.
- \*\* 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, 13<sup>th</sup> salary (the 12<sup>th</sup> portion) and grossed up value of holiday gifts. The amount of the 13<sup>th</sup> salary was calculated by dividing the regular salary by 12.
- \*\*\* The displayed salary for non-permanent employees under special agreements is the salary eligible for severance pay only. (In the data file there are two salary fields – regular salary and severance pay. The field that is used for calculations is severance pay.)

4.4 Data obtained for assets, payments and contributions consisted of the following (at nominal value):

Data item		NIS '000
<b>Assets as at the valuation date</b>		
4.4.1	Balance of plan assets for post-employment benefits	28,820,967
4.4.2	Balance of assets according to Section 116A (of IAS 19) benefits	1,921,441
<b>Payments during the reporting period</b>		
4.4.3	Increased severance pay to employees under special agreements	1,902
4.4.4	Supplemented severance pay (2.33%) to generation C employees	–
4.4.5	"20-year grant"	3,622
4.4.6	Termination benefits – for paid benefits by the fund, and for benefits not paid by the fund (electricity, holiday gifts)	75,926
	Termination benefits – for paid benefits by the fund	75,393
4.4.7	Unutilized sick leave grant	64,973
4.4.8	Post-employment benefits (excluding termination benefits)	835,314
4.4.9	"up to 35 years" grant	8,639
4.4.10	Discounted electricity benefit and holiday gifts	43,081
4.4.11	Withdrawals from plan assets for payment of benefits	760,591
<b>Contributions during the reporting period</b>		
4.4.12	Company's contributions to plan assets or assets according to Section 116A (of IAS 19)	1,279,500
4.4.13	Employees' contributions to plan assets or assets according to Section 116A (of IAS 19)	–

<sup>7</sup> includes combined salary, management increment, service addition, personal addition, continual education addition and physical effort addition.

## 5. Actuarial assumptions

The assumptions detailed below represent the Company's assumptions – the Company being the entity that is responsible, according to IAS 19, for determining the assumptions. The financial assumptions (see section 5.1 below) are based on generally accepted market data as published by an external party. The Company set the rest of the assumptions, most of which were set in consultation with us, and in our opinion they are reasonable.

In principle, changes may be expected to assumptions as a result of investigations relating to employees and pensioners demographic experience or other relevant information, that are carried out from time to time, and/or after publications of new mortality and disability tables by the Israeli Ministry of Finance or other parties, to the extent that it is decided that these tables apply to the Company.

### 5.1 Financial assumptions

5.1.1 Inflation rate – the difference between the nominal spot interest rate (on non-indexed corporate bonds) and the real spot interest rate (on indexed corporate bonds). 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 increases are mostly 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 for calculating the erosion of real value, based on a duration of 16.2 years, is currently 1.78%.

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 corporate 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 corporate bonds) and adding inflation (the difference between the nominal and real interest rates) to the projected cash flows, leads to the same result.

5.1.2 Discount rates – on November 25, 2014, the Israel Securities Authority published its position that in Israel there exists a deep market in high quality corporate bonds. According to the accounting policy of the Company, the discount rates used in the valuation are taken from a yield curve based on market data for high quality corporate bonds tied to inflation as of December 31, 2015, as established by Mervach Hogen Ltd (in the previous quarter, the discount rate was based on Government bond yields). The use of these interest rates is required by IAS 19, given the Company's opinion (which coincides with that of other Israeli corporations) regarding the existence of a deep market in high quality corporate bonds in Israel.

If the plan assets yield lower real returns than the discount rates, based on their fair value, the net liabilities (total liabilities net of plan assets) will increase and vice versa.

See Appendix B for details of the projected cash flows of benefits.

See Appendix C for information on the values of the interest rates.

- 5.1.3 The interest cost rate and expected return on assets for the reporting period were determined by the Company at 4.77% pa, as described in section 3.7 above.

## 5.2 Salary and benefit increases

The actuarial valuation was prepared in accordance with IAS 19, according to which the liability should be calculated on the basis of the existing labor and pension agreements at the valuation date. Accordingly, the valuation took into consideration that the salary components will increase according to the framework of salary increases and rank progression included in the Company's existing labor agreements and policies, as specified in Appendix F and in accordance with general salary and cost-of-living allowance agreements as described in section 5.2.1.1, without the possibility of creating new ranks or executing other changes to employment terms and to the existing system of salary increases and rank progression.

- 5.2.1 For employees in the defined benefit pension plan and generation C, it is assumed that the salary and benefit increases will be as follows:

- 5.2.1.1 The annual increase in respect of general salary and cost-of-living allowance agreements will be as follows:

In respect of the period from 2013 until 2017:

A cumulative increase of NIS 356 per month for each employee, and a further 3.75% nominal. This increase is spread proportionally over the 5 year period. This increase assumption is based on the current salary agreement which was agreed upon for civil servants, under which the average salary increase will be 7.5%, with at least half given as a uniform absolute increase. This assumption leads to an average annual increase of 1.24% nominal.

In respect of the period starting from 2018: the annual salary increase will be at the rate of the increase in the CPI less 0.5% per year (a 0.5% erosion each year in real terms).

This assumption affects all of the salary components, but does not affect the discounted electricity, holiday gifts and convalescence (it is assumed that the Arava and home service components will be included in future salary agreements).

- 5.2.1.2 It is assumed that the average annual salary increase which results from promotions (including a promotion to senior rank) and from changes in eligibility to new or increased salary components related to the job classification increment, master's degree, "shift work", "home service", "Arava addition" and additional grade at Eilat, will be at the following annual rates:

Age	Non-senior employees	Senior employees
0 – 32	1.43%	1.27%
32 – 37	0.77%	1.27%
37 – 42	0.43%	1.27%
42 – 47	0.37%	1.27%
47 – 52	0.34%	1.27%
52 – 57	0.26%	1.65%
57 – 62	0.20%	0.91%
Over 62	0.17%	0.76%

5.2.1.3 For employees who at the valuation date are not entitled to continuing education payment A and/or B, the annual rate of eligibility is as follows:

Age	Eligible for payment A	Eligible for payment B
Until 40	7.8%	3.5%
40 – 50	3.5%	1.5%
50 – 60	1.1%	0.8%
Over 60	0.0%	0.4%

5.2.1.4 It is assumed that the ceiling for continuing education payment B for employees at professional grade 44 (nominal) and up will be linked to salary and cost-of-living allowance agreements. The amount of the ceiling, correct to the valuation date, was NIS 930.

5.2.1.5 According to labor agreements, the value of holiday gifts (including tax grossing up) and convalescence pay will increase by the actual rate of increase in the CPI, and that the update (for CPI) of convalescence takes effect in June each year, and of holiday gifts takes effect at in January each year. The cost of the gifts for pensioners is increased for grossed up tax at a rate of 14.02% (at all ages), and for pensioners who retired before retirement age the cost is increased for an additional grossed up tax (in respect of National Insurance) at a rate of about 18.48%, until their reaching the legal retirement age.

5.2.1.6 The cost of discounted electricity is calculated according to the electricity tariff of a domestic consumer at the valuation date (the fixed monthly fee before VAT is NIS 13.90 and the variable rate per kilowatt-hour before VAT is NIS 0.4558), and according to the following assumptions:

- The change in the discounted electricity tariff (including VAT and tax grossing up) is in accordance with the forecast that we received from the Company.

- The cost of discounted electricity for pensioners is increased for VAT and also for grossed up tax at a rate of 15.64% (at all ages), and for pensioners who retired before retirement age the cost is increased for an additional grossed up tax (in respect of National Insurance) at a rate of about 18.48% until their reaching the legal retirement age.
- The assumed electricity consumption in kWh is according to the age of the pensioner, and according to the classification of the pensioner into the following groups: a) recipients of old-age pension and disability pension, b) recipients of survivors' pension. It is assumed that the average power consumption per pensioner at any given age will remain constant.
- The reduction in the cost of electricity in respect of pensioners who do not utilize the benefit is according to the age of the pensioner, and according to the classification of the pensioner into the following groups: a) recipients of old-age pension and disability pension, b) recipients of survivors' pension.

5.2.1.7 It is assumed that there were no changes, and will not be any changes, to employees' rate of part-time employment, and that the current rate of part-time employment reflects the average rate of part-time employment from the past and that will be in future.

5.2.1.8 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.

5.2.1.9 An update for pension amounts takes place in the month of January each year, in accordance with the rate of annual change in the Consumer Price Index (the ratio of the index for the most recent month of December to the index for the December previous to that). In cases when the change is negative, pension amounts are not updated downwards. A future pension update in respect of a positive change in the index will be effected only after offsetting the negative index change that had accumulated since the previous pension update. In light of this, we assumed that pension amounts will be updated only after the index has increased by 1.19%, which is the extent of the decrease in the index since the previous pension update in January 2014.

5.2.2 In respect of non-permanent employees under special agreements, a real annual salary growth of 2.0% is assumed, including the general salary updates and individual employee salary increases.

### 5.3 Mortality and disability rates

5.3.1 See Appendix E below regarding changes made to the mortality assumptions.

#### 5.3.2 Life expectancy improvement (decline in mortality rates)

The value of the actuarial liability is highly sensitive to the mortality assumption. It is known that medical developments and lifestyle improvements have helped to increase life expectancy in general. The actuarial assumptions take into account the continued increase in life expectancy.

The mortality rates detailed below are in effect as of December 31, 2008. We assumed a decline in mortality rates (leading to prolonged lifespan) from December 31, 2008 and on, based on the Circular no. 2013-3-1 on the subject of "Calculation Method for Actuarial Balance Sheets and Annuitisation Factors for Pension Funds" issued by the Capital Markets, Insurance and Savings Division of the Israeli Ministry of Finance on January 30, 2013 ("Pension Circular 2013")<sup>8</sup>.

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", published by the Capital Markets, Insurance and Savings Division of the Israeli Ministry of Finance regarding an updated basis of demographic assumptions of pension funds ("the study"). In Pension Circular 2013-3-1, which was released after the publication of the Position Paper, the same mortality tables as in the Position Paper were published.

Based on the study, we recommended to the Company to adopt the tables in the "Pension Circular 2013" with adjustments that take into account the experience of the Company, while, inasmuch as the experience was more reliable (the statistical significance of the data is greater), we gave more weight to the experience and less to the "standard" table. The Company accepted our recommendation and established the assumptions accordingly.

For pensioners the assumption is:

- for males –table P3 of the "Pension Circular 2013", without adjustment
- for females –table P3 of the "Pension Circular 2013", without adjustment

Below is a sample of the remaining life expectancy of pensioners, based on this assumption and combined with the assumed improvement in life expectancy.

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<sup>8</sup> 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.

<b>Age and year</b>	<b>Female</b>	<b>Male</b>
67 at the end of 2010	21.92	20.19
67 at the end of 2020	22.89	20.78
67 at the end of 2030	23.63	21.41

#### 5.3.4 Survivors' mortality

According to the aforementioned study, the assumption for survivors is:

- for males – up to age 60, according to table P2 of the "Pension Circular 2013", decreased by 2%, and applying from age 60 table P5 of the "Pension Circular 2013", decreased by 2%.
- for females – up to age 55, according to table P1 of the "Pension Circular 2013", and applying from age 55 until age 67 table P3 of the "Pension Circular 2013".

#### 5.3.5 Mortality for active employees

According to the aforementioned study, the assumption for employees is:

- for males – according to table P1 of the "Pension Circular 2013", decreased by 22%.
- for females – according to table P1 of the "Pension Circular 2013", decreased by 16%.

#### 5.3.6 Mortality for disabled pensioners

According to the aforementioned study, the assumption for disabled pensioners is:

- for males – with effect from age 67 according to table P3 of the "Pension Circular 2013", increased by 21%, and below this age a mortality rate of 17% in the first year after retirement, and 1.6% thereafter.
- for females – with effect from age 67 according to table P3 of the "Pension Circular 2013", increased by 15%, and below this age a mortality rate of 17% in the first year after retirement, and 1.6% thereafter.

#### 5.3.7 Disability incidence

– based on Table P8 of the "Pension Circular 2013".

#### 5.3.8 Disability recovery

– no recovery is possible as the liability is in respect of permanent disability.

### 5.4 Retirement age, leaving and early retirement

5.4.1 As stated in section 5, these assumptions were determined by the Company.

5.4.2 It is assumed that normal retirement will occur at the mandatory retirement age (67 for men and women). Therefore employees over age 67 are assumed to retire immediately.

#### 5.4.3 Leaving rates (prior to normal retirement age), for generation C:

The assumed rates of leaving upon termination and resignation, by age and sex, are detailed in the table below:

For generation C	Leaving rates (resignations) (not entitled to benefits)	Leaving rates (terminations) (From age 60, with service of 10 years and up, entitled to all benefits detailed in section 2.3.2. Below age 60, entitled to supplementation of severance pay at 2.33% only.)	
		Women	Men
Age	Women and Men		
up to 59	0.16%	0.24%	0.24%
60	–	0.40%	0.40%
61	–	0.40%	0.40%
62	–	0.85%	0.87%
63	–	0.85%	0.87%
64	–	0.85%	0.87%
65	–	1.62%	1.73%
66	–	4.76%	2.56%

#### 5.4.4 Leaving and early retirement rates (prior to normal retirement age), for those insured in the defined benefit pension plan:

It is assumed that there will be no leavers at all, besides for early retirements.

The early retirement rates represent the assumption regarding early retirements that are not defined as "termination benefits" pursuant to IAS 19 since, according to IAS 19, the cost of terminations is not to be recognized in advance except under certain conditions. In practice, this assumption is difficult to make as it is very difficult to distinguish between early retirements that should be defined as termination benefits and others. It is even more difficult to make this assumption because employees' behavior in regard to terminations is highly affected by various past and future special retirement programs.

The early retirement rate assumption was determined by the Company on the basis of past experience, from the years 2002 to 2013, of the rate of early retirements, excluding retirements within a special early retirement program (defined as terminations). This assumption has been updated for the valuation at December 31, 2013 (see section 6 below). The early retirement rate assumption, by age and sex, is detailed in the table below:



<b>Early retirement rates</b>					
<b>Employees in defined benefit pension plan</b>					
<b>Age</b>	<b>Female</b>	<b>Male</b>	<b>Age</b>	<b>Female</b>	<b>Male</b>
Up to 40	0.00%	0.00%	53	0.20%	0.15%
40	0.03%	0.08%	54	0.20%	0.15%
41	0.03%	0.08%	55	0.24%	0.23%
42	0.03%	0.08%	56	0.24%	0.23%
43	0.03%	0.08%	57	0.24%	0.23%
44	0.03%	0.08%	58	0.24%	0.23%
45	0.09%	0.13%	59	0.24%	0.23%
46	0.09%	0.13%	60	0.24%	0.23%
47	0.09%	0.13%	61	0.24%	0.23%
48	0.09%	0.13%	62	1.70%	1.74%
49	0.09%	0.13%	63	1.70%	1.74%
50	0.20%	0.15%	64	1.70%	1.74%
51	0.20%	0.15%	65	3.23%	3.46%
52	0.20%	0.15%	66	9.52%	5.11%

#### 5.4.5 Leaving in respect of non-permanent employees under special agreements:

The assumed rates of leaving with eligibility for benefits included in this valuation, by service, are detailed in the following table:

<b>Service</b>	<b>Leaving rates (terminations) (eligible for benefits)</b>	<b>Leaving rates (terminations) (not eligible for benefits)</b>
0	3.0%	0.0%
1	1.5%	0.0%
2+	0.0%	0.0%

\* For non-permanent employees under special agreements, in addition to these rates, it is assumed that they will leave at the end of the maximum work period based on the special agreements, which is 5 or 10 years from commencement (whether it is 5 or 10 depends on the date of commencement of work), and will receive increased severance pay upon leaving.

#### 5.5 Marriage rates and age difference between spouses

– Marriage rates for males are according to Table P10 of the Pensions Circular 2013-3-1, and for females according to Table P9 of the Pensions Circular 2007-3-6, and from age 68 according to Table P10 of the Pensions Circular 2013-3-1. It is assumed that widow/ers will not remarry, so the payment of a survivor's pension to the widow/er is not assumed to discontinue due to remarriage. The age difference between a man and his spouse is a constant 3.2 years up to age 67, and linearly increases up to an age difference of 8.7 at age 110. The age difference between a female and her spouse is a constant 3 years (the female is younger). This assumption was made by the Company.

#### 5.6 Orphans

The number of children and their ages are determined according to Table P11 of the Circular. These assumptions were made by the Company.

5.7 Utilization of sick leave days (for calculating the unused sick leave benefit)

It is assumed that every employee's proportion of unutilized sick leave days will be identical to the proportion of unutilized sick leave for the working period until the valuation date. This assumption was made by the Company.

5.8 It is assumed that all non-permanent employees under special agreements will receive increased severance pay.

5.9 Future Company expenditure in respect of the operation of the pension plan was not taken into account.

5.10 Below are certain issues that were not taken into consideration in the valuation. We believe the overall effect of these issues is immaterial:

- pensions for "dependent orphans" over age 21 for future orphans;
- possible future pensions for "dependent parents" of deceased employees or pensioners;
- increases in pensions to future orphans in the absence of widow/ers (not taken into account);
- the actual dates on which pension is paid for 13<sup>th</sup> and 14<sup>th</sup> salaries (we assumed that the 12<sup>th</sup> portion of the annual allowance is paid monthly);
- possible grant of discounted electricity and holiday gifts to orphans (we assume that all orphans have a parent receiving these benefits);
- a few pensioners who received a capitalized amount of future pensions for a period of 6 years. The valuation is not based on the decreased pension during the remaining capitalization period but rather on the full pension;
- additional severance pay or grants in respect of the difference between the salary reported in the data file and the minimum salary, to be paid to a small number of generation C employees who retire or leave with salary lower than the minimum salary;
- the supplement to the disability pension with respect to dependants was not taken into account for future disabled pensioners. On the other hand, a reduction to the supplement to the disability pension with respect to dependants was not taken into account for existing disabled pensioners in respect of the future death of the dependants;
- the liability in respect of the additional benefit for life insurance in the event of an accident was not taken into account;
- the increased bereaved parent pension in respect of active employees was not taken into account; and
- the following additional benefits for pensioners / survivors were not taken into account:
  - bonuses on marriage and birth (including tax grossing up);
  - gifts for children of pensioners and survivors serving in the IDF (including grossing up);
  - Company participation in the cost of setting a tombstone and a bouquet of flowers – solely in cases of death as a result of a work accident;
  - compensation in cases of death as a result of a work accident, to the amount of 36 months' salaries;

- meals partially subsidized by the Company at Company facilities – up to 10 meals per month;
- Higher Education grants for children of widows of employees who died while working for the Company;
- an outing for widows of workers who died while working for the Company;
- reduction of cost of connecting electricity to the pensioner's apartment as well as transfer or increase of existing connection; and
- the possible effect in respect of 9 employees / pensioners for whom a note is recorded within the Division of Pension Savings Among Separated Spouses Law.

## 6. **Valuation changes in the current valuation**

For changes made prior to the current valuation, see Appendix E.

In the current quarter, the assumed increase in the future electricity tariff was updated in accordance with the Company's expectations. This change reduced the liability by about NIS 120 million.

In the current quarter, the updated salary increase assumption increased the liability by about NIS 616 million.

In the current quarter, the updated mortality assumption increased the liability by about NIS 160 million.

In the previous quarter, the VAT rate was revised to 17% (from 18%) for the purpose of calculating the cost of electricity. This change reduced the liability by about NIS 20 million.

In the year of this report there were no additional changes to assumptions or to the rules according to which the liability is calculated, except for changes to the discount rate and the changes detailed above.

## 7. Valuation results

The values of the liabilities (in million NIS) as at December 31, 2015, 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	<b>14,592.6</b>
Pensioners and survivors	<b>11,281.9</b>
Total	<b>25,874.5</b>

7.2 Liability for special agreements on early retirement – in respect of the past:

Pensioners and survivors	<b>365.2</b>
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7.3 Liability for 20 year grant:

Active employees	<b>14.6</b>
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7.4 Liability for increased severance payments for (non-permanent) employees under special agreement – in respect of the past:

Active employees	<b>23.5</b>
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**In Appendix A, additional information is provided which is required for the financial statement disclosures according to IAS 19.**

## 8. Uncertainties and risks

8.1 Due to the nature of the benefits and the long term of the valuation, the future payments of benefits are uncertain and may materially differ in practice from this valuation despite the efforts made to assess them as accurately as possible. For this reason, the Company is exposed to a risk that the estimated liability does not properly represent future payments and, consequently, additional costs will be incurred in the future for past accrued rights that are under-estimated and/or additional revenues will be derived from past accrued rights that are over-estimated. Below are the main issues that we believe result in said uncertainties and risks.

### 8.2 Interest, inflation and returns

Future fluctuations in market interest rates used to estimate the liabilities (using discounted expected cash flows) will change the gross value of the liabilities. Higher or lower plan asset returns compared to these interest rates will result in the decrease or increase of the net liabilities, respectively. At times, these two changes are offset one against the other to a certain extent based on the level of matching between the assets and liabilities.

Sensitivity analysis:

- a) If the discount rate falls by 1%, the liability will increase by NIS 4,622 million (17.6%).
- b) If the discount rate falls by 0.1%, the liability will increase by NIS 413 million.
- c) If the discount rate increases by 0.1%, the liability will decrease by NIS 416 million.

Actual inflationary changes affect the value of the liability (indirectly due to the connection between salary / pension and inflation) and the value of the assets (due to index-linked assets) and in this case, the two changes are offset one against the other to a certain extent.

Anticipated inflationary changes affect the value of the liability and the value of the assets based on the anticipated inflationary influence on market interest rates and the value of unlinked assets.

### 8.3 Future salary increases

The assumption of general salary increases (in respect of salary and cost-of-living allowance agreements) considerably affects future cash flows. The assumption is (as described in section 5.2.1.1 above):

In respect of the period from 2013 until 2017: a cumulative increase of NIS 356 per month for each employee, and a further 3.75% nominal.

In respect of the period starting from 2018: an annual salary increase at the rate of the increase in the CPI less 0.5% per year (a 0.5% erosion each year in real terms).

**Sensitivity analysis:**

- a) If the actual change in respect of salary and cost-of-living allowance agreements to the overall salary scale, starting from 2018, is at the rate of the increase to the CPI (instead of the assumed salary increase at a real rate of 0.5% per year), the liability will increase by approximately NIS 545 million (2.1%).
- b) Similarly, if the actual change of salary will be higher than what is assumed (from the valuation date and thereafter), by 0.5% per year, the liability will increase by approximately NIS 668 million. If the actual change of salary will be lower than what is assumed (from the valuation date and thereafter), by 0.5% per year, without a change to the rate of pension increases, the liability will decrease by approximately NIS 626 million.

#### 8.4 Life expectancy

Although the actual mortality rates are relatively stable, and the mortality assumption corresponds with current experience relatively well, the mortality factor contains considerable uncertainty regarding the distant future owing to the increase in life expectancy, whose rate is extremely difficult to assess and may significantly differ from the assumption. The life expectancy increase rate is affected by behavioral and social changes and by medical developments, both past and future, and these factors are liable to affect life expectancy significantly and unexpectedly, in addition to the fact that, even without these new developments, the changes in future life expectancy cannot be clearly foreseen.

Sensitivity analysis: if the annual rates of decline in mortality are double what was assumed<sup>9</sup>, the life expectancy of a 67 year-old male at the end of 2020 (for example) will rise from 20.78 to 22.87 years (for women – from 22.89 to 25.41 years) and the total liability will increase by approximately NIS 1,167 million (4.4%).

For comparison sake: if the actual mortality rates will be 20% lower than assumed, the life expectancy of a 67 year-old male at the end of 2020 (for example) will rise from 20.78 to 22.5 years (for women – from 22.89 to 24.51 years) and the total liability will increase by approximately NIS 1,147 million (4.5%).

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<sup>9</sup> See section 5.3.2 above.

## 8.5 Early retirements

As stated in section 5.4.3 above, the early retirement pattern is relatively unstable and the determination of the assumption is highly challenging both due to the applicable accounting standards and since it is naturally difficult to anticipate employee behavior in an unstable environment. This phenomenon materially affects the payment of benefits and the valuation of the liability since under early retirement the employee will begin receiving the fully accrued pension immediately without any pension reduction that would have offset the added cost of pension payments in the years prior to normal retirement age.

Sensitivity analysis: if the actual early retirement rates are double the assumed rates (see section 5.4.3 above), the total liability will increase by approximately NIS 262 million (1.0%).

Yours truly,

Ernst & Young (Israel) Ltd.

## **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 nominal basis.
- All amounts are in NIS millions.

### **1. Surplus assets at end of the period**

	<b>31.12.2015</b>	<b>31.12.2014</b>
<b>Fair value of plan assets</b>	28,820	27,739
<b>Present value of the obligation - gross</b>	(23,192)	(23,352)
<b>Subtotal</b>	5,628	4,387
<b>Obligation at end of period - pensions</b>	(342)	(77)
<b>Surplus assets</b>	5,286	4,310

### **2. Funds in trust – designated for actuarial obligations (116A assets)**

	<b>31.12.2015</b>	<b>31.12.2014</b>
<b>Funds in trust to cover actuarial obligations (assets per Section 116A)</b>	1,921	1,909

### **3. Liability at the end of the period for other post-employment benefits (including special agreements for early retirement)**

	<b>31.12.2015</b>	<b>31.12.2014</b>
<b>Present value of obligation for other post-employment benefits</b>	2,730	2,928



#### 4. Movement in the present value of the obligation

	Year ending 31.12.2015	Year ending 31.12.2014
<b>Present value of the obligation –beginning of period</b>	23,352	22,900
<b>Interest cost</b>	1,110	1,122
<b>Current service cost</b>	294	299
<b>Benefits paid</b>	(718)	(692)
<b>Losses (gains) on remeasurement:</b>		
<b>Actuarial losses (gains) from demographic assumption changes</b>	160	0
<b>Actuarial losses (gains) from financial assumption changes</b>	(583)	25
<b>Experience adjustments</b>	(423)	(302)
<b>Total actuarial losses (gains) on remeasurement</b>	(846)	(277)
<b>Present value of the obligation – end of period</b>	23,192	23,352

#### 5. Movement in the present value of the obligation for post-employment benefits (including obligation for special agreements for early retirement)

	Year ending 31.12.2015	Year ending 31.12.2014
<b>Present value of the obligation – beginning of period</b>	2,928	2,918
<b>Interest cost</b>	139	146
<b>Current service cost</b>	61	61
<b>Reduction in grants due to their exchange for retirement grants under the special retirement program</b>	(36)	0
<b>Cost of new retirements – early retirement</b>	21	0
<b>Benefits paid</b>	(122)	(95)
<b>Losses (gains) on remeasurement:</b>		
<b>Actuarial losses (gains) from demographic assumption changes</b>	0	0
<b>Actuarial losses (gains) from financial assumption changes</b>	(263)	(111)
<b>Experience adjustments</b>	2	9
<b>Total actuarial losses (gains) on remeasurement</b>	(261)	(102)
<b>Present value of the obligation – end of period</b>	2,730	2,928

## 6. Movement in the fair value of plan assets

	Year ending 31.12.2015	Year ending 31.12.2014
Fair value of plan assets – beginning of period	27,739	25,038
Interest income on plan assets	1,327	1,227
Company contributions – including employee contributions	1,280	600
Benefits paid	(761)	(706)
Gains (losses) on remeasurement:		
Return on plan assets (excluding amounts included in interest income)	(765)	1,580
Fair value of plan assets – end of period	28,820	27,739

## 7. Movement in the fair value of the funds in trust to cover actuarial obligation (116A assets)

	Year ending 31.12.2015	Year ending 31.12.2014
Fair value of trust assets – beginning of period	1,909	1,728
Interest income on trust assets	91	85
Company contributions	0	0
Benefits paid	0	0
Gains (losses) on remeasurement:		
Return on trust assets (excluding amounts included in interest income)	(79)	96
Fair value of trust assets – end of period	1,921	1,909

## 8. Components of the costs for the period of all the post-employment benefits

	Year ending 31.12.2015	Year ending 31.12.2014
Current service cost	355	360
Employee participation	(27)	(28)
Net current service cost	328	332
Interest cost	1,249	1,268
Interest income from plan assets	(1,327)	(1,227)
Interest income from trust assets (116A assets)	(91)	(85)
Total costs for the period	159	288

## 9. Actual return on assets

	Year ending 31.12.2015	Year ending 31.12.2014
Interest income on plan assets	1,327	1,227
Return on plan assets (excluding amounts included in interest income)	(765)	1,580
Actual return on plan assets	562	2,807

## 10. Actual return on assets in trust to cover actuarial obligation (104A assets)

	Year ending 31.12.2015	Year ending 31.12.2014
Interest income on trust assets	91	85
Return on trust assets (excluding amounts included in interest income)	<u>(79)</u>	<u>96</u>
Actual return on trust assets	12	181

## 11. Obligation for special agreements for early retirement (termination benefits)

	31.12.2015	31.12.2014
Obligation at end of period - pensions	342	77
Obligation at end of period – other benefits**	23	5
Obligation at end of period – total	365	82

(\*\*) These obligations are included in Tables 3 & 5 above.

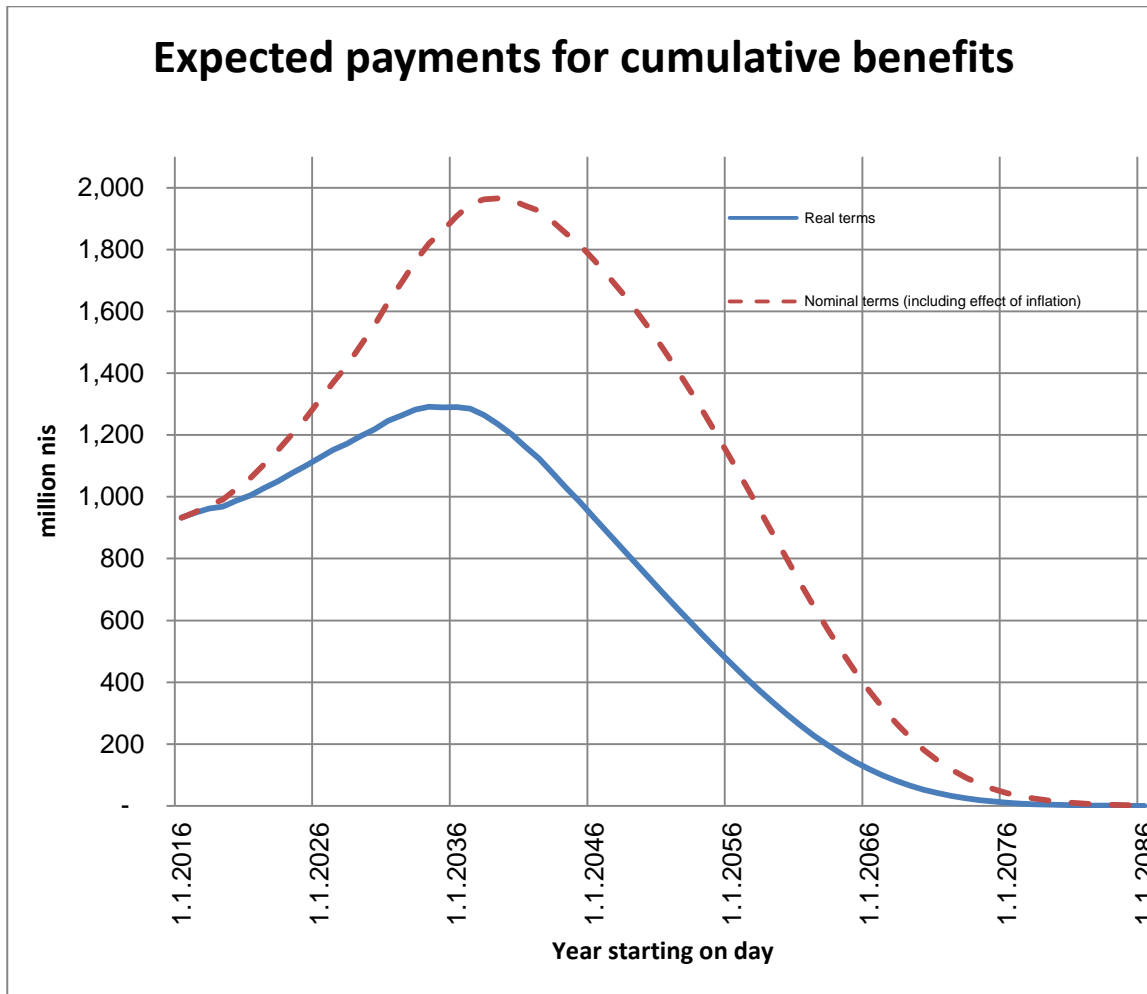
## 12. Obligation for 20 year grant (other long-term employee benefits)

	31.12.2015	31.12.2014
Obligation at end of period	15	16

**Appendix B – forecasted benefit payments**

Below is a graph of the expected cash flows included in the valuation (including all benefits for all employees and pensioners), in real terms and in nominal terms (including the future expected influence of inflation).

The payments are annual.



**Appendix C – additional detail regarding the financial assumptions (annual rates shown)**

	Period ending	
	31.12.2014	31.12.2015
<b>Weighted average <u>real</u> discount rate used to compute liabilities at the end of the period *</b>	2.56%	2.86%
<b>Expected inflation rate</b>	2.15%	1.78%
<b><u>Nominal</u> interest rate used to compute the interest cost on pension liabilities</b>	4.91%	4.77%
<b><u>Nominal</u> interest rate used to compute the interest cost on other post-employment liabilities</b>	4.91%	4.77%
<b><u>Nominal</u> interest rate used to compute the expected return on plan assets</b>	4.91%	4.77%
<b><u>Nominal</u> interest rate used to compute the expected return on trust assets (116A assets)</b>	4.91%	4.77%

\* 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. "ong1215" – 15,349 records – data including all employees / retirees / survivors (permanent workers only).
2. "actuarpizuisug13411215" - 668 records – data including all non-permanent workers (special agreement).
3. "פורשי דצמבר 2015" – 24 records.
4. "change102015", "change112015", "change122015", "change122015g" – files that describe status changes of employees / retirees in the months October to December 2015.
5. "חשמל דצמבר 2015 מעודכן" – data regarding electricity rates, rate of VAT and grossing up of tax.
6. "שי דצמבר 2015 מעודכן" – value of holiday gifts grossed-up for tax.

## **Appendix E – changes to the valuation that took effect in the 3 years prior to the current year**

### **Changes that took effect in the course of 2014**

- In each quarter of 2014, interest rates were updated in accordance with market interest rates at the valuation date. In the valuation at December 31, 2014, there was a transition to discounting based on the returns of high quality corporate bonds. The impact of the transition from a discount rate based on Government bonds to a discount rate based on corporate bonds was a decrease in the liability of about NIS 5,188 million.
- In the fourth quarter of 2014, the salary increase assumption was updated in accordance with our recommendation which is based on actual past experience, the Company's expectations and inflation expectations. The main change is to the assumed salary increase that results from general wage agreements, from -1.38% real (and 1% nominal for 2013 to 2014) to -0.75% real (and 0.8% nominal for the years 2013 to 2016 inclusive), which increased the liability by NIS 1,078 million. Other changes in salary increase assumptions reduced the liability by about NIS 11 million.
- In the fourth quarter of 2014, the assumed increase in the future electricity tariff was updated in accordance with the Company's expectations. This change increased the liability by about NIS 53 million.
- In the fourth quarter of 2014, we received updated information regarding the determining service for entitlement to severance pay for generation C employees. This update reduced the liability by about NIS 8 million.

### Changes that took effect in the course of 2013

- The assumed increase in the electricity rate (which is required for calculating the liability in respect of the discounted electricity benefit) was updated in the valuation at June 30, 2013, according to the Company's expectations. The updated assumption is for the years 2013 to 2015 only. The impact of this update was a decrease in the liability of about NIS 3 million. Another update to the assumption for the years 2014 to 2015 according to the Company's expectations was made in the valuation at December 31, 2013, and its impact is a decrease in the liability of about NIS 10 million.
- During July 2013 a new salary agreement was signed, under which salaries would be increased by 0.9456%. Likewise, for pensioners who retired between July 2012 and June 2013, the pension would be increased by a rate of between 0.1576% and 0.9456%, based on the retirement date. The agreement is in respect of the period July 2012 to December 2012. The increase according to the salary agreement, over and above the assumed increase of 0.5% that was taken into account in the valuation at March 31, 2013, increased the valuation liability at June 30, 2013, by about NIS 52 million.
- In the valuation at June 30, 2013, the amounts of life insurance were updated. This update increased the valuation liability by about NIS 13 million.
- In September 2013 we carried out an experience analysis of the electricity consumption among pensioners, from 2005 to 2012. Based on the analysis, we recommended to the Company to adopt an electricity consumption assumption based on age and pensioner group. The Company accepted our recommendation, and the assumption for the valuation at December 31, 2013 was set accordingly. This change to the electricity consumption assumption reduced the valuation liability by about NIS 81 million.
- During December 2013 we conducted an analysis of marriage rates and age differences between pensioners and their spouses. The Company accepted our recommendation and the assumption for the valuation at December 31, 2013 was set accordingly. The impact of the change in assumption was a decrease in the liability of about NIS 98 million.
- During January 2014 we conducted an update to the analysis of historical early retirements, excluding retirements within a special early retirement program (defined as terminations), based on data from 2002 to 2013, in order to make a recommendation for the early retirement rates assumption. The Company accepted our recommendation and the assumption for the valuation at December 31, 2013 was set accordingly. The impact of the change in assumption was a decrease in the liability of about NIS 78 million.



## Changes that took effect in the course of 2012

In December 2012 we carried out an analysis of the disability incidence experience among active employees, in the years 2004 to 2011, relative to the disability incidence tables of Pension Circular 2012-3-4 (replaced in January 2013 by Pension Circular 2013-3-1, with no change to the tables). On the basis of the study we recommended the Company to adopt the new disability incidence table, P8 of this Circular. The company accepted our recommendation and the assumption in this quarter was set accordingly. The aforementioned change to the disability incidence table reduced the liability by about NIS 142 million.

In the valuation as at December 31, 2012, the liability in respect of life insurance benefits totaling about NIS 88 million was taken into account. This liability was not taken into account in previous valuations. The comparative figures for previous periods in Appendix A have been amended to reflect this benefit.

After giving consideration to the leaving rates assumption in reference to a generation C employee, for the valuation as at September 30, 2012 this assumption was changed: The leaving rates for generation C employees were set to a rate of 0.4% up to age 61 (inclusive), where up to age 59 (inclusive) the proportion of resignations among the leavers is assumed to be 40% and the proportion of terminations is assumed to be 60%, and at ages 60-61 all are assumed to be terminations. The assumed rates of terminations beyond age 61 were set to be 50% of the early retirement rates of generation A and B employees. This change had an immaterial impact on the value of the liability, to the amount of about NIS 1.5 million (decrease in the liability).

In the valuation as at March 31, 2012, the assumption regarding the future annual increase of salary and cost-of-living allowance agreements (the general update of the salary scale) was changed to the actual increase in the CPI index minus 1.38% per year. This rate is determined by the Company on the basis of salary growth for the years 1990-2012. In the previous valuation the assumption was as stated, minus 1.54% (see section 5.2.2.1) – this change increased the liability before the implementation of the CPI index link agreement by about NIS 419 million. The impact of this assumption was partially offset by about NIS 229 million, due to the implementation of the CPI index link agreement, so that the total impact of the assumption change, considering the existence of the agreement, was an increase of about NIS 190 million.

In the valuation as at March 31, 2012, the pension updating mechanism was changed on account of the linked pensions agreement, which came into force in February 2012. According to the agreement, with effect from January 1, 2012, the determining salary components for calculating monthly pensions will be updated in January each year, in accordance with the rate of annual change in consumer price index (the ratio of the index for the most recent month of December to the index for the December previous to that). This change increased the liability by NIS 2,771 million, of which a total of NIS 768 million is unrecognized past service cost.

In the valuation as at June 30, 2012, the following assumptions changed:

- On July 11, 2012 the Ministry of Finance published a draft working paper that includes, among others, a proposal for new mortality assumptions. Although this constitutes a draft proposal, and it is possible for draft proposals to change, the Company decided that it is correct to consider the information and opinions of the Ministry of Finance, which are contained in the draft working paper. In addition, in order to test the suitability of the proposed new assumptions of the Ministry of Finance, a mortality study was carried out for the Company's employees, pensioners and survivors. As a result of this process, we made recommendations to the Company regarding changes to mortality assumptions, the overall effect of which is about a NIS 125 million increase in the liabilities. The changes are:

- a) Adoption of the proposed new assumption of the Ministry of Finance regarding future changes in current mortality rates. This change led to most of the aforementioned effect.
  - b) Adoption of the proposed new mortality tables of the Ministry of Finance, inasmuch as they are adjusted based on the mortality experience of the Company (except for male pensioners where an adjustment was not required). Note that since the previous assumptions were reasonable overall for the Company, these changes (adoption of the new tables with adjustments) did not cause a significant change in the liabilities.
- Just before the valuation as at June 30, 2012, a study was conducted to quantify those changes in employees' salaries which do not stem from general salary agreements or from ongoing and regular increases (such as promotion in grade and service increment). The findings of this study indicate that, on average, there has been an additional salary increase of about 0.2% per year on average. This additional increase is due to employee promotions (the transfer of employees from one role to another, where the employee begins the new role at a higher grade, or another grade scale, in accordance with the definitions of the role). Therefore, the Company decided to assume the average additional salary increase at rates which vary by age group, which are detailed in 5.2.2.3 above, in accordance with the findings of the study. The impact of this assumption change in the valuation is an increase of about NIS 240 million.
  - The assumed increase in the electricity rate (which is required for calculating the liability in respect of the discounted electricity benefit) has been updated to reflect the change in the Electricity Authority's outline of the electricity rate increase in coming years. The essence of the change, in relation to the previous assumption, is the spread over several years of the required rate increase and the addition of "interest" due to the spread, rather than a once-off increase in 2012, as was assumed in the previous valuation. Since this does not constitute a significant change in the expected overall increase (but only to the timing of the increase), this change caused an immaterial increase in the liabilities.

**Description of the Main Rights which Should be Taken into Consideration in Determining the Actuarial Obligation with respect to Benefits After Termination of Employment**

**The Determining Salary Components for Calculating the Pension:**

1. **Normal Salary** - including combined salary, service increment (up to a 40 year maximum), extra effort increment, continuing education payments, job classification increment, personal extra, cost of living allowance.

**Normal Salary Calculation Formula (will be paid to pensioners/survivors according to the pension rate):**

$$\text{Normal salary} = \left[ \begin{matrix} \text{Extra} \\ \text{Effort} \end{matrix} + \begin{matrix} \text{Continuing} \\ \text{Education} \end{matrix} + \begin{matrix} \text{Personal} \\ \text{Extra} \end{matrix} \right] (1.01)^N \times \left[ \begin{matrix} \text{Command} \\ \text{Increment} \\ \text{Percentage} \end{matrix} + 1 \right] \times \left[ \left[ \begin{matrix} \text{Cost of} \\ \text{Living} \\ \text{Allowance} \\ \text{Rate} \end{matrix} + 1 \right] \times \begin{matrix} \text{Salary} \\ \text{Grade} \end{matrix} \right]$$

N – number of years of service for calculating the service increment for payment

**Normal Salary Components:**

- (a) **The Combined Salary** is according to accepted salary tables in the Company.

On July 18, 2013, a new collective agreement (salary agreement) was signed. 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 stated salary agreement exhausts the employees' claims regarding salary increments for the period until December 31, 2012. The agreement also determines a commitment to industrial peace regarding this issue until December 31, 2014. A labor dispute was announced in January 2015, regarding the employees' demand to conduct negotiations with respect to the salary agreement for the years 2013 onward.

The combined salary of Management level members includes global payment for overtime.

Regarding this matter also see the reference by the Supervisor of Wages in his address of October 10, 2013, regarding global overtime for pension of members of the management of the Company, members of the management ranking at Heads of Divisions/Districts and above receive salary having a structure of "comprehensive salary", which is composed of a rank value and a global overtime value, and are not entitled to a separate payment with respect to overtime. The Supervisor of Wages instructs not to include the global overtime in the pension salary of the Company management members who were appointed after 1996. The Supervisor of Wages intends to consider a demand to return payments paid in excess to active and pensioner members of management .

## Appendix F – Details of Benefits

In legal proceedings held in the months of March - September 2014, the Court ruled that at this stage the stated decision by the Supervisor of Wages will not enter into force, and that the parties will later on submit an update to the Court with regard to the recommendations of the Steering Team or the discussions regarding the implementation of the recommendations, and a continued hearing of the application will accordingly be determined.

On December 11, 2014, the Supervisor of Wages sent a letter with respect to his decision regarding the salary irregularities and the retirement terms of the Company. In this letter, the Supervisor of Wages repeats the main points of the previous decision, with only slight changes.

On April 19, 2015, the parties signed a consent concerning the authorization of the Court to arbitrate between them regarding the decision of the Supervisor within an arbitration agreement. The arbitration proceeding was interrupted due to various reasons shortly after it began. In a hearing on July 20, 2015, the Haifa Regional Court of Labor determined that the Supervisor of Wages should announce his position regarding the continuation of the arbitration.

On August 2, 2015, the State notified that it is not willing to return to the arbitration. In light of this notice, the proceedings are continuing in Court.

### (b) Service increment:

1. The annual service increment rate is 1% for each year of service.
2. The Service Increment Calculation Formula:

Service Increment Amount for Payment =  $[(1.01)^N - 1] \times$  (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%.

### (c) 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.

**(d) 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:

<b><u>Service years in the field of occupation/ profession</u></b>	<b><u>Required study hours related to the occupation or the profession</u></b>
Up to one year	800
Up to two years	700
Up to four years	600
Up to six years	500
Up to eight years	400
Up to ten years	300
Up to twelve years	200
Twelve years and up	100

Note: An employee with long tenure in his occupation requires a smaller number of study hours.

3. Employees who fulfill all the terms specified in section 2 and also accumulated 400 study hours according to the tests listed in Section 5 of HR procedure "Continuing Education Payments to Employees in Managerial Grade" (No.04-01-04).
4. Threshold Terms (for section 3):  
Courses/continuing education recognized by the "Committee for Recognizing Courses and Continuing Education of the Ministry of Education and Culture" and listed in the Approved Courses List, that ended within a period of 5 years prior to the request for payment filing date.
5. Rate Update:  
Managerial continuing education payments rate is updated for active employees according to each cost of living increment. Rate update derived from a wages agreement – if specified in the agreement.

**(e) 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.

## Appendix F – Details of Benefits

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.

### (f) 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 Management (salary groups C, D, E): 23.5%
  - Senior Management (salary groups A, B): 26.0%

(\*) Including employees employed by the Company for 20 years at least who were not entitled to any Job Classification Increment.

2. Calculation of Job Classification Increment:  
(Job classification factor rate x salary grade).

Regarding this matter, see also the reference of the Supervisor of Wages in his letter of October 10, 2013, concerning the command increment. According to the letter of the Supervisor of Wages, the command increment should only be paid in accordance with a collective agreement of 1994, that is - at lower rates than those that some of the employees of command ranking are receiving at present. The Supervisor of Wages intends to demand the return of payments that were paid in excess to employees and pensioners. In legal proceedings held in the months of March - September, the Court ruled that the stated decision by the Supervisor of Wages will not enter into force at this stage, and that the parties will later on submit an update to the Court with regard to the recommendations of the Steering Team or the discussions regarding the implementation of the recommendations, and a continued hearing of the application will accordingly be determined.

## Appendix F – Details of Benefits

On December 11, 2014, the Supervisor of Wages sent a letter with respect to his decision regarding the salary irregularities and the retirement terms of the Company. In this letter, the Supervisor of Wages repeats the main points of the previous decision, with only slight changes.

On April 19, 2015, the parties signed a consent concerning the authorization of the Court to arbitrate between them regarding the decision of the Supervisor within an arbitration agreement. The arbitration proceeding was interrupted due to various reasons shortly after it began. In a hearing on July 20, 2015, the Haifa Regional Court of Labor determined that the Supervisor of Wages should announce his position regarding the continuation of the arbitration.

On August 2, 2015, the State notified that it is not willing to return to the arbitration. In light of this notice, the proceedings are continuing in Court.

(g) **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<sup>th</sup> Salary**

1. Employees from their 2<sup>nd</sup> year of employment and pensioners/survivors are entitled to 13<sup>th</sup> salary payment.
2. The 13<sup>th</sup> 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<sup>st</sup> part before Passover and the 2<sup>nd</sup> part before the Jewish New Year (Rosh Hashana).
3. The 13<sup>th</sup> salary is paid to pensioners/survivors according to the pension rate.

3. **20/25 years Salary Payment (14<sup>th</sup> Salary Bonus)**

An addition at the rate of one normal salary, payable once a year, to a woman after 20 years and to a man after 25 years, provided that the employee started working in the Company before January 1, 2004.

The 20/25 year salary is paid to entitled pensioners/survivors according to the pension rate.

Entitlement to payment is according to years of work in the Company, less all unpaid leave periods the employee took after the salary agreement signing date, January 31, 2011, unless and insofar as the employee purchased rights with respect to the unpaid leave period, by paying the Company a payment at the rate of 18.5% of the determining components for calculating the monthly pension (including an increment of 1/12 for convalescence pay).

The aforesaid does not affect an unpaid leave of an employee taken before the signing date of the salary agreement on January 31, 2011, for a period that does not exceed one year and was or will be taken into account by the Company for the purpose of time periods specified in this section.

## 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 1<sup>st</sup> year of work in the Company. At the end of the year the employee will also be entitled to convalescence payments with respect to parts of the year, relative to the number of paid days.
3. The following are Convalescence Days Quotas (to permanent employees, pensioners and survivors):

<u>Number of work years</u>	<u>Number of Convalescence days per year</u>
1. After one year of work (for the 2 <sup>nd</sup> year)	13
2. After two years of work	14
3. After three years of work	16
4. After eight years of work	18
5. After twelve years of work	20

4. Convalescence Day Rate:  
The rate per one convalescence day is updated once a year on June 15, according to the cumulative changes in the CPI from the CPI of May to the CPI in May on the following year.
5. Payment Date:  
An advance on account of convalescence payment is paid in the salary for April and the balance is paid with the salary for July.
6. Convalescence payments are paid to pensioners/survivors according to the pension rate.

### 5. Arava Addition

1. Arava addition is paid to an employee whose permanent work site and base are located in the Negev, south of latitude 30.
2. Arava addition will be included in calculations of pension to eligible employees who received the addition for at least three years before retiring from work, and will be paid to entitled pensioners/survivors according to the pension rate.
3. The Arava addition rate is updated for active employees after each cost of living allowance. Rate update derived from a wages agreement – if specified in the agreement.

### 6. Home Service Payment

1. An addition paid to employees on home service, according to the grading of the Company, included in the calculation of the pension.
2. The criteria for including home service payment in the calculation of the pension are:



## Appendix F – Details of Benefits

- 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%.

**Description of the Rights which should be Taken into Consideration in Determining the Actuarial Obligation with respect to Benefits After Termination of Employment**

**Electricity Rate for Company Employees**

1. Permanent employees and receivers of pension (pensioners/survivors), insured in the budgetary pension arrangement, as defined in the labor constitution and according to the directives of the pension regulations are entitled to the electricity rate for Company employees. The obligation of the Company includes the cost of the benefit, the VAT and the grossed up income tax with respect to them.
2. Generation C employees and pensioners and their survivors are entitled to electricity at the Company electricity rate in each of the following cases:
  - An active generation C employee.
  - Upon retiring from work in the Company due to a disability which is recognized as an entitling event by the pension insurer of the employee, as long as the employee is recognized as a disabled person by the insurer.
  - Upon retirement from work at the Company due to dismissal, at the age of 60 or later, provided that the employee has 10 years of work at least.
  - Upon retirement from work at the Company due to age, provided that the employee has worked for the Company for at least 10 years.
  - Survivors are entitled to pension from the pension insurer of an entitled generation C employee.
3. The aforementioned entitled employee will be entitled to electricity at the rate of Company employees for one residential unit only, at his actual residence, provided that the electricity is intended for domestic consumption and personal use only.
4. In the event that two entitled persons reside together in the same residence, only one of them is entitled to the electricity rate for Company employees.
5. Pensioners/survivors are entitled to electricity at the rate of Company employees without doubling the pension rate.
6. Pension recipients are entitled to electricity on condition that the pension from the Company is their main source of subsistence.

**Holiday Presents**

1. The Company grants holiday presents to its employees, pensioners and their survivors, handed out on two dates: just before Passover and just before the Jewish New Year (Rosh Hashana). The Company liability includes the cost of the benefit and also the grossed up income tax with respect to them. The amount of the gift is linked to the Consumer Price Index.
2. Generation C employees and pensioners and their survivors are entitled to holiday presents in each of the following cases:
  - An active generation C employee.
  - Upon retiring from the Company due to a disability which is recognized as an entitling event by the pension insurer of the employee, as long as the employee is recognized as a disabled person by the insurer.
  - Upon retiring from work at the Company at the age of 60 years or later, provided that the employee has 10 years of work at least.
  - Upon retirement from work at the Company due to age, provided that the employee has worked for the Company for at least 10 years.
  - Survivors are entitled to pension from the pension insurer of an entitled generation C employee.
3. In the event that in one family the pension is paid to survivors in separate payments, only one family member is entitled to holiday presents.
4. Pensioners/survivors are entitled to holiday presents without doubling the pension rate.

## **Life Insurance and Compensation for Successors**

### **1. “Risk” Insurance – CPI-linked Amounts (Benefits and Premiums)**

- 1.1. Insurance applies to: employees upon starting work, pensioners, and spouses.
- 1.2. The benefit – Two thirds of the premium is paid by the Company (the amount is credited to the employee as value for tax purposes).
- 1.3. One third of the premium is paid by the employee.

### **2. “Risk – Additional Layer” Insurance – CPI-linked Amounts (Benefits and Premiums)**

- 2.1 Insurance applies to: Permanent employees, executives, temporary employees under special contract (after two years of work), special veteran agreements (after one year of work) and pensioners up to the age of 70 as well as pensioners aged 72 and over who have a spouse.
- 2.2 The benefit – Two thirds of the premium is paid by the Company (the amount is credited to the employee as value for tax purposes).
- 2.3 One third of the premium is paid by the employee.

From July 1, 2013, the “Risk – Additional Layer” insurance replaced the mutual insurance as well as the grant for pensioners aged over 72 that was paid by the Company.

## **Raise of Salary Grade for Active Employees**

1. An employee in the managerial grades up to grade 15 (inclusive), or an employee in the professional grades up to grade 40 (inclusive), will be promoted by one grade every year. An employee in the managerial grades, from grade 16 and up, or an employee in the professional grades from grade 41 and up, will be promoted by one rank once every two years.
2. Employees employed at managerial grade 27 / 46 professional will not be promoted until their retirement.
3. Senior employees - in principle, promotion in salary grade usually occurs after promotion to a higher position (deputy section manager/section manager/Deputy CEO). Promotion to senior department manager is not automatic and may only be granted after at least 5 years at the previous grade, by recommendation of supervising section manager and Deputy CEO and with CEO approval. With respect to senior department managers, to date, grade C only serves as a retirement grade.

## **Star Grade**

An employee who began working at the Company before January 1, 2004, and has 25 years of service for a male / 20 years of service for a female, are entitled to a payment equivalent to one additional salary grade to their grade, without changing the nominal grade.

Entitlement to payment is determined according to years of work in the Company, less all unpaid leave periods of the employee after entering the salary agreement, on January 31, 2011, unless and insofar as the employee purchased rights with respect to the unpaid leave period by paying the Company payments at the rate of 18.5% of the determining components for calculating the monthly pension (including and increment of 1/12 for convalescence pay).

## Appendix F – Details of Benefits

The aforesaid does not affect an unpaid leave of an employee taken before the signing date of the salary agreement on January 31, 2011, for a period that does not exceed one year and was or will be taken into account by the Company for the purpose of time periods specified in this section.

Pensioners/survivors who fulfilled the aforesaid conditions on the eve of their retirement are entitled to a star grade. A star grade will be paid as before to an employee entitled to budgetary pension who retired/will retire from the Company and who, on the eve of his/her retirement, was/will be entitled to a star grade, according to the aforementioned description.

Employee who is entitled to a grade promotion and to a star grade on the same date, will be concurrently promoted to both grades.

### Additional Grade at Eilat

A permanent employee employed at Eilat under a special tenure agreement and a temporary employee under a special agreement is entitled from starting work in this region to payment equivalent to one additional salary grade, without changing the nominal grade.

The aforementioned employee, who moves out of the Eilat region to another region at the end of seven years of work or more, will carry over the entitlement to payment of the additional salary grade.

### Promotion in Grade upon Retirement

1. Starting from the date of the "Changing the Update Method of Budgetary Pension Law, 2012", an employee entitled to budgetary pension who will retire from the Company (and in the event of the demise of such an employee, his survivor), will be entitled to one salary grade on the retirement date from the Company, regardless of the date on which he was promoted by one salary grade as an employee.
2. If an active employee is entitled on April 1, 20XX, to a salary grade according to the work agreements and is scheduled to retire to pension on this date, he will be entitled on April 1, 20XX to both a salary grade according to the work agreements and to a retirement salary grade.
3. An employee who is entitled to a star grade will receive a retirement grade, as detailed above, as if he had the subsequent grade.
4. The following table details the granting mode of retirement salary grades to retiring employees at present:

Grade before retirement date	Granting retirement grade on the retirement date (after 12 months at least in the former grade)
+43 / 22	44 / 23
44 / 23	+44 / 24
+44 / 24	45 / 25
45 / 25	+45 / 26
+45 / 26	46 / 27
46 / 27	+46 / +27
(f) 46 / (f) 27	+ (f) 46 / + (f) 27
*46 / *27	+*46 / +*27
*(f) 46 / *(f) 27	+ *(f) 46 / + *(f) 27

5. Retirement Grade for Senior Employees  
A Deputy CEO / section manager / deputy section manager (of grades A and B) are not entitled to 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 13<sup>th</sup> salary, home service (to those entitled), 1/12 of the 14<sup>th</sup> 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 as of 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 13<sup>th</sup> salary and 14<sup>th</sup> 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 will be paid once a year, in the month of December, and will 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 13<sup>th</sup> and 14<sup>th</sup> 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. **Apprenticeship period grant**

A monetary sum given to an employee retiring to pension, for the period of his work as an apprentice, with respect to which the employee did not receive compensation. This grant is calculated according to one salary for each work year as an apprentice at the Company. The grant is calculated on the basis of a regular salary plus a 13<sup>th</sup> salary (plus a 14<sup>th</sup> salary if the employee worked at the Company for more than 35 years and is over 60 years old for a male and over 55 for a female).

3. **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.

4. **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.

5. **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.

## Appendix F – Details of Benefits

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. **Unused sick days benefit** (including Generation C employees)

A sum of money paid to an employee upon retirement to pension (including early retirement and disability retirement), or to survivors of a deceased employee, according to the percentage of sick days used to which he was entitled during all his years of employment in the Company and in accordance with the number of unused sick days accumulated to his credit as of the retirement date:

- For an employee whose percentage of used sick days is less than 36%, a grant equal to 26.66% of the unused sick days accumulated to his credit is paid.
- For an employee whose percentage of used sick days is between 36% and 65%, a grant benefit equal to 20% of the unused sick days accumulated to his credit is paid.
- For an employee who used 65% or more of the sick days, a grant is not paid.

It should be noted that until April 1, 1990, the annual quota of sick days benefit was 26 days per year and from this date the annual quota of sick days benefit is 30 days per year.

The salary per sick day for purposes of calculation of the grant is 1/25 of the normal monthly salary (including the 13<sup>th</sup> salary). The salary per sick day after 35 years of service and after age 60 (55 for women) includes the 25/20 years salary. Attributing the balance of sick days accumulated to the credit of the employee at the date of his retirement (at least 55/60) will be performed according to the FIFO method. Namely, first using accumulated sick days up to 35 years and after them those that were accumulated beyond 35 years. Payment of the benefit will first be for the sick days accumulated beyond 35 years (namely, including 20/25 years salary) and after them for sick days that were accumulated up to 35 years (namely, not including 20/25 years salary, only the part of 13<sup>th</sup> 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.

### 7. **Supplement of Company obligation for severance payments to Generation C employees**

For permanent employees who began work after June 10, 1996.

Generation C employees who received tenure by March 2012 - according to the relevant collective agreement, the Company provides a sum each month equal to 6% of employees' monthly insurable salary for the severance pay obligation to these employees who are insured by an external cumulative pension fund. This provision is under the conditions of Section 14 of the Severance Pay Law ("in place of supplement") and therefore, the Company has no obligation to supplement it.

In addition, these employees will receive a severance benefit of 2.33% of their last salary only if they are entitled to severance pay in any case of dismissal or, alternatively, upon retirement due to age.

Generation C employees who received tenure from March 2012 - employer deposits for severance pay at a rate of 8.33% for these employees (with respect to their employment period as temporary employees and until the date of transition to tenure) were deposited in full - in the pension fund (the Company has not withdrawn the completion of severance pay at a rate of 2.33%). It is noted that as of the date of transition to tenure, the Company provides each month 6% of the monthly insurable salary for the severance pay obligations to these employees. Completion of the severance pay at a rate of 2.33% according to their last salary will be paid only if they are entitled to severance pay in any case of dismissal or, alternatively, upon retirement due to age.



An employee who terminates his employment is not entitled to supplementary severance pay.

The supplementary severance payments for generation C employees are as follows: last normal salary (including the 13<sup>th</sup> 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 20/25 year salary, the 20/25 year 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.

**8. 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 3<sup>rd</sup> 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.

As of January 1, 2005, the maximum term of employment for these employees is five years. In February 2015, a collective agreement was signed between the Company and the New National Federation of Labor and the Employees' Organization. This agreement also included, inter alia, reference to the extension of the employment of up to 330 temporary project employees, mostly from the performance division (employees under a special agreement and the portfolio of those entitled to increased severance payment) for a period until the end of February 2016, without them being entitled to tenure. Approximately 160 project employees as mentioned above will end their employment during January 2016. Employees who will be dismissed or will resign during the period of extension of their employment will be entitled to increased severance pay as is customary in the Company (employees returning to work - will only be entitled to the maximum rate of severance pay for the period of extension of their employment. Increased severance payments will also be paid in the event of death (employee survivors), disability and at the end of the employment period according to the agreement.

**Note: Company procedures include extended details of the rights specified in this document.**

## **Rights of Employees Entitled to Pension from the Pension Fund of Company Employees and Rights of Pensioners**

### **1. Retirement Pension**

1.1 Upon retiring from work according to work agreements, the status of the employee will change from an entitled active employee in the fund to the status of an entitled pensioner.

### **1.2 Advance Notice**

An entitled employee due to retire receives at last four months advance notice from the Electric Company about reaching the compulsory retirement age, with a corresponding notice to the managing company.

A female employee due to retire receives at least six months advance notice before reaching the retirement age. A female employee who chooses to retire after the retirement age and before the compulsory retirement age will notify the Company in advance about her intention and will indicate her retirement age, four months in advance at least.

### **1.3 Entitlement to Retirement Pension**

An active entitled employee, who ends his employment with the Electric Company due to one of the following circumstances will become an entitled pensioner and will receive a retirement pension for life:

– **Retirement for Age Reasons** ("Age Retirement"):

An entitled, active male / female employee who worked for at least ten years in the Electric Company and reached the compulsory retirement age will be entitled to receive retirement pension for life.

The 1<sup>st</sup> retirement pension will be paid in the calendar month following the month on which the employee retired from work, for the current month. Retirement from work when retiring on the compulsory retirement age will be at the end of the month on which the employee reached the compulsory retirement age.

- A female employee is entitled to retire on age retirement if she worked in the Company for at least 10 years and chose to retire between the retirement age and the compulsory retirement age. It should be mentioned that, based on the experience of the recent years, there were only a few cases of women retiring voluntarily in the range between retirement age and compulsory retirement age, therefore the subject is immaterial.

– **Retirement due to Employment Termination** ("Termination Retirement"):

An entitled active employee who worked in the Company for ten years at least and is over age 40 and was dismissed from the Company under circumstances detailed in work agreements, will be entitled to receive a retirement pension for life.

– **Early Retirement** ("Early Retirement"):

An entitled active employee who worked for at least 30 years, aged 55 or older (if male) or 50 or older (if female), who wishes to retire from work voluntarily and the Electric Company consented or, where the Electric Company would like the employee to retire and the workers committee consented to this move, will be entitled to receive a retirement pension for life.

– **Special Retirement** ("Special Retirement"):

An entitled employee is entitled to retirement pension under a special retirement framework, if – and to the extent that – it will be established according to a specific agreement, made and approved by the legally authorized authorities, according to the approved principles.

– **Disability Retirement** – see above.

#### 1.4 **Pension Rate**

In age retirement, termination retirement, early retirement or special retirement, the pension rate shall not be less than 25% and not more than 70% of the determining salary of the employee for calculating the pension, and the rate will always be a calculation of the number of work years, determined by the Electric Company, according to the following principles:

- After ten years of work: 25% of the determining salary of the employee.
- For each additional year until 30 years of work: 25% with respect to the first 10 work years and an addition of 2% for each full year of work after the first 10 years (up to a maximum of:  $25\% + 20 \times 2\% = 65\%$ ).

For calculating entitlement for a fraction of a year, the employee will be entitled to an addition of 2% if he/she worked more than half a year and a 1% addition only when working for a shorter period.

- For each additional year over 30 years and up to 35 years of work - 65% with respect to the first 30 years of work and an addition of 1% for each full year or a fraction thereof, of work after the first 30 years (up to a maximum of:  $25\% + 20 \times 2\% + 5 \times 1\% = 70\%$ ).

## 2. **Pension to Survivors of a Pensioner:**

### 2.1 **Eligibility of Pensioner Survivors to Pension**

The widow, orphans and also parents who were dependent on the employee while employed are entitled to receive a pension subject to the following:

- **A widow** - is entitled to pension until she remarries.
- **An orphan** – is entitled to pension until he/she reaches age 18, or until age 21 if and as long as he/she does compulsory service in the army/national service, or without any age limitation if he/she cannot support him/herself due to an illness.
- **A parent** – is entitled to pension if he/she was dependent on the deceased when he/she was alive.

### 2.2 **Pension Rates to Survivors**

- The pensioner's widow will be paid a monthly pension equal to 60% of the pension paid to her deceased husband. In addition, 25% of the pension paid to the deceased pensioner will be paid to all other dependants jointly. Eligibility of a widow will stop when she remarries.

- When a deceased pensioner has no widow, or upon the death of a widow, a monthly pension of 15% of the pension paid to the deceased pensioner will be paid to each of the survivors. In addition, 45% of the pension paid to the deceased pensioner will be paid to all survivors, even if there is only one, provided that the total pension payments to all survivors will not exceed 80% of the deceased's pension.

### 3. **Pension to Survivors of an Active Employee:**

Following the death of an active employee, his survivors will be eligible to a pension, as detailed below:

#### 3.1 **Entitlement of Active Employee Survivors to Pension**

The widow, orphans and also parents who were dependent on the active employee while employed are entitled to receive a pension as detailed below and according to the entitlement and tests thereof, as stated in section 2.1 above.

#### 3.2 **Pension Rate to a Widow**

The widow of an active employee will receive a monthly pension according to the number of the employee's work years in the Company, at the following rates:

- Widow of an employee who worked in the Company – after one or two years of work – 20% of his determining salary.
- Widow of an employee who worked in the Company – after three or four years of work – 25% of his determining salary.
- Widow of an employee who worked in the Company – after five years of work and up – 42% of his determining salary.

#### 3.3 **Pension Rates to all Other Survivors**

- Up to 5 years of work, the other survivors will each receive a pension of 10% of the determining salary, provided that the total pension to the widow and all other survivors jointly shall not exceed 50% of the determining salary of the employee just before his death.
- Starting from the fifth year of work onwards, the other survivors will each receive a pension of 15% of the determining salary, provided that the total pension to the widow and all other survivors jointly shall not exceed 70% of the determining salary of the employee just before his death.

#### 3.4 **Survivors Pension in the Absence of a Widow or after her Death**

- Up to 5 years of work, each of the survivors will be entitled to a pension of 10% of the determining salary of the employee just before his death, with the addition:
  - Of 10% to all survivors, even when there is only one survivor, if the deceased worked for up to two years.
  - 15% to all survivors, even when there is only one survivor, if the deceased worked for 3 to 4 years.
  - The aforesaid is subject to the principle that payments to survivors of an employee according to this section will not exceed 50% of the determining salary of the employee just before his death.

## Appendix F – Details of Benefits

- Starting from the fifth year of work onwards, each of the survivors will be entitled to a pension of 15% of the determining salary of the employee just before his death, with an addition of 25% to all the survivors, even if there is only one survivor, provided that the total payments to the employee's survivors according to this section shall not exceed 70% of the determining salary of the employee just before his death.

### 4. **Survivors Pension to a Common-Law Wife of a Deceased Pensioner/ Employee:**

In the absence of a widow, a common-law wife (as defined in Section 4.9 of HR Procedure No. 04-12-11 "Pension to Survivors") will be eligible to a pension as if she is a widow, subject to the following conditions:

- 4.1 A common-law wife who is entitled to a widow's pension from any other source on the date of death of the employee/pensioner, will be entitled to a pension from the Company only if the pension to which she is entitled from the Electric Company is higher than the pension to which she is entitled from another source. In this case, the common-law wife is entitled to a pension from the Electric Company according to the difference between the pension to which she is entitled from the Electric Company and the pension she receives as a widow from another source.
- 4.2 A common-law wife, whose pension from another source as a widow is higher than the pension she would have been eligible to from the Electric Company if she would not have received a pension from another source, is not entitled to a pension from the Electric Company and/or any other entitlement due to a pensioner of the Electric Company (electricity rate for Company employees, gifts).

### 5. **Disability Pension:**

#### 5.1 **Determining the Eligibility to Disability Pension**

The disability of an active employee will be determined as follows:

The employee will be examined by a medical board. If the medical board decides on permanent disability, an interdisciplinary team will be appointed, headed by the Human Resources Manager, the welfare officer and a representative of the workers committee. Based on the recommendations of the medical board, the interdisciplinary team will determine if the permanent disability of the employee prevents him from fulfilling any other position in the Company. In the event that the interdisciplinary team decides that the employee cannot fulfill any other function in the Company and upon approval of the Senior Vice President - Human Resources, the employee will retire to disability pension.

#### 5.2 **Pension Rate**

An employee entitled to a disability pension will receive a pension, at the rate calculated according to the number of work years as determined by the Electric Company, according to the following principles:

- After one work year and up to the end of two work years - 20% of the determining salary.
- Starting from the 3<sup>rd</sup> year and up to the end of four work years – 25% of the determining salary.
- Starting from the 5<sup>th</sup> year and up to the end of the 5<sup>th</sup> year – 30% of the determining salary.
- Starting from the 6<sup>th</sup> year and up to the end of 25 work years – a 2% addition for each work year after the 5<sup>th</sup> year and up to the 25<sup>th</sup> year (up to a maximum of:  $30\% + 20 \times 2\% = 70\%$ ).

There is no incremental disability pension with respect to work years exceeding 25 years.

5.3 **Supplements to the Disability Pension with respect to Dependants**

- 5.3.1 **A dependant for the purpose of this section:**
- Wife/ husband.
  - Child, including a step child or an adopted child until age 18, or without age limit if the child is unable to support himself due to an illness.
  - Parents of the disabled employee, if they are dependent on the disabled employee.
- 5.3.2 After 1 year to the end of 5 years of work – the pension is increased by 10% of the determining salary for each dependant of the disabled person as long as the total payments to the disabled person do not exceed 50% of his final determining salary. After 6 years of work – the pension is increased by 10% of the determining salary for each dependant of the disabled person as long as the total payments to the disabled person do not exceed 70% of his final determining salary.
- 5.3.3 The additional entitlement to disability pension with respect to dependants will be paid for each dependant at any time and as long as the definition of a dependant applies to the dependant, as detailed above.
- 5.3.4 A divorced employee who retired due to disability is entitled to a percentage of increment with respect to children until age 18, even if these children are not in the employee's care.
- 5.3.5 Marriage of an employee who retires due to disability, or birth of children to such a pensioner, after the retirement date, **does 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.

## **Appendix F – Details of Benefits**

- Absence for a period of up to one year due to continued studies or appointment to a mission on behalf of institutions, upon written approval of the Company. Cases of absence from work for a period exceeding one year will be submitted to a discussion between the Company's management and the workers committee.

### **6.4 Complete Entitlement of an Orphan to Pension**

An orphan's right to receive pension according to these rules is complete and does not depend on the economic condition, employment or marital status of the surviving parent.

### **6.5 Responsibility of the Surviving Parent to a Pension for the Orphan**

The widow or widower will be responsible for drawing the pension due to orphans, for their support. If proven that pension funds paid for the orphans are not used for the intended purpose, the Company and/or the Fund and/or the Managing Company have the right to pay the pension to the said orphans in another appropriate way.

### **6.6 Pension Payment to Parents**

Pensions to parents will be paid to them directly, together or separately, according to their wishes.

### **6.7 Payment of One Time Only Amounts and Pension Capitalization**

The fund is not permitted to pay to an eligible employee or his survivors one time only amounts, including capitalization of his/her pension, except capitalization permitted by work agreements, as valid on the joining date, or according to any law, subject to the directives of the Central Provident Fund for Pension Statutes and the income tax regulations. When all the above are fulfilled, an employee who retires to pension or a pensioner up to two years from his retirement date, are entitled to capitalize up to 25% of the respective pension. The capitalization is for six years. A reduced pension, based on the proportion capitalized, is paid for six years to the pensioner. Following the death of a pensioner, his survivors are entitled to a pension, according to pension regulations, as if there was no capitalization.

### **6.8 Prevention of Double Pensions**

The person who is eligible to two pensions of the same type according to these rules has the option to choose only one of them. In this case, each of the following will be regarded as separate types: retirement pension, survivors pension, disability pension.

### **6.9 Minimum Pension**

An employee who retires due to age or disability, whose pension rate is less than 40%, may have the pension increased to 40%, provided that the two following conditions are fulfilled:

- The pension paid according to these rules is the only income of the pensioner, for as long as it is the sole source of income. An allowance from the National Insurance Institute will not be considered as additional income in this case.
- The pensioner was accepted as an employee of the Company before reaching age 55.

### **6.10 Rights of Company Employees who are Members of Bereaved Families**

6.10.1 The law requires an employer to employ a widow/widower or a parent of a person who was killed in certain circumstances (soldier/policeman/jailor that were killed, and a victim of hostilities that passed away as a result of the injury), including a step parent and an adopting parent (subject to the Families of Soldiers Killed in Action Law – 1950), who is qualified to work, for the period as follows:

## Appendix F – Details of Benefits

Until they turn 72 years old for men and 67 years old for women, following Amendment 35 to the “Families of Soldiers Killed in Action (Compensation and Rehabilitation)” Law. In effect from January 1, 2014.

- 6.10.2 The pension of a bereaved parent (a parent of a soldier who was killed) who retires as a pensioner will be increased by 50% provided that it does not exceed full doubling of the pension with respect to the actual service period of the bereaved parent in the Company.

Notwithstanding the above mentioned, if a bereaved person deserves to receive a pension of 45% and more before increase of the pension rate, his pension will be increased by 6% only, up to a maximum of 70% pension.

### 7. **Pension to Survivors Shortly after the Death of an Employee/Pensioner**

- 7.1 In the case of the death of an employee/pensioner, survivors will receive, respectively, full determining salary (100%) for the 3 months after the death, or the full pension paid to the deceased pensioner before his death. Pension payments to survivors according to pension regulations will begin from the fourth month after the death of the employee/pensioner.
- 7.2 Survivors of an employee whose death was caused by a work accident will receive the determining salary for pension (100%) paid to the employee for the 1<sup>st</sup> 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.

10. The Division of Pension Savings Among Separated Spouses Law - 2014 entered into effect on February 6, 2015. The Company is implementing the Law word for word.

### 11. **Transfer of members of management employed within a collective employment to employment by personal contracts.**

The Board of Directors of the Company decided to transfer the members of management employed within a collective employment to employment by personal contracts.

At this stage, only the Senior Vice President of Human Resources and Organization has transferred to employment by personal contract. As of yet, final conditions have not been agreed upon for future contracts between the Company and the Government Companies Authority, and the Commissioner of Wages and Labor Agreements of the Ministry of Finance and the Company are not able to predict them.

12. Senior managers employed by personal contracts of the Government Companies Authority are entitled, with approval by the Board of Directors, to additional compensation payment at a rate of up to 100% on the date of termination of their duty in the Company.  
At present, 9 managers as mentioned above are employed at the Company (including the Chairman of the Board of Directors).



## **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 13<sup>th</sup> salary. This grant is not calculated for the years for which the retiring employee is entitled to receive excess years grant.

The grant rate (50%) will be offset at the rate of 1.111% for each month of work over age 62 and up to age 65, consequently, the grant rate starting from age 65 after the offset is 10% (similar to the grant for up to 35 years of work).

It is noted, that when a female employee chooses to continue working in the Company after retirement age and retires from the Company due to severance, she will be entitled to a grant at the rate of 50% of the salary, according and subject to the aforementioned, as applied to any other employee.

### **Severance payments for employment termination without pension**

Upon termination without pension entitlement, an employee is eligible to a severance payment of one monthly salary for each year of employment. Upon resigning after a prolonged employment period, the aforesaid severance payment is paid if the authorized authorities approve it. The severance pay is calculated on the basis of the normal salary with the addition of the 13th salary.

### **Additional rights and benefits for Pensioners**

In addition to the aforesaid, the pensioners of the Company are entitled to the following rights and benefits:

- Bonuses for marriage and birth (includes the grossing up of tax).
- Gifts for children of pensioners and successors serving in the IDF (including tax grossing up).
- Company participation in cost of setting a tombstone – solely in cases of death as a result of a work accident.
- Compensation in cases of death as a result of a work accident.
- Partial participation of the Company in meals at Company facilities – up to 10 meals per month.
- Higher Education grants for children of widows of employees who died while working for the Company.
- An outing for widows of workers who died while working for the Company.
- Reduction of cost of connecting electricity to the apartment as well as transfer or increase of existing connection.

These benefits are not material and therefore no actuarial liability is calculated in respect thereof.



# The Israel Electric Corporation Ltd.

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*Asset impairment test as of December 31, 2015 in accordance with IAS 36*

*March 2016*



# Disclaimer

- As requested by the Company's management, this report has been prepared for the Israel Electric Corporation Ltd. ("**IEC**" and/or "**the Company**") for the purpose of asset impairment test in accordance with IAS 36, as of December 31, 2015.
- This report has been prepared by Ascola Economic and Financial Advisory Ltd, through Wise (CG) Ltd. ("**Wise**"), and is intended solely for the Company use. It is not to be used in any other way, including distribution, copying or transferring by any other means, without receipt of our authorization in advance and in writing, except for the report's publication in the Company's financial statements as of December 31, 2015.
- For the preparation of this report, we have relied on information and/or explanations and/or forecasts and/or exhibits the Company and/or anyone on its behalf have provided us with. Giza Singer Even assumes that this information is credible and does not perform an independent examination of the information. Also, nothing which may point to the data being unreasonable has come to our attention. The data has not been examined in an independent manner, and therefore the report presented to you does not constitute a verification of these data's correctness, completeness and accuracy. An economic evaluation should reflect in a reasonable and fair manner a given state of being at a given time, based on known data, while considering the basic assumptions and estimated forecasts.
- This report does not constitute a due diligence review and is not to replace such. Furthermore, this report is not intended to determine the Company's value for a specific investor, and there is nothing within this report to constitute any legal advice or opinion.
- This report does not include any accounting auditing regarding the compliance with the accounting rules. Wise is not liable for the manner of the Company's accounting presentation of the financial reports in all that regards the accuracy and completeness of the data and the implications of that accounting presentation, as far as such exist.
- This report includes a description of the methodological principles and analysis principles. The description refers to the main substantial practices which we have implemented, and does not constitute a complete and detailed description of the Company and its environment.
- If the case may be that the data Wise has relied upon is not complete nor accurate or credible, the results of this report might change. We reserve the right to return and update this report in light of new data which might have not been brought before us. For the avoidance of any doubt, this report is valid only for the time it has been signed.
- This report includes Forward-Looking Information as defined in the Securities Law, 1968, received, inter alia, from the Company. In this opinion, we referred, inter alia, to evaluations, projections and assessments provided by Company management. Realization of this information is not certain. The information is based in part on knowledge existing in the Company as of the date of the report, as well as on various assumptions and expectations pertaining both to the Company and to various outside elements, including the state of the market in which the Company is active, potential competition and the state of the economy as a whole. We emphasize that there is no certainty that these conjectures and expectations will be realized, in whole or in part.
- We hereby confirm that we are not dependent on the report or on the Company, with the exception of the fact that we are receiving a fee for this report. Likewise, we hereby confirm that our fee is not dependent on the results of the report.
- We confirm that we have no personal interest in the company.



# Sources of Information

- Wise Consulting group provides advisory services for the Company regarding its financial instruments and hedge accounting implementation.
- We hereby confirm that we have no personal interest in the Company or its controlling interest.

## Main sources of information

- Audited annual financial statements of IEC for the fiscal years 2013 -2015
- The Company's budget for the year 2016
- Various other data received by the company as per our request
- Background material and market data , from public information published on web sites ,articles in the press or other public sources
- Publications of the Bank of Israel and the Central Bureau of Statistics
- Publications of the Public Utilities Authority, and specifically the charge rate basis book
- Capital IQ database and Bloomberg information system
- Meetings, correspondences, and phone calls with various Company officials



# Details of the Valuating Company

Ascola Economic and Financial Advisory Ltd through a related company - Wise (CG) specializes in providing economic, strategic and financial advisory services.

Wise offers unique combination of academic theory and practical experience. Wise offers economic and financial valuations, expert opinion letters, debt and capital market analysis, regulation advisory and game theory applications including tender design and strategic consultancy.

Wise (CG) is a team of leading economic and financial professionals providing clients with a wide range of business and financial services for any product, business, or market. Our team of experts accompanied the biggest economic processes in Israel.

This Report has been prepared by a team headed by Yoel Sequerra, CPA. Mr. Sequerra holds BA in Accounting and Economics and MA in accounting and has 12 years experience in the field of financial accounting advisory.

Sincerely yours,

Wise (CG) Ltd.

March, 2016



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# Executive Summary

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# Executive Summary

## Valuation summary

### Scope of services

- We were requested by the Company’s management to perform an asset impairment test in accordance with IAS 36 for Israel Electric Corporation , as of December 31, 2015.
- We estimated the value in use of the Company’s generation, transmission and distribution segments. which, according to management clarifications, together constitute one cash generating unit.

### Notable events that can affect the valuation

- TOP - The company has signed a Take or Pay agreement (TOP) with Tamar gas reservoir, whereby it undertakes to purchase certain gas quantities in the future. According to calculations prepared by the Company's management, the TOP agreement is not expected to have an impact on the recoverable amount.
- Emission reduction facilities costs- the company has invested substantial funds in constructing emission reduction facilities for the coal based power plants. According to company's management assumptions, all the costs invested in those facilities will be recovered.

- RUL of coal based power plants and emission reduction facilities – According to a decision submitted on December 8, 2015 by the Electricity Authority, in connection with the remaining useful life (RUL) of emission reduction facilities and coal based power plants (Orot Rabin 5-6, Rotenberg 1-4), the RUL was estimated to be 25 years from the date of operation of the emission reduction facilities. On March 10, 2016 the Electricity Authority set a date for a late hearing regarding the above decision. This guidance is not final, therefore for the purposes of determining the recoverable amount we didn’t consider it in determining the value in use.

### Valuation Results

**We compared the recoverable amount to the carrying amount of the assets in accordance with IFRS, and concluded that the recoverable amount is greater than the carrying amount:**

	<i>NIS Million</i>
Recoverable Amount	68,545
Carrying amount	67,554
<b>Surplus (deficit) in recoverable amount over carrying amount</b>	<b>991</b>





# Executive Summary

## Sensitivity analysis

The following are the key assumptions we applied in the valuation and the results which would have occurred had we applied different assumptions (assuming maximum influence in each case):

<i>NIS Million</i>	<i>Maximum change in recoverable amount</i>	<i>Surplus (deficit) of recoverable amount over carrying amount</i>
Implementation of a new charge rate basis for the transmission and distribution segments according to the internal PUA document (Navigant's report)*	(2,368)	(1,377)
Recognition of only 80% of investment costs in environmental projects	(1,391)	(400)
Non-recognition of full pension costs for the "new" units in the generation segment	(83)	908
Non-recognition of fixed assets liquidation costs	(319)	672
Non-recognition of irregular construction costs	(70)	921

	<i>Weighted Average Cost of Capital</i>				
	<b>4.70%</b>	<b>4.10%</b>	<b>3.60%</b>	<b>3.10%</b>	<b>2.60%</b>
Surplus in recoverable amount over carrying amount	657	838	991	1,145	1,301
Change in recoverable amount	(334)	(153)	0	154	310

	<i>Leverage Ratio</i>				
	<b>85.00%</b>	<b>80.00%</b>	<b>75.00%</b>	<b>70.00%</b>	<b>65.00%</b>
Surplus in recoverable amount over carrying amount	960	991	991	1,022	1,022
Change in recoverable amount	(31)	0	0	31	31

	<i>Market Premium</i>				
	<b>6.85%</b>	<b>6.60%</b>	<b>6.35%</b>	<b>6.10%</b>	<b>5.85%</b>
Surplus in recoverable amount over carrying amount	960	991	991	1,022	1,052
Change in recoverable amount	(31)	0	0	31	62



# Chapter A – Description of the Company

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# Description of the Company

## Description of the company

### General description

- The Israel Electric Corporation Ltd. was incorporated in Israel on March 29, 1923, and is engaged in the generation, transmission, distribution, sale and supply of electricity to consumers in Israel.
- The validity of the Concessions was set for a period ended on March 3, 1996, and from that time on, the provisions of the Electricity Sector Law - 1996, which replaced the Electricity Concessions Order.
- The Company generates, transmits, distributes and supplies most of the electricity consumed in the Israeli national economy pursuant to the licenses that have been granted to it for each such type of operation, in accordance with the Electricity Sector Law, which have been extended over the years. The Company also operates as an electricity system administrator.
- The licenses of the Company have been extended by the Ministers, from time to time over the years. On November 30, 2015 the law of the economic plan (Amendments for the Implementation, Economic Policy Budget in 2015 and 2016 ) was officially published, which amended, inter alia , the Electricity Sector Law and extended the validity of licenses until January 1, 2017.
- As of January 1, 2016 the Electricity Authority is subject to the Minister and Ministry of National Infrastructures, Energy and Water resources.
- The Company is an “essential service supplier license” holder and is also engaged in the construction and setup of the infrastructure that is required for its other operations.
- As of the date of the valuation, the State of Israel holds approximately 99.8% of the issued, paid-up share capital of the Company, and therefore, the Company is a “government company”, and is also subject to the provisions of that law.

The balance of the issued and paid up capital of the Company is held by approximately 120 individuals and corporations.

### Description of fields of activity

- The Company operates as a single combined, coordinated system that engages, as set forth, in the supply of electricity to consumers, from the stage of generation of the electricity to its transmission, distribution, supply and trade. In addition, the Company engages in the establishment of infrastructures that are required for the operations that have been set forth above and operates as the administrator of the electricity system.
- As of the time of the valuation, the Company has three primary fields of activity:
  - **Generation of electricity** – the operations of the Company in this field include all of the operations that are involved in the generation of electricity at the generation sites of the Company.
  - **Transmission and transformation of electricity** – the operations of the Company in this field include the transmission of electricity from the generation sites using high and extra high voltage lines to the switching stations and major substations, and between the switching stations and major substations to the substations.
  - **Electricity distribution** – the operations of the Company in this field include the transfer of electricity from substations to consumers via high voltage lines and low voltage lines and the supply and sale of electricity to consumers.
- It should be noted that the sectors of activity in accordance with the Electricity Sector Law include also system administration, supply and trading of electricity. As of the valuation date, the system management activities are included in both production and transmission sector, and the delivery and trade operations is included in the distribution sector.



# The Generation Segment

## Description of the generation segment

### The generation segment

- The electricity generating system is based on five steam driven power stations, which are powered by steam force that turns the blades of turbines, and which are spread along the country's shores, located in Haifa, Hadera ("Orot Rabin"), Tel Aviv ("Reading"), Ashdod ("Eshkol") and Ashkelon ("Rothenberg"). The steam driven power stations are powered by coal or natural gas, or fuel. In addition to the steam driven power stations, another generation array of gas turbines operates, which are powered by diesel or natural gas.
- As of December 31, 2015, the Company possesses and operates 17 sites of power stations (of which five are steam driven power stations sites) with total installed generation capacity of about 13,617 MW.
- As of December 31, 2015, the Company generates approximately 79% of the electricity in the State of Israel (84% as of December 31, 2014), while the remaining is generated by private electricity producers and small photo voltaic installations, from which the Company purchases electricity at low rates (about 21% and 16% of the electricity the Company supplied in 2015 and 2014, respectively).

### Steam generation units

- The steam generation units of the Company, which generate electricity using gas turbines, are powered, in accordance with what has been stated above, using coal as their primary fuel, or fuel oil or natural gas. Some of the generation units are "dual fuel". As of the time of the valuation, their total installed generation capacity is approximately 6,462 megawatts.
- Dual-fuel power plants require large investment and long construction period, but when they are running on coal, the cost of kWh produced by them is low.
- Following the energy crisis in the 70's, it was decided to diversify fuel use by establishing dual-power plants. After initial supply of gas from "Tamar", part of oil production was converted to run on natural gas.

- As part of the company's development and in accordance with the order of the Ministry of the Transverse Environment, the Company must act to reduce emissions. Within this framework, the Environmental Protection Agency approved in July 2011 a plan to reduce emissions, in which purification facilities will be installed gradually until the end of 2016.

### Gas turbines

- Gas turbines are divided into jet turbines and industrial turbines. As of December 31, 2015, the Company has 16 jet gas turbines and 15 industrial gas turbines, with a combined installed generation capacity of 504 megawatts and 1,570 megawatts, respectively.
- Construction of gas turbines requires fairly low investment and short construction duration, but production of electricity using jet gas turbines is more expensive than using steam units or industrial gas turbines. Since the company can stop operations of the gas turbines in a relatively short time than steam generation units, the company mostly operates the gas turbines particularly during peak demand.

### 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.
- As of December 31, 2015, the Company had 14 combined cycle units, all of which are natural gas and diesel powered and whose (combined) generation capacity is 5,081 megawatts.



# Changes in the Field of Electricity Generation

## Changes in the field of electricity generation

### Market entry of private electricity producers

- Since the enactment of the Electricity Sector Law, it has been the policy of the Government of Israel to encourage competition in the Electricity Sector while increasing the electricity generation capacity by private electricity producers.
- According to the Electricity Sector Law and its regulations, PEP holder can sell electricity to an essential service provider's license, or vendor, under the terms of its license. In addition, PEP can obtain a license to sell electricity directly to end users.
- Accordingly, the objective determined by the Government of Israel for increasing the generation capacity of private electricity producers is 20% of the installed generation capacity in the State of Israel by 2020 (excluding renewable energy). As of the valuation date, the total installed generation capacity of private electricity producers stands at approximately 22% including renewable energy (excluding – 17.5%). In 2016, it is expected to stand at approximately 25% (excluding renewable energy – 18.9%), in accordance with the company forecasts, that the likelihood of the establishment and operation of production units of renewable energies as part of the electricity production in the coming years is high.

### Encouragement of renewable energy

- In addition to this objective, in later resolutions a guiding objective for generation of electricity from renewable energy was set at 10% of the electric energy needs of the State for 2020.

### Repercussions for the Company

- The Company assesses that in the upcoming years a significant increase can be expected in the installed generation volume of the private electricity producers. Such an increase may have a number of repercussions, including the following:
  - The Company estimates that part of the electricity consumption currently supplied by it and the increase in electricity consumption at the national scale will be supplied in the future by the private electricity producers. As a result of this, there will be a reduction in the actual generation of electricity by the Company, and accordingly a decrease in the generation segment revenues and thus to a potential loss of strategic consumers.
  - Notwithstanding, following the decrease in the volume of generation, a decrease mainly in the fuels expenses and marginally in the operation expenses that are variable is expected (since most operating expenses are fixed).
  - As the Public Utilities Authority (“**PUA**”) encourages the entry of private electricity producers into the Electricity Sector, a safety net and preferential conditions have been extended to the private electricity producers, covering, inter alia, the use of the transmission and distribution system of the Company and a commitment of the Company to serve as a backup source in the case of failure of private electricity producers to supply electricity to consumers. Because of these preferential conditions, there is no certainty that the Company will be able to compete with the private electricity producers. Notwithstanding the above, the Company assesses that the entry of private electricity producers into the Electricity Sector in Israel will not change the monopolistic status of the Company in the field of generation in the Electricity Sector in the coming years either.



# Changes in the Field of Electricity Generation

## Changes in the field of electricity generation

### Take or Pay agreement

- Since 2013, the Company purchase under a Purchase Agreement signed with "Tamar" gas partnership. An essential component of the purchase agreement is the clause - "Take Or Pay" (TOP), which defines the minimum amount of gas the Company undertook to purchase.
- With regard to gas consumption forecasts, including the entry of private producers, the significant decline in coal prices and the significant slowdown in demand for electricity, the company examined whether it could be exposed to excess gas procurement.
- On January 1, 2016, the Company received instruction from the Minister of National Infrastructure, Energy and Water Resources (signed by the Minister on December 31, 2015), in which, According to Article 10 (c) of the coal-fired generating units permits, concerning "Orot Rabin" and "Rotenberg", in favor of reducing polluting emissions and maintaining energy operation security of coal units .
- The Minister's instruction states that the coal-fired generating units will be operated in such manner that power production at these units will be reduced by 15% on an annualized basis relative to the volume of electricity production units in 2015. The reduction will be divided among power stations "Orot Rabin" and "Rotenberg" in the range between 50:50 to 40:60
- Company's management examined the impact of the TOP agreement taking into consideration the Minister's instruction of Energy and concluded that there are no unexpected time discrepancies between the future purchase dates and future gas consumption dates. Therefore, and in accordance with economic calculation made by the Company's management, it is not expected to record a significant gain or loss from the implementation of the TOP agreement.



# The Transmission and Distribution Segments

## Description of the transmission and distribution segments

### The transmission segment

- Within the framework of this field of activity, the majority of electricity that is generated, as described by the Company, and partly by private electricity producers, is transferred by the Company via its transmission grid. The transmission grid is deployed throughout the State of Israel and the territories that have been subject to its rule since June 1967 (East Jerusalem, the West Bank and Gaza).
- The transmission grid consists of extra high voltage lines (400 kV) and a high voltage grid (161 kV), through which electrical energy is transmitted from the generation units to the switching stations (stations of 400 kV voltage) and to the major substations (stations of 161 kV voltage) and from the switching stations and the major substations to substations that are built nationwide.
- At the switching stations and substations of the Company, transformation activity is performed, changing the electricity voltage levels from extra high or high voltage (through connection transformers) and from high to medium (through the output transformers at the substations). The electricity transmission at extra high voltage facilitates the transfer of energy between the power stations generating the energy and the switching stations and substations of the transmission segment, at low energy losses.
- Operation, maintenance and handling malfunctions should also be included in the execution of activity of the segment of electric energy transmission.

- The Company has three types of substations: permanent, temporary, and mobile. Mobile substations are built on land that is not usually zoned for the construction of a permanent substation, until the construction of a permanent substation in the area.
- In addition, there are private substations divided into 2 types:
  - New substations owned by a consumer or producer of high voltage. The operational and maintenance responsibility of the high voltage and extra high voltage lies with the Electric Company.
  - Old substations that are owned by a consumer of high voltage.

### The distribution segment

- The distribution segment of the Company conveys electric energy from the substations, at which the voltage level drops to the level of the distribution voltage, for consumption purposes. The distribution system consists of distribution lines of 33 kilovolt, 22 kilovolt and 6.3 to 12.6 kilovolt tension levels (all of these are high voltage lines), low voltage lines and a distribution transformer that interconnects them.
- The Company delivers to most consumers electricity at low voltage, and to major consumers (that is, consumers that consume a large amount of electricity) electricity at medium voltage.
- The distribution segment has five districts, which cover the entire country, through which most of the work and service relations between the Company and its companies are held, whose number as of the date of this report is approximately 2.62 million.



# The Electricity Charge Rate

## The electricity charge rate

### The manner of determining the charge rate

- The revenues of the Company are based on the electricity charge rate that the Company charges consumers. In accordance with the Electricity Sector Law, the electricity charge rates and their manners of update are determined by the PUA, **under the main principle that the electricity charge rate should cover all of the costs sustained by the Company due to the operation of its assets that are required for fulfilling the duties of the Company as an essential service supplier. These costs consist mainly of the costs of fuels, costs of operation and maintenance, and costs of capital (depreciation, financing and return on capital).**
- Every few years, the PUA is supposed to establish a **charge rate basis** for a certain test period. The charge rate basis has a number of components, some applying to all activity segments and some relevant to only a certain segment. The electricity charge rates for the various consumers are set in accordance with the type of consumption and the supply voltage.
- In accordance with the Electricity Sector Law, the electricity charge rates are to be updated according to an update formula that the PUA will determine. Since the charge rate for consumers is not updated following each theoretical update, a gap forms between the revenues for the actual charge rate and the theoretical update. This gap may be positive or negative in accordance with the recognized cost for the Company. In accordance with the accounting rules implemented by the Company, this gap is imputed to a regulatory asset (or liability) and is included in the charge rate calculation applying from the next annual update date.





# The Generation Segment Charge Rate

## The generation segment charge rate

### The charge rate basis for generation segment

- **On February 1, 2010, the resolution of the PUA was adopted with respect to the update of the charge rate basis for the generation segment for 2010-2014 (“the New Generation Charge Rate Basis Book”).** This resolution and the charge rates derived from it took effect on February 15, 2010.
- **The new generation charge rate basis** states the cost basket recognized for the Company in the generation segment for 2010-2014, including costs of capital, costs of operation, the fuels mix and more. The recognized costs were determined after audit of the costs of the Company that were carried out by the PUA, as they were listed in the books of the Company.
- As of the valuation date, a new rate base for the generation segment hasn't been published.

### Components of the generation charge rate basis

- **Calculating the fuel mix:** the recognized fuels mix for a certain year is calculated at the beginning and at the end of the year. **Within the annual update of the subsequent year, an accounting will be made according to the difference between the revenues of the Company from the fuels mix in retrospect and the revenues that was calculated in advance.** The difference will be returned to consumers or to the Company with the addition of interest and linkage.
- **Recognized assets and depreciation:** the assets that were recognized in the new charge rate basis were established according to a future outline for 2010-2014. The recognized cost for units was determined on the basis of a plan that includes the list of production units and their operation dates. The PUA has determined that the recognized cost for active assets will relate to two categories:
  - **“old” generation units** (activated before December 31, 2002) – **the recognition of the costs of these units is based mainly on the costs listed in the books.**

- **“new” generation units** – **the recognition of the costs of these units is in accordance with normative parameters** such as operation dates, construction times and normative interest rates.

### Emission reduction Facilities:

- On December 8, 2015 the Company received the decision of the electricity authority regarding the recognition of emission reduction facilities costs related to Orot Rabin Units 5-6 and Rothenberg Units 1-4. According to a decision made on 10/3/16, the Authority recognizes the costs of emission reduction facilities in accordance with the approved budget power as of 2013 totaling approximately 5.5 billion ₪. These costs will be added interest costs during construction.
- Authority will not recognize any deviation beyond the above amount until it will receive a detailed explanation for the deviation. The company will report any further deviation above the amount above, including a detailed explanation of the deviation as a condition for cost examination.
- This decision was made without a public hearing and therefore, the company petitioned the High Court to cancel the decision. On January 4<sup>th</sup>, 2016, after the valuation date, a letter was received from the electricity authority, which states that the Authority will publish a second hearing. The company estimates that authority will recognize all the costs.
- **Financing costs (recognized return rate):** the recognized return rate is used starting as a basis for recognition of capitalization of financing costs of assets at the time of their construction. The rate of return is derived from three variables: the financial leverage level, return on equity capital rate, and interest on foreign capital.



# The Generation Segment Charge Rate

## The generation segment charge rate

### The charge rate basis for generation segment (Cont.)

- **Operating costs:** the recognized operating costs for the test period are derived from the average operating costs according to the financial statements of the Company for 2002-2006 while separating labor costs and other costs and after performing certain adjustments. A depreciation coefficient of 2% per year is applied to these recognized costs. Prior to June 2013 the PUA recognized all costs as variable costs, and adjusted them through the years by kWh produced each year. After June 2013, the PUA recognized 88% of the costs as fixed costs, which were adjusted by installed capacity, and 12% as variable costs, which continued to be adjusted by kWh produced.
- **Pension costs:** the examination of the pension costs has not yet been completed by the PUA. As of the time of the valuation, the recognized pension costs shall include the following:
  - **“Old units”** – the cost of assets recognized that began production before 2002, was taken off the books of the Company and included in the pension costs of the employees of the Company.
  - **“New units”** – the cost of assets recognized that began production after 2002, shall only include costs of accumulating pensions of third generation employees. The costs shall not include actuarial pension costs of first generation employees, second generation employees or third generation employees relating to free electricity, gift for holidays and bonuses.



# The Generation Segment Charge Rate

The generation segment charge rate – overview of potential gaps between the recognized costs and the actual costs

## Potential gaps between recognized and actual costs

- As mentioned before, the charge rate basis should cover all of the costs sustained by the Company due to the operation of its assets, including financial costs and shareholders' required return.
- **Theoretically, the calculated electricity charge rate should cover all of the Company's costs, and as such, there should not be a positive nor negative gap between the assets' carrying amount and their value in use (as defined in Chapter B of this report).**
- Notwithstanding, the charge rate basis is not identical to the actual cost structure which changes over time, and the determined rate of return is not the same as the rate of return used to discount the free cash flows. Therefore, there may be positive or negative gaps, which may detach the discounted cash flow from the carrying amount.
- **The following is a brief recap of the major costs of the generation segment and their coverage according to the charge rate basis:**
  - **Fuel mix** – the charge rate basis covers the complete actual fuel costs, thus there should not be any gaps between the value in use and its carrying amount for this item. Notwithstanding, the Company may profit or loss from the usage of diesel oil inventory, since its book value is higher than its recognized price, and vice versa.
  - **Asset costs: "old" units** – the charge rate covers all actual costs, therefore there should not be any negative gaps between value in use and carrying amount.
  - **Asset costs: "new" units** – the charge rate covers normative costs, which are not necessarily identical to actual costs. Therefore, there should be positive gaps between the value in use and the carrying amount if the normative costs are higher than the actual costs, and negative gaps otherwise.
  - **Emission reduction facilities costs** - in accordance with the Authority's decision dated 8 December 2015, the Authority recognizes the costs of emission reduction facilities in accordance with the budget prepared and approved in 2013, plus a return . As actual costs were higher than budget, the company had approached to provide an explanation for the gaps. On 10 March 2016 the Electricity Authority submitted a decision to set a late hearing. The Company's management believes that the provision of explanations and calculations of these costs will be recognized in full . Effect of non-recognition of full costs of building facilities emissions reductions presented in the sensitivity tests performed .
  - **Financial costs (recognized rate of return)** – the return on assets is intended to reimburse the Company for the time differentials between cash outflow and cash inflows. The recognized rate of return is different from the discount rate, and as long as the difference between them are positive, there should be positive gaps, and vice versa.



# The Generation Segment Charge Rate

The generation segment charge rate – overview of potential gaps between the recognized costs and the actual costs

## Potential gaps between recognized and actual costs (Cont.)

- **Operating costs** – the recognized operating costs are based on the average operating costs from the Company's financial statements of 2002-2006 while factoring a depreciation coefficient of 2% per year and adjusting these costs by kWh produced each year prior to 2013, and by installed capacity (for 88% of the costs) since 2013. If the actual streamlining would be different than 2%, and the decrease in kWh would not result in a similar decrease in operating costs, there should be gaps between actual and recognized operating costs, and therefore there can be a gap between the value in use and the carrying amount.
- **Spare parts** – spare parts are included in the operating costs, and originally only 50% of the average cost calculated by the PUA are covered and in 2014 another 50% was paid to the Company (total of 100%) since 2010 (in retrospect). Even still, a negative gap between the recognized cost of spare parts plus the mentioned addition, to the book value still exist.
- **Pension costs** – the determination of recognized pension costs is different from the actual costs. However, it is the Company's view that in the future the Company will receive full and complete coverage of these costs, and therefore there should not be any gaps between the value in use and the carrying amount, because these costs are an integral part of the wage components agreements backed and approved by regulators.
- **Index Differential** - Following the transition to IFRS, the company ceased to coordinate the of fixed assets balance linked to the CPI. However, the balances of fixed assets, recognized for the electricity tariff revenues continue to be linked to the CPI. The difference between the CPI linked balance of the fixed assets to the balance in the books presented, generated from 1/1/2014 and 31/12/15 was not reflected in the balance sheets of the Company designated as Regulatory liability. Therefore, with respect to this element there is a gap between the fair value presented in books recognized for rate purposes .



# The Transmission and Distribution Segments Charge Rate

## The transmission and distribution segments charge rate

### The charge rate basis for transmission and distribution segments

- The electricity charge rate for the transmission and distribution segments was set in accordance with the resolution of the PUA dated July 1, 2002 (“**2002 Charge Rate Basis Book**”), which took effect on July 5, 2002.
- The 2002 Charge Rate Basis Book stated that if until December 31, 2005 no new charge rates would be set with respect to January 1, 2006 onward, then the resolutions of the PUA would be valid until the date of setting new charge rate bases.
- As of the date of the report, the PUA has not yet set new charge rate bases for the transmission and distribution segments. This is based upon the PUA’s resolution from March 22, 2012, which determined that the new charge rate basis for the transmission and distribution segments will take effect retrospectively from April 1, 2012.
- In October 2015 the Company received an updated report of the consulting firm Nabight by the Electricity Authority regarding transmission and distribution rate bases update. The report adopted the methodology proposed by the company that revenue recognized in the rate will be based on the forecasts of investment and operating segments network. The report's recommendation was not to recognize about 34 % of the salary costs, claiming that the IEC employees earn higher wage than the average wage of comparable US employees. The Company appealed this recommendation, and by its opinion the recommendation will not be accepted by the Electricity Authority .

### Components of the current charge rate basis

- **Recognized assets and depreciation:** the asset basis in the transmission and distribution segments was calculated based on the average net active fixed data in 2000, while making certain adjustments (for instance, recognition of additional costs for burying lines in urban Starting from 2002, since there is a requirement of the Department of Energy and infrastructure). Accordingly, the recognized depreciation costs were based on the recognized assets as mentioned above. However, under the assumption of full coverage from 1/4/12, it was assumed that the for this date the property recognized for The rate is the same as the books balance .
- **Financing costs (return on assets):** like the new charge rate basis for the generation segment, the calculation of the recognized return on its assets is derived from three variables: leverage level, return on equity capital and return on foreign capital. The recognized normative leverage ratio in the charge rate and the rate of return on foreign capital are in accordance with the new **generation** charge rate basis book.
- **Operational costs:** the recognized costs of operation for the transmission and distribution segments were based on the operation costs listed in the books of the Company based on 2000, while making certain adjustments (Such as non-recognition of employee bonus components, and adjustments for part of revenue variables).
- **Pension costs:** Salary costs included in recognized costs were determined based on the company costs in previous years, including normative pension costs coverage, in line with the latest actuarial.
- **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.



# The Transmission and Distribution Segments Charge Rate

The transmission and distribution segments charge rate - potential gaps between the recognized cost to the record books

## Potential gaps of costs recondition

- As noted , the rate base structure for transmission and distribution segments is intended to cover the costs of the segments including financing costs and required return by the owner.
- **Theoretically, the calculated electricity charge rate should cover all of the Company's costs, and as such, there should not be a positive nor negative gap between the assets' carrying amount and their value in use (as defined in Chapter B of this report).**
- Notwithstanding, the charge rate basis is not identical to the actual cost structure which changes over time, and the determined rate of return is not the same as the rate of return used to discount the free cash flows. Therefore, there may be positive or negative gaps, which may detach the discounted cash flow from the carrying amount.
- **The following is a brief recap of the major costs of the transmission and distribution segments and their coverage according to the charge rate basis:**
  - **Recognized assets (costs and depreciation)** - it is assumed that the base rate will cover fully the costs listed in the books As of 01/04/12 (date of full recognition). Since between the date of actual full recognition to the valuation date, the company received lower flows of costs than listed in the books, there is a debt which is expected to be paid in the future, which is added to the recoverable amount.

**Operational costs** - In October 2015 the Company received an updated report of the consulting firm Navigant by the Electricity Authority regarding basic update transmission and distribution rate. The report's recommendation was not to recognize 34 % of its wage costs. The company appealed this recommendation and the report's recommendations, according to the company's opinion, does not indicate the content of the final decision which will be accepted by the Electricity Authority, and the Company's management believes the report's recommendations will not be adopted. However, the sensitivity analysis performed, shows the effect of implementation of the recommendations of the report on the recoverable value.

**Index Differential** - Following the transition to IFRS, the company ceased to coordinate the of fixed assets balance linked to the CPI. However, the balances of fixed assets, recognized for the electricity rate revenues continue to be linked to the CPI. The difference between the CPI linked balance of the fixed assets to the balance in the books presented, generated from 1/1/2014 and 31/12/15 was not reflected in the balance sheets of the Company designated as Regulatory asset/liability. Therefore, with respect to this element there is a gap between the fair value presented in books recognized for rate purposes .



# Chapter B – Value in Use

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# The Accounting Standard

## The accounting standard

- As requested by the Company, the valuation shall be used to implement International Accounting Standard 36, Impairment of Assets (“the Standard”) in its financial statements.
- The purpose of the Standard is to establish procedures a corporation must implement in order to ensure that its assets are not presented at a sum higher than their recoverable sum. An asset is at a sum higher than its recoverable amount when its book value is higher than the sum received from the use or sale of the asset. In this case the asset has an impairment and the Standard demands that the corporation recognize an impairment loss. The Standard also specifies when a corporation must write off impairment loss and requires certain disclosure regarding assets undergoing impairment, and regarding investment in investees not constituting subsidiaries presented in the Financial Statements at sums significantly exceeding their market value or net sales price.
- The Standard prescribes the accounting treatment and presentation required in the event of impairment of assets. If a corporation prepares consolidated financial statements (including through relative consolidation), the standard shall be applied to the accounting treatment of the impairment of all the assets appearing in the corporation’s consolidated balance sheet, including investment in investees not constituting subsidiaries, goodwill deriving from the purchase of subsidiaries and fair value adjustments. This standard also applies to investments in subsidiaries and jointly-controlled companies in such a manner that impairment provisions recognized in the consolidated financial statements for the assets of the subsidiary or the jointly controlled company, including goodwill and fair value adjustments, shall be presented in the parent company’s separate financial statements as a reduction of the balance of the investment in the subsidiary or the jointly-controlled company.
- The Standard states that the asset’s recoverable sum shall be assessed whenever signs indicate the possibility of the asset’s impairment. This standard requires recognition of the impairment loss of an asset (meaning that the value of the asset has dropped) at any time the book value of the asset supersedes its recoverable sum. Impairment loss shall be recognized in the Statement of Income regarding those assets presented at cost and shall be treated as a reduction of a new assessment, this only regarding those assets presented at the re-assessed sum, in accordance with other accounting standard or as required by law.
- The Standard states that the recoverable sum shall be calculated as the fair value (less sales costs) or the value of use, whichever is higher:
  - The Net selling price (less sales costs) is the sum that may be received from the sale of the asset in a good faith transaction between a willing buyer and a willing seller, acting in an enlightened manner, less any direct added sales costs.
  - The value of use of an asset is the current value of estimated future cash flow expected to be derived from the continuous use of the asset and its sale at the end of its useful life span.
- In determining an asset’s value of use, this standard requires that a corporation use, among other things:
  - cash flow projections on the basis of reasonable and established assumptions that:
    1. Reflect the asset’s current value.
    2. Represent the management’s best estimate regarding the economic conditions that will apply throughout the balance of the asset’s useful life span.
  - Pre-tax capitalization rate, which reflects current market estimates of the money’s time value and the risks specific to the asset. The capitalization rate will not reflect risk to which future cash flows have already been adjusted.
- Estimated recoverable amount will be calculated for each asset separately. If this is impossible, this standard requires that the corporation set the recoverable sum for the cash-generating unit to which the asset belongs. A cash-generating unit is the smallest identified group of assets that yield cash inflows from continuous use, which are largely independent of inflows from other assets or from other groups of assets. At the same time, if the output created by an asset or a group of assets is traded on the open market, the asset or group of assets shall be recognized as a separate cash-generating unit, even if part or all of the output produced by the asset or the group of assets is intended for internal use.
- When examining the impairment of a cash-generating unit, this standard demands taking into account goodwill and shared assets (such as head office assets) related to that cash-generating unit.





# Valuation Methodology

## Methodology

### Discounted Cash Flows (DCF)

- The valuation was conducted according to the discounted cash flow approach (DCF). The discounted unlevered cash flows in a commonly accepted method in the Theory of Finance, and in mentioned as the preferred method in IAS 36.
- A DCF analysis is appropriate and reasonable as long as the basic assumptions it is based on are correct and accurate. Furthermore, the analysis is sensitive to the determination of the appropriate discount rate, which by itself is not an easy task and is somewhat subjective.
- According to the Standard, the cash flows shall be discounted by a pre-tax discount rate, that reflects current market expectations of the time value of money and the specific risks relevant for the asset. The discount rate shall not reflect uncertainties that the forecasted cash flows had already been adjusted for.
- Theoretically, discounting pre-tax cash flows by a pre-tax discount rate, should arrive to the same result as discounting post-tax cash flows by a post-tax discount rate, as long as the pre-tax discount rate is equivalent to the post-tax discount rate after certain adjustments to reflect the amount and the timing of tax payments. In accordance with common practice, we discounted post-tax cash flows by post-tax discount rate.

### Cash Generating Units

- **According to the Company's view, the generation, transmission and distribution segments together constitute one CGU**, for the following reasons:
  - According to its license, the Company is obligated to operate in all three segments and cannot discontinue the operation in one segment or any part of it, even if it is unprofitable, due to the fact the Company is a "government company", whose shareholder's (the State of Israel) concern are not necessarily pure economic.
  - The Company is a vertically integrated company which generates cash flows as a whole, where practically nearly all its consumers purchase its final product, utilizing all of its segments.
  - It should be noted the definition of an active market in IFRS 13 is a market where transactions are conducted frequently and in a sufficient extent that may provide information regarding the prices on a continuous basis. In this case, there is no active market for electricity generation, transmission and distribution, and it is the Company's opinion that the fact that the regulator determined different charge rates for each segment does not change the accounting conclusion that there are no different active markets for each segment.
  - A benchmark analysis conducted by the Company revealed there are other vertically integrated companies in the line of electricity that defined the whole chain as one CGU (e.g. Fortis Inc, BC Hydro).



# Key Assumptions

## General assumptions

### Main Assumptions

- **Full coverage:** as mentioned above, once every few years the PUA updates the charge rate basis. With no specific information about future charge rate basis, it is assumed that the company will receive full coverage of its operating and capital expenses from the new charge rate basis update going forward. This implies that there will be no positive or negative gaps between book asset value and value in use from this moment on.
- **The transmission and distribution segments:** as of the date of the valuation, a new charge rate basis for these segments has yet to be announced. Therefore, it is assumed that the Company will receive full coverage for these segments from 1/4/12.
- **The Palestinian Authority and East Jerusalem Electricity Company:**
  - As of the date of the valuation, the Palestinian Authority has an outstanding debt to the company of NIS 1.8 billion. The company estimates that some of it would be difficult to collect.
  - It is the Company's view that the entire amount will eventually be collected, and the Company will be affected in the value of time. Therefore, we calculated the time value separately, and subtracted it from the value in use derived from the DCF.
  - **The time value effect of the Palestinian Authority's outstanding debt is estimated at NIS 22 Million.**
- **Regulatory assets and liabilities:**
  - As of the date of the valuation, the company has net regulatory liability of NIS 954 million presented in the financial statements. the valuation did not include cash flows deriving from regulatory assets and liabilities, and these balances were treated as financial assets/liabilities and thus excluded from the carrying amount, excluding a regulatory liability of NIS 320 million that were taken into account, since they were included as part of cash discounts .
  - These balances were taken into account in the calculation of the leverage ratio in the WACC analysis.



# Chapter C – The Generation Segment

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# The Generation Segment – Assumptions for the Forecasted Period

## Assumptions for the generation segment

### Forecasted period

- In accordance with the Company's management's clarifications, which were based on its discussions with the PUA, we assumed that the new charge rate basis for the generation segment will be announced and will take effect on January 1, 2017. Accordingly, we assumed that from this day forward, the Company will received full coverage of its operating and capital expenses .

### Income from capital services

#### • Return on assets:

- The return on assets is calculated according to the depreciated amount of the recognized assets, as can be shown in the tables in the new generation charge rate basis book. The recognized assets are divided into old generation units and new generation units.
- The rate of return is calculated according to certain parameters defined by the PUA (see page 15). The calculated rate of return is 6.11% in 2016.

#### • Depreciation cost:

- The depreciation cost is calculated on the basis of recognized assets panels the Electricity Authority published.

It should be noted that on 10 March 2016 a decision to set a late hearing was made. in connection with the remaining useful life of emission reduction facilities and coal-fired stations , whereby the life of the facilities shall be 25 years from the date of operation of these facilities. Although this guidance is not final, for the purposes of this valuation, it was assumed that the lifespan of the stations will be determined according to above and there won't be time discrepancies between the dates of depreciation and recondition.

- Adjustments to the assets: some adjustments are conducted to the assets in accordance with the clarifications in the chare rate basis book, and other adjustments are conducted due to costs arising from statutory obligations:

- Environmental costs – According to a decision submitted on December 8, 2015 by the Electricity Authority, in connection with the remaining useful life (RUL) of emission reduction facilities and coal based power plants (“Orot Rabin 5-6” and “Rotenberg 1-4”), the RUL was estimated to be 25 years from the date of operation of the emission reduction facilities. On March 10, 2016 the Electricity Authority set a date for a late hearing regarding the above decision. The Company's management believes, based on past experience and arguments Electricity Authority will recognize these costs in full.
- Consumer funding – the PUA instructed that a sum representing the Company's capital expenditures funded by its consumers, shall be deducted from the recognized assets.



# The Generation Segment – Assumptions for the Forecasted Period

## Assumptions for the generation segment

### Income from capital services (con't)

- Irregular costs – the gap between actual and normative construction costs of new generation units, factored by a probability in accordance with the Company's assumptions.
- Gas conversion – the recognized conversion costs for natural gas, according to the provisions of the PUA, include piping costs, connection costs and other costs.
- Liquidation reserves – the recognized assets, in Haifa, "Reeding" and "Orot Rabin" should be adjusted for liquidation reserves according to the PUA. However, since we did not take these reserves into account for the recognized assets, we also deducted them from the carrying amount.
- Net pension costs included in the "new" units and the effect of implementing IAS 19 – although the subject is still examined by the PUA, the Company expects to receive full coverage for its pension costs. Therefore, we deducted the debated amount from the book value.

### Income from fuels

- **Profit from fuels:** the Company estimates that the recognized diesel oil price reflect the approximate fuel costs as reflected in the Inventory balance sheet. Thus, the company is not expected to generate significant gain or loss from fuel.

### Income from fuels (con't)

- **Working capital – fuel inventory:** according to the provisions of the charge rate basis, the Company should be reimbursed for the financial costs of maintaining its fuel inventory, derived by multiplying the operating inventory levels that are recognized by the Authority by the recognized prices.
- **Working capital trade receivables – fuels:** according to the provisions of the charge rate basis, the Company should be reimbursed for the fuel component of its customer credit, in accordance with the number of credit days weighted in the tariff book.

### Recognized operating costs

- Recognized operating costs are calculated according to the provisions of the charge rate basis.
- Due to entry of private electricity producers, the total kWh generated by the Company had decreased, while the Company is still obliged to serve as a backup source in the case private producers fail to supply electricity. Therefore, the PUA made certain adjustments to the recognized costs in accordance with kWh forecasted to be generated by the private producers.

### Other income

- Other income constitutes mainly sales of vehicles, heavy equipment and inventory, and adjustments for employees benefit expenses which were included in the costs.



# The Generation Segment – Assumptions for the Residual Value

## Assumptions for the generation segment

### Expenses

- In accordance with the Company's budget documents for 2015 and forecasted costs and investments for 2016, its expenses mainly include fuel costs, operating costs for the generation segment, general and administrative costs attributed to the generation segment, and current investments in power plants.

### Investments

- **Investments in environmental projects:** Besides investments in emission reduction that the Company is obliged to carry out, the company predicts additional investments in existing power stations. For these investments, the company expects to receive full coverage.
- **Investments in joint assets and newly installed computer systems:** the generation segment's share in joint investments will be 43.7%.
- **Other investments:** completion works in operating units are recognized for coverage.

### Changes in working capital

- **Account receivables:** the balance of trade receivables was calculated according to the Company's historical day sales outstanding.
- **Inventory:** the Company does not expect to purchase diesel oil nor fuel oil during the forecasted period due to increase in natural gas usage. Any usage of these fuels will result in a decrease in inventory.
- According to the Company's estimates, other working capital balances are expected to remain constant over the years.

### Non operating assets

- Rogozin land - according to the company's assumptions, the land is a part from the generation and its cash flow represents the fair value of the land. Therefore, the value of land, which was established by an external appraisal, the value added to the recoverable generation segment. The land value in the balance sheets is NIS 354 million, compared with the appraisal value of NIS 241 million.

### Full coverage

- As previously mentioned, in accordance with the Company's management's assumptions, which were based on its discussions with the PUA, we assumed that the new charge rate basis for the generation segment will be announced and will take effect on January 1, 2017.
- We assumed that from this day forward, the Company will receive full coverage of its operating and capital expenses in the generation segment (excluding emission reduction costs, as stated in the previous slide).

### Residual value of recognized assets

- According to the full coverage assumption, it was assumed that to the date of placing the full coverage assumption the Residual value of the recognized assets of the company reflects the future discounted cash flow of the company and therefore the recoverable amount for that date. The residual value of the recognized assets is the net amortized balance of the recognized assets (in accordance with normative depreciation tables), as of the full coverage assumption date.
- Project D - for reasons of caution, it was assumed by the Company's management that the value in use of future cash flows resulting from the project is non-existent. The value of the project as reflected in the balance sheets of the company is about NIS 31 million.



# The Generation Segment – Assumptions for the Residual Value

## Assumptions for the generation segment

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### Residual value of other operating balances

- Working capital – in accordance with the Company's view, we assumed that the net balance of working capital as of the date of the full coverage assumption is its recoverable amount.
- Joint assets – in accordance with the Company's view, the Company will receive full coverage of costs related to its joint assets. Therefore, we added the generation segment's share in joint assets to the residual value.



# The Generation Segment – Cash Flow

## Cash flow for the generation segment

<i>NIS Million</i>	<i>2016</i>	<i>Residual Value as of December 31, 2016</i>
Financing costs for active assets	1,187	
Depreciation costs	2,012	
<b>Total income from capital services</b>	<b>3,199</b>	
<b>Recognized operating costs</b>	<b>2,781</b>	
Fuel basket costs	6,510	
Working capital – fuel inventory	78	
Working capital trade receivables – fuels	26	
Profit (loss) from fuels	(2)	
<b>Total income from fuels</b>	<b>6,611</b>	
<b>Other income</b>	<b>110</b>	
<b>Total income from the generation segment</b>	<b>12,700</b>	
<b>Expenses:</b>	<b>(6,510)</b>	
Fuel costs	(2,467)	
Total operating costs	(128)	
Investments in operating power plants	(173)	
Cyclical renovations	(2,367)	
Depreciation expenses	<b>(11,646)</b>	
<b>Total expenses</b>	<b>1,055</b>	
<b>Operating profit</b>	<b>2,367</b>	
Depreciation expenses		
<b>EBITDA</b>	<b>3,422</b>	<b>26,379</b>

<i>NIS Million</i>	<i>2016</i>	<i>Residual Value as of December 31, 2016</i>
<b>Tax expenses</b>	<b>(264)</b>	
<b>Investments in fixed assets:</b>		
Investments in environmental projects	(964)	
Investments in joint assets and newly installed computer systems	(162)	
Other investments	(169)	
<b>Total investments in fixed assets</b>	<b>(1,294)</b>	
<b>Changes in working capital</b>	<b>1,212</b>	
<b>Residual value of other operating assets</b>		<b>5,024</b>
<b>Free cash flow</b>	<b>3,076</b>	<b>31,402</b>
<b>Period</b>	<b>0.50</b>	<b>1.00</b>
<b>Discount Factor</b>	<b>0.98</b>	<b>0.97</b>
<b>Discounted cash flow</b>	<b>3,023</b>	<b>30,311</b>
<b>Other operational assets, net</b>	<b>241</b>	





# Chapter D – Network segments

(transmission and distribution)

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# The Generation Segment – Assumptions for the Residual Value

## Assumptions for the network segments

### Full coverage

- As mentioned, in accordance with the Company's management's clarifications, excluding index differential and the accumulated debt of full recognition differences from April 1, 2012, as detailed below, there will be full coverage of costs and therefore no calculation was conducted for the recoverable value of the network segments .

### Recognized operating costs

- As mentioned in chapter A, the company appealed the recommendation of Navigant report, of not recognizing 34% of the salary cost of the network segments, and according to the company's opinion, the recommendation does not indicate the content of the final decision which will be accepted by the Electricity Authority. However, the sensitivity analysis performed, shows the effect of implementation of the recommendations of the report on the recoverable value.

### Residual value of other operating balances

- Working capital – in accordance with the Company's view, we assumed that the net balance of working capital as of the date of the full coverage assumption is its recoverable amount.
- Joint assets – in accordance with the Company's view, the Company will receive full coverage of costs related to its joint assets.

### Index (CPI) Decrease

- Following the transition to IFRS, the company ceased to coordinate the of fixed assets balance linked to the CPI. However, the balances of fixed assets, recognized for the electricity tariff revenues continue to be linked to the CPI.
- The normative fixed assets balance recognized for electricity base rate revenues will continue to be linked to the CPI.
- The difference between the CPI linked balance of the fixed assets to the balance in the books presented, generated from 1/1/2014 and 31/12/15 was not reflected in the balance sheets of the Company designated as Regulatory liability.
- For the period from 1/1/2014 to 31/12/15 the CPI decreased by 1.2%. The influence of this reduction on the recognized fixed assets for the tariff is approximately NIS 395 million.

### Coverage gap from 1/4/2012

- As described above, full cost coverage was assumed in relation to the costs listed in the books As of 1/4/12 (the date of full recognition) and beyond. Since as of the valuation date only partial coverage was received, there is an aggregate outstanding balance of \$ 2.5 billion, which the Company's management anticipates to receive in the future, for which it has not recognize a deferred account. For valuation purposes, the company's management examined the debt under different scenarios and received a weighted sum of 1.2 billion recoverable value added.



# Chapter E – Cost of Capital

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# Cost of Capital

## Weighted Average Cost of Capital

### Weighted Average Cost of Capital

For the purpose of the valuation, we used a Weighted Average Cost of Capital (WACC) of 3.6%.

We used the Capital Asset Pricing Model (CAPM) to determine the required return on the Company's equity, and made certain assumptions to determine the Company's appropriate cost of debt and capital structure.

### Cost of equity

Parameter	Value	Note
Risk free rate	0.91%	1
Market premium	6.35%	2
Beta	0.94	3
<b>Cost of equity</b>	<b>6.9%</b>	

1. Real yield to maturity of government bond with a duration of 12.2 years, as of December 31, 2015. The duration was selected according to the average duration of the generation segment's assets, as we received from the company.
2. The market premium in Israel is estimated at 6.35%.\*
3. In order to determine the Company's Beta, we selected a number of publicly traded companies which operate in the generation, transmission and distribution segments together (see Appendix 4 for list of comparables).

The following is the calculation of the Company's re-levered Beta:

Parameter	Beta calculation
Unlevered Beta – industry average	0.31
Selected leverage ration	271%
Long term tax rate	25%
<b>Re-levered Beta</b>	<b>0.94</b>

### Leverage ratio and cost of debt

The selected leverage ration (D/E) is the Company's specific leverage ratio. To determine the ratio, we implemented an iterative calculation using the Company's asset value as is calculated in the valuation.

The value of debt was determined according to the Company's fair value of the debt raised from banks, financial corporations and the public, net of the value of regulatory liabilities, as we received from the Company.

The long term tax rate was determined according to Israel's corporate tax rate, from January 1, 2016 – 25%.



# Cost of Capital

## Weighted Average Cost of Capital (con't)

### WACC summary

The following tables summarizes the WACC calculation:

Parameter	Value	Note
Risk free rate	0.91%	
Market premium	6.35%	
Beta	0.94	
<b>The Company's cost of equity</b>	<b>6.9%</b>	
Cost of debt	3.1%	4
Tax rate	25%	5
D/V*	73%	
<b>WACC</b>	<b>3.60%</b>	

4. The cost of debt was determined according to the rate of return of corporate inflation-linked bonds rated Aaa3 with a duration of 12.2 years, as quoted by "Mirvah Hogen" as of December 31, 2015.
5. The long term tax rate was determined according to the Israel's corporate tax rate, from January 1, 2016 – 25%.



# Chapter F – Valuation Results

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# Valuation Results

## Valuation results

	<i>NIS Million</i>
The generation segment – recoverable amount	33,575
The transmission and distribution segments - recoverable amount	34,992
<b>Total value of segments</b>	<b>68,567</b>
Net of: adjustments for the Palestinian Authority debt restructuring	(22)
<b>Recoverable amount</b>	<b>68,545</b>
<b>Carrying amount</b>	<b>67,554</b>
Surplus of recoverable amount over carrying amount	<b>991</b>

**We compared the recoverable amount to the carrying amount of the assets in accordance with IFRS, and concluded that the recoverable amount is greater than the carrying amount.**



# Sensitivity Analysis

## Sensitivity analysis

The following are the key assumptions we applied in the valuation and the results which would have occurred had we applied different assumptions (assuming maximum influence in each case):

<i>NIS Million</i>	<i>Maximum change in recoverable amount</i>	<i>Surplus (deficit) of recoverable amount over carrying amount</i>
Implementation of a new charge rate basis for the transmission and distribution segments according to the internal PUA document (Navigant's report)*	(2,368)	(1,377)
Recognition of only 80% of investment costs in environmental projects	(1,391)	(400)
Non-recognition of full pension costs for the "new" units in the generation segment	(83)	908
Non-recognition of fixed assets liquidation costs	(319)	672
Non-recognition of irregular construction costs	(70)	921

	<i>Weighted Average Cost of Capital</i>				
	<b>4.70%</b>	<b>4.10%</b>	<b>3.60%</b>	<b>3.10%</b>	<b>2.60%</b>
Surplus in recoverable amount over carrying amount	657	838	991	1,145	1,301
Change in recoverable amount	(334)	(153)	0	154	310

	<i>Leverage Ratio</i>				
	<b>85.00%</b>	<b>80.00%</b>	<b>75.00%</b>	<b>70.00%</b>	<b>65.00%</b>
Surplus in recoverable amount over carrying amount	960	991	991	1,022	1,022
Change in recoverable amount	(31)	0	0	31	31

	<i>Market Premium</i>				
	<b>6.85%</b>	<b>6.60%</b>	<b>6.35%</b>	<b>6.10%</b>	<b>5.85%</b>
Surplus in recoverable amount over carrying amount	960	991	991	1,022	1,052
Change in recoverable amount	(31)	0	0	31	62





# Appendices

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# Appendix 1 – Consolidated Balance Sheet

## Consolidated Balance Sheet

Assets, NIS Million	31.12.2014	31.12.2015	Liabilities and Equity, NIS Million	31.12.2014	31.12.2015
<b>Current assets</b>			<b>Current liabilities</b>		
Cash and cash equivalents	4,504	2,524	Credit from banks and other credit providers	8,355	2,756
Short-term investments	2,559	407	Trade payable	1,925	1,753
Trade receivables for sales of electricity	4,546	4,145	Other current liabilities	1,631	1,877
Other current assets	537	715	Customer advances, net of work in progress	453	496
Inventory – fuel	1,053	839	Provisions	719	726
Inventory – stores	146	132		<b><u>13,083</u></b>	<b><u>7,608</u></b>
	<b><u>13,345</u></b>	<b><u>8,762</u></b>	<b>Non-current liabilities</b>		
<b>Non-current assets</b>			Debentures	35,703	34,923
Inventory – fuel	1,509	1,124	Liabilities to banks	4,742	5,248
Long-term receivables	1,833	1,659	Liabilities with respect to other benefits after employment termination	2,930	2,732
Investment in an investee company	86	74	Provisions for funding amounts to customers	2,675	2,758
Assets with respect to benefits after employment termination	6,219	7,207	Deferred taxes, net	5,663	5,788
<b>Fixed assets, net</b>			Debentures to the State of Israel	2,534	2,511
Fixed assets in use, net	57,020	55,636	Liabilities to the State of Israel	2,905	2,591
Fixed assets under construction	6,497	6,806	Other liabilities	683	756
	<b><u>63,517</u></b>	<b><u>62,442</u></b>		<b><u>57,835</u></b>	<b><u>57,307</u></b>
Intangible assets, net	1,384	1,295	<b>Equity</b>		
	<b><u>74,412</u></b>	<b><u>73,801</u></b>	Shareholders' equity	<b><u>16,353</u></b>	<b><u>16,694</u></b>
<b>Total assets</b>	<b><u>87,757</u></b>	<b><u>82,563</u></b>	<b>Total liabilities and equity</b>	<b><u>87,271</u></b>	<b><u>81,609</u></b>
Balance of deferred Regulatory assets	2,876	837	Balance of deferred Regulatory liabilities	3,362	1,791
<b>Total assets and deferred Regulatory assets</b>	<b><u>90,633</u></b>	<b><u>83,400</u></b>	<b>Total liabilities, deferred Regulatory liabilities and equity</b>	<b><u>90,633</u></b>	<b><u>83,400</u></b>



# Appendix 2 – Consolidated Income Statement

## Consolidated Income Statement

Income Statement, NIS Million	For the year ended at December 31, 2015	
	2015	2014
<b>Revenues</b>	<b>23,058</b>	<b>25,305</b>
<b>Cost of operating the electricity system</b>		
Fuels	8,440	8,039
Purchases of electricity	2,653	1,708
Operation of the generation system	4,042	4,252
Operation of the transmission and distribution system	3,151	2,956
<b>Profit from operating the electricity system</b>	<b>4,772</b>	<b>8,350</b>
Sales and marketing expenses	904	901
Administrative and general expenses	763	1,157
Expenses (income) for liabilities to pensioners, net	531	(3)
<b>Income from current operations</b>	<b>2,574</b>	<b>6,295</b>
Financing expenses, net	1,778	2,838
<b>Profit before income taxes</b>	<b>796</b>	<b>3,457</b>
Taxes on income	217	916
<b>Profit for the year</b>	<b>579</b>	<b>2,541</b>
Changes in net Regulatory liabilities, net of Tax	(344)	(2,064)
Company's share of the loss of associated companies, net	(12)	(12)
<b>Net Profit</b>	<b>223</b>	<b>465</b>
Re-measurement of a defined benefit plan after tax	131	1,143
Loss of Hedge accounting, net	(13)	(6)
Other comprehensive income (loss) for the year, after taxes	118	1,137
<b>Comprehensive profit for the year</b>	<b>341</b>	<b>1,602</b>



## Appendix 3 – Carrying Amount

### Carrying amount

<i>NIS Million</i>	<i>Generation Segment</i>	<i>Transmission Segment</i>	<i>Distribution Segment</i>	<i>Total</i>
Fixed assets in use, net	24,172	12,533	18,918	55,623
Fixed assets under construction	5,100	1,306	360	6,766
Other fixed assets	276	188	828	1,292
Working capital, net	3,901	424	(371)	3,954
<i>In addition of:</i>				
Regulatory assets for units in generation segment	320	–	–	320
<i>Net of:</i>				
Fixed assets liquidation liabilities	(319)	–	–	(319)
Adjustments for pension costs in the generation units	(82)	–	–	(82)
<b>Total</b>	<b>33,368</b>	<b>14,451</b>	<b>19,735</b>	<b>67,554</b>



# Appendix 4 – Determination of Unlevered Beta

## List of comparables

<u>company</u>	<u>Unlevered Beta</u>
Duke Energy Corporation	0.21
Electricite de France SA	0.37
NextEra Energy, Inc.	0.38
Southern Company	0.19
Exelon Corporation	0.27
American Electric Power Co., Inc.	0.31
Korea Electric Power Corp.	0.18
SSE plc	0.37
PPL Corporation	0.27
Xcel Energy Inc.	0.22
FirstEnergy Corp.	0.30
Entergy Corporation	0.29
Chubu Electric Power Company, Incorporated	0.36
Pinnacle West Capital Corporation	0.35
OGE Energy Corp.	0.48
Tokyo Electric Power Company, Incorporated	0.32
Tohoku Electric Power Co. Inc.	0.37
VERBUND AG	0.46
CPFL Energia S.A.	0.21
Companhia Energética de Minas Gerais S.A.	0.21
Westar Energy, Inc.	0.38
The Chugoku Electric Power Co.,Inc.	0.29
Emera Incorporated	0.30
Great Plains Energy Incorporated	0.38
<b>Average</b>	<b>0.31</b>