



## APPENDIX A

### Israel Electric Corporation ("IEC") - Description of Corporate Business

#### 1. Main activities:

- (a) The Company is a vertically integrated electricity company which generates, transmits, distributes and supplies electricity to customers in the State of Israel, the Jerusalem District Electricity Co. Ltd (JDECO) and the Gaza Strip.
- (b) The Company's activities are composed of four principal segments:
- (1) Generation - power plants producing electricity.
  - (2) Transmission grid— high voltage lines (161 KV and 400 KV), switching stations and substations for high-voltage electricity that carry electricity to the Distribution grid and to high-voltage end users.
  - (3) System operator – dispatch and balancing activities, and load management.
  - (4) Distribution grid - distribution lines and the transformer stations system that carries electricity to mid voltage and low voltage end users.
  - (5) Supply – wholesale and retail supply of different voltage levels .

#### 2. Regulation

- (a) The electricity sector in Israel consists almost entirely of the activities of the Company, which currently acts as a monopoly in all segments of the electricity sector: generation, transmission, system operator, distribution, supply; and provision of back-up services for electricity customers and manufacturers. The Company is therefore subject to regulation and license requirements.

The Government's power to supervise and control the Company is





derived primarily from the Electricity Sector Law (ESL), the Israeli Antitrust Law, the Israeli Companies Law, the Government Companies Law and from its power as the owner of 99.846% of the Company's shares . In addition, the Company is subject to all other laws of the State of Israel.

- (b) Pursuant to the ESL, the Minister of Energy and Water Resources (Minister) has an overall responsibility for the electricity sector of Israel, including responsibility for the Company and its overall supervision .
- (c) The PUA is empowered under the ESL to issue licenses for all activities in the electricity sector. In order for that to take effect, licenses must be approved by the Minister (see Paragraph 2.5).
- (d) January 5, 1999, the Commissioner of Restrictive Trade Practices declared the Company to be the holder of a "monopoly" on the Electricity Sector, among other things, in the fields of electricity generation and sales, transmission and distribution of electricity, and the provision of backup services to customers and producers of electricity. The Restrictive Trade Practices Law — 1988 (the "Restrictive Trade Practices Law") grants the Commissioner of Restrictive Trade Practices, among other things, the right to review new standard-form contracts of a monopoly, intervene on matters which are liable to injure the public, and apply to the Restrictive Trade Practices Court for an order that the monopoly be dissolved by dividing it into two or more separate business entities.
- (e) In accordance with the provisions of the Israeli Companies Law, the company operates as a "public company".
- (f) Under the provisions of the Government Companies Law, the Minister, in collaboration with the Minister of Finance, is responsible for the affairs of the Company. The Ministers, after consultation with the Appointments Review Committee (a body established under the Government Companies Law), jointly appoint the Directors of the Company, and approve the appointments of the Chairman of the Board and the Chief Executive Officer of the Company.
- (g) Under the terms of the ESL the electricity tariff of the Company is regulated by the PUA.
- (h) The ESL sets forth, among other things, the basis and timetable for the Sector Reform of the electricity sector in Israel, including the





Company, in order to encourage competition in the sector.

### 3. Tariff Structure

- (a) Since March 4, 1996, the Company has operated in accordance with the ESL, which replaced the Electricity Concession Ordinance.
- (b) The term “Tariffs” (following Amendment No. 9) refers to:
- (1) Payments made by a customer, IPPs or a holder of a self-production license, to a holder of an ESL (including payments for infrastructure and backup services);
  - (2) Payments made by an ESP holder to another license holder (excluding payments set in a tender issued by the Government);
  - (3) Payments made by a holder of an ESP License to a customer, for electricity generated by such a customer or for arrangements for the management of the demand of electricity.
- (c) The main provisions of the ESL on the subject of tariffs are as follows:
- (1) The PUA determines tariffs on the basis of recognized cost, taking into account, among other things, the type and standard of services, and including a fair rate of return on equity.
  - (2) When setting tariffs, the PUA may ignore some or all of the costs that, in its opinion, are not necessary to enable the Company as an Essential Service Provider to fulfill its obligations.
  - (3) Every tariff will reflect the cost of the particular service price with no cross subsidizing, meaning no reduction of one service price at the cost of raising another service price.
- (d) The Company operates as one combined and coordinated system to supply electricity to customers at different voltage levels, from the stage of electricity generation through the transmission and distribution networks. In accordance with the provisions of the ESL, the Company has separate tariffs, set by the PUA, for various activity segments. In addition, the PUA sets the tariffs that the Company pays for electricity produced by IPPs.
- (e) The tariff that the Company charges for self production of electricity services in the various activity segments is based on a formula established by the PUA that has been periodically revised for defined **Test Period** (see 2.4 below).





- (f) The bill of some groups of customers is based on TOU tariff differentiated by voltage levels, but the bill of most electricity customers is based on a uniform tariff, which is calculated as the weighted average of TOU tariff that emerges from the aggregative distribution of the group members' consumption by TOU hours of consumption. About 60% of the electricity produced is purchased by TOU customers.
- (g) The main provisions of the ESL on the subject of tariffs are as follows:
- (1) The PUA determines tariffs on the basis of recognized cost, taking into account, among other things, the type and standard of services, and including a fair rate of return on equity.
  - (2) When setting tariffs, the PUA may ignore some or all of the costs that, in its opinion, are not necessary to enable the Company as Essential Service Providers ("ESP") to fulfill its obligations.

#### **4. The tariff concept, the tariff formula and the tariff updating Mechanism of services supplied by the company**

- (a) The tariff concept that relates to the electricity produced and transformed to the consumers by IEC, through the transmission and distribution grids, is a "price cape" concept. The total recognized cost in the generation segment and the transmission segment is allocated among the electricity consumed at different times of use according to "marginal cost ratio".
- (b) The bill of some groups of customers is based on TOU tariff differentiated by voltage levels, but the bill of most electricity customers is based on a uniform tariff which is calculated as the weighted average of TOU tariff that emerges from the aggregative distribution of consumption of group members by TOU hours of consumption. About 60% of the electricity is purchased by TOU customers.
- (c) Effective as of February 15, 2010, the PUA set a new tariff base for the generation segment which will be in force between 2010 and 2014. (it's not relevant what used to be the price before the last adjustment of the price for the generation segment). The new tariff





base determines a cost level recognized for the generation segment for 2010 to 2014 ("tariff period").

- (d) The tariff's update does not include any reference to the Company's pension costs because the PUA has not yet finalized the relevant calculations. The subject is still under discussion with the PUA.
- (e) The tariff Formula for the services supplied in the transmission, distribution and supply was determined on July 2002 and was based on data from 2000. During the tariff period, the Company's recognized cost increases according to the growth rate of KWh sold less efficiency factors relating to different segments of the company's activities. As of today, a new tariff formula for the transmission and distribution segments has not been published, and the same price determination of 2002 is being used. On March 2012, the PUA made the following decision regarding the tariff of those segments:
- (1) Increase the recognized cost of transmission, distribution Medium Voltage and distribution low Voltage by 4.3%, 8.7%, and 13.8%, respectively;
  - (2) Until the PUA publishes a new tariff formula for the transmission and distribution segments, the recognized cost formula will not include efficiency coefficients;
  - (3) The difference between the payment that should have been paid to the company according to the new recognized cost, and the payment that was made to the company according to the old recognized cost (more or less), will be defined as a debt which will be added or deducted for a fixed period of time, until the termination of the debt.
- (f) The PUA is interested in engaging the services of a consultant to assist in the process of costing and pricing the transmission, the system operator and the distribution services for the purpose of establishing a tariff formula for each of those segments.

(g) Tariff Updating Mechanism:

- (1) The tariffs will be updated according to the formula set by the PUA. The updated formula may consider an efficiency factor.
- (2) The PUA calculates the tariff every two weeks (upon the





publication of the CPI and upon the publication of fuel prices) (the “Theoretical Update”). Differences between the actual update and the Theoretical Update are recorded as a regulatory asset or liability and included in the tariff as of the annual update date.

(3) Beginning March 22, 2012, the current updating of the tariff by the PUA using the following mechanism:

Update the tariffs on the earliest of:

- A change exceeding 3.5% in the recognized cost from the last update.
- Four months since the last update.

(4) Each year, on April, the PUA performs an annual update of the various components of the costs recognized in the tariff.

(5) The PUA publishes the Company’s yearly recognized fuel basket during the following year. Moreover, the recognized fuel basket is retroactively updated in the annual update of the subsequent year, according to the actual demand, the updated operation dates of generation units and other unexpected events that occurred during that year. The Company records an asset/liability in its books, with respect to the difference between the actual fuel components charged and the theoretical fuels basket that will be recognized retroactively, and for compensation with respect to the delay in updating the fuels components in the tariff.

(6) According to the decision of the PUA, dated March 7, 2011, approximately 2 billion NIS, out of the long-term regulatory liability with respect to 2009, will be repaid to customers through a deduction in the tariff, spread out through the end of 2025. Until it is repaid to the customers, this amount will be used by the Company as a loan to finance part of the Emergency Plan Phase B for constructing several generation plants that are required to be constructed in a short period of time due to forecasted shortages in electricity generation. This





repayment will be deducted from the recognized cost. As a result, the Company has a long-term regulatory liability.

## 5. Electricity Sector Law and Licenses

- (a) Since March 5, 1996, following the termination of the Concessions, the electricity sector has been regulated under the Electricity Sector Law. The purpose of the ESL is to regulate the activity of the electricity sector for the benefit of the public, while ensuring reliability, availability, quality and efficiency, facilitating competition and reducing costs. The ESL provides that each activity in the electricity sector will be governed by licenses granted by the PUA. Thereof, the validity is subject to the approval of the Minister. The types of licenses which may be granted under the ESL include:
- (1) Generation license
  - (2) Transmission license
  - (3) Supply license
  - (4) Distribution license
  - (5) Self-production license
  - (6) System operations license.
- (b) In addition, the ESL provides that a holder of a license for transmission, distribution or system operation, as well as a holder of one or more generation licenses, who is determined by the Minister to concentrate a material portion of the electricity generation, is defined as a holder of an "Essential Service Provider License."
- (c) Under the ESL, the Minister has an overall responsibility for the electricity sector, including the supervision of the Company. The PUA is responsible for granting licenses, supervising the holders of such licenses, setting the tariffs and determining the standards of service which are required from a holder of an Essential Service Provider License (ESP License) (i.e., a holder of a license for transmission, distribution or system operation, as well as a holder of one or more generation licenses who is determined by the Minister to hold a material portion of the electricity generating capacity of Israel). Pursuant to the ESL and the terms of licenses granted there





under, such licenses may, in certain circumstances, be terminated or amended (even on a retroactive basis) before their expiration.

- (d) Pursuant to the ESL, a holder of an ESP License is required, among other things, to provide service to the general public without discrimination (according to criteria set by the PUA), purchase electricity from IPPs, provide infrastructure and certain backup services, and act to ensure provision of all of its services throughout the license period, including services pursuant to a development plan approved in accordance with the ESL. Furthermore, the Minister has the authority, in consultation with the PUA, to require a holder of an ESP License to submit development plans relating to the operation of such a license to the Minister for approval. If the holder fails to submit such development plans for approval, the Minister may, in consultation with the PUA, impose a development plan which the license holder would be obligated to implement.
- (e) The ESL further provides that a holder of a License will collect payments pursuant to the tariffs set by the PUA and will make payments to another license holder or a customer, pursuant to the tariffs.
- (f) The Company's Current Licenses:
- (g) The Company has been granted, pursuant to the ESL, a general License for the transmission, distribution, supply, trade and sale of electricity (which also covers the Company's system operation activity, which was added to the Electricity Sector Law in 2007). In addition, the Company was granted generation Licenses for each generation unit it operates.

## 6. Financial Data

- (a) The Company is one of the largest industrial companies in Israel. For the year ended December 31, 2011, the Company had total revenues of NIS 24,532 million (U.S.\$ 6,420 million) and recorded a net income of NIS-785 million (U.S.\$ -205 million) and, as of December 31, 2011, the Company had total assets of NIS 82,663





million (U.S.\$ 21,634 million), in each case in adjusted December 2011 Shekels.

(b) As of December 31, 2010, the Company had an aggregate installed generating capacity of 12,769 MW. Currently, the Company owns and operates 17 power station sites, including five steam driven power stations sites. The company's total electricity sales in 2010 and 2009 were 51,977 GWh and 48,947 GWh of electricity, respectively. As of September 30, 2011, the Company had an aggregate installed generating capacity of 12,909 MW. During the ten years between 2000 and 2010, the aggregate demand for electricity in the State of Israel grew at an average annual rate of 3.3%, exceeding the average annual growth rate of the State of Israel's gross domestic product ("GDP"), which was 3.0% during the same period.

(c) The table below contains summary information regarding the Company's activity attributed to segments for the ended December 31, 2011:

	Generation	Transmission	Distribution	Total
Total assets	42,112	16,081	24,045	82,238
Total revenues	20,032	1,797	2,703	24,532
Income from current operations	2,260	508	(9)	2,759
Net Income (loss)	382	(271)	(896)	(785)

## 7. Generation and Demand

(a) Installed Generating Capacity:

(1) The Company's installed generating capacity has increased from 10,487 MW in December 31, 2006 to 12,759 in December 31, 2011, representing an annual growth rate of 4%. This growth in generating capacity has been achieved through the expansion of existing power plants, the construction of new power plants and by improving the operational performance of the existing power plants.

(2) The following table sets forth the various generating units and their generating capacity in MW, as of December 31, 2011,





including electricity purchased from IPPs and distributed by the Company:

<u>Installed generation capacity (in MW)</u>	<u>Number of units</u>	<u>Site</u>	<u>Type of unit</u>
			<b><u>Steam driven power station generation units</u></b>
			<b>Coal powered units</b>
2,590	6	Orot Rabin (Maor David A, B)	Coal primary fuel, fuel oil secondary fuel
2,250	4	Rothenberg	Coal primary fuel, fuel oil secondary fuel
<b>4,840</b>	<b>10</b>		<b>Total coal units</b>
			<b>Gas converted units</b>
			Gas primary fuel, fuel oil secondary fuel
912	4	Eshkol	
282	2	Haifa	Gas primary fuel, fuel oil secondary fuel
428	2	Reading	Gas only
1,622	8		<b>Total gas converted coal units</b>
<b>6,462</b>	<b>18</b>		<b>Total steam driven power station generation units</b>
			<b>Gas turbines</b>
			<b>Industrial gas turbine</b>
450	4	Ramat Hovav	
220	2	Tzafit	
220	2	Alon Tavor	
34	1	Eilat	
68	2	Atarot	
592	4	Gezer	
1584	15		<b>Total industrial gas turbine</b>
			<b>Jet gas turbines</b>
40	1	Hartov	
40	1	Eitan	
11	1	Ra'anana	
130	3	Caesarea	
80	2	Haifa	
80	2	Kinarot	
15	1	Orot Rabin	
40	2	Rothenberg	
10	1	Eshkol	
58	2	Eilat	
<b>504</b>	<b>16</b>		<b>Total jet gas turbines</b>
<b>2324</b>	<b>32</b>		<b>Total gas turbines</b>
			<b>Combined cycle gas turbines</b>
335	1	Ramat Hovav	
1019	3	Hagit	
377	1	Eshkol	
744	2	Gezer 3, 4	





373	1	Alon Tavor
374	1	Haifa
<b>3222</b>	<b>9</b>	<b><u>Total Combined cycle units</u></b>
		<b><u>Gas turbines that are scheduled to operate in the future in combined cycle form</u></b>
235	1	Tzafit
256	1	Hagit
260	1	Eshkol
236	1	Ramat Hovav
		<b><u>Total combined gas cycle turbines and turbines scheduled to operate in the future in combined cycle form</u></b>
<b>3973</b>	<b>13</b>	<b><u>cycle form</u></b>
<b>12,759</b>	<b>62</b>	<b><u>Total generation units in the Company</u></b>
<b>26</b>	<b>1</b>	<b><u>Generation by private producers regulated by the Company (Etgal Ashdod Ltd.)</u></b>
<b>12,785</b>	<b>63</b>	<b><u>Total private producers regulated by the Company</u></b>

(b) Electricity Generated and Load Factor

- (1) In 2011, the Company generated a total of 57,175 million KWh of electricity, representing a load factor of 57.1%, compared with 56,102 million KWh and 58.5%, respectively, for the year ended December 31, 2010.
- (2) The following table sets forth the peak demand, the installed generating capacity and the available capacity during peak demand for the years 2011 and 2010 (in MW):

	2011	2010
Installed generation capacity (the Company + Etgal Ashdod Ltd.)	12,785	12,795
Peak demand throughout the Company	10,450	10,950
Generation capacity available at peak demand times	11,112	11,520

- (3) Peak demand typically increases during the summer and winter months because of extreme heat or cold conditions and an increased usage of air conditioners. The Company's installed capacity exceeded peak demand in each of the periods indicated in the tables above.



- (4) The Company has a shortage management policy. A shortage management situation is implemented when the Company knows in advance that it will not be able to supply the energy required at a specific time and, in order to balance the power grid, the Company is forced to initiate short power interruptions (of up to approximately one hour) distributed through various parts of the State of Israel.

## 8. Transmission

- (a) All of the electricity produced by the Company, or purchased by the **Company** from IPPs, is transmitted through the Company's high voltage transmission grid which covers the entire State of Israel and those territories under the rule of the State of Israel since June 1967. The grid consists of high voltage lines which transfer the electricity generated by the units to the main switching stations. The main switching stations transform and distribute the electricity to sub-stations all over the State of Israel. From the sub-stations the electricity is sent to end users via the distribution system.
- (b) The following table sets forth the high voltage lines owned by the Company as of December 31, 2011 and December 31, 2010.

Date	400 KV lines km circuit	161 KV lines km circuit	115 KV upper lines km circuit	161 KV underground line km circuit
December 31,2010	736.8	4,285	123.5	93.5
December 31,2011	736.8	4,295	123.5	100.8

- (c) Electricity Transmission is more efficient at high voltage levels than at low voltage levels because it reduces losses in transmission. As a result, the Company intends to expand its 400 KV transmission grid.

- (d) The following table sets forth the number of switching stations and





sub-stations (belonging to the Company and its customers) and the installed transformation capacity as of December 31, 2011 and December 31, 2010.

Date	Switching station 400/161 KV	Substation 161KV	Private 161 KV	Total
December 31,2010	10	147	40	197
December 31,2011	10	147	40	197

(e) For additional information regarding the Transmission grid see Financial Reports December 31, 2011 and statistical report year 2011 of IEC (<http://www.iec.co.il/EN/IR/Pages/default.aspx>).

## 9. Distribution

(a) The Company's distribution system connects the sub-stations which reduced voltage levels from 161 KV to 33 KV, 22 KV and 12.6 KV (Those voltages are referred to as "Medium Voltage"). From the sub-stations, the electricity is transmitted through the Company's medium-voltage power lines to transformers, which decrease the voltage to 220V (That voltage is referred to as "Low Voltage"). From the transformers, electricity is distributed through the Company's Low Voltage lines to the customers. The Company also distributes directly to certain medium-voltage customers through Medium Voltage lines.

(b) The Company's distribution system supplies electricity to approximately 2.5 million customers and covers the following five geographical regions:

(1) Northern Region: This region covers the northern part of Israel, excluding Haifa and its environs. As of December 31, 2011, this region served 413 thousands customers, compared with 405 thousands in December 31, 2010.





- (2) Dan Region: This region stretches from Road No. 5 in the north, Bar Ilan and Or Yehuda in the east, and the town of Holon in the south. This is the most densely populated area of all of the Company's regions and therefore most of the distribution grid in the Dan region is underground. As of December 31, 2011, this region served 546 thousands customers, compared with 542 thousands in December 31, 2010.
- (3) Jerusalem Region: This region covers Greater Jerusalem, Beit Shemesh, Har Tuv, Har Hevron and its southern environs Samaria, including the town of Ariel, and the Jordan Valley between Ein Gedi and Mechula. As of December 31, 2011, this region served 281 thousands customers, compared with 277 thousands in December 31, 2010. To the best of the Company's knowledge, in addition to the listed number of customers, the district secures the supply of electricity to approximately 250 thousand Palestinian customers.
- (4) Southern Region: This region is the largest region, stretching from Emek Hefer in the north to Eilat in the south, excluding the Dan region. In accordance with its size, this region serves 40% of the Company's customers. As of December 31, 2011, the southern region served 1,011 thousand customers, compared with 994 thousand in December 31, 2010.
- (5) Haifa Region: This region covers Haifa and its environs, from the South Acre Industrial Zone in the north, Shefaram and Mishmar Ha'emek in the east, Bat Shlomo in the south and the Carmel Beach settlements in the west. This region is a relatively densely populated urban area, and therefore about two thirds of the grid lines are underground. As of December 31, 2011, the Haifa region served about 270 thousand customers, compared with 268 thousand in December 31, 2010.
- (6) The following table sets forth the Medium Voltage and Low Voltage lines owned by the Company as December 31, 2011:

Date	Medium voltage (KM)	Low voltage (KM)
December 31, 2011	25,625	19,804
December 31, 2010	25,254	19,615





(7) The following table sets forth the number of transformers owned by the Company and their total transformation capacity as of December 31, 2011:

Transformer types	12.6-6.3 kV	22 kV	33 kV	Total
December 31, 2011	2,704	39,014	4,150	45,868
December 31, 2010	2,684	38,727	4,105	45,516

(8) For additional information regarding the Distribution grid see Financial Reports December 31, 2011 and statistical report year 2011 of IEC (<http://www.iec.co.il/EN/IR/Pages/default.aspx>).

## 10. Customer base

The table below sets forth electricity consumption arranged by type of customer for the periods ended December 31, 2010 and 2011 (in millions of KWh, except for percentages):

	December 31, 2011	In% of total electricity consumption	December 31, 2010	In% of total electricity consumption
Residential	15,909	30	15,591	30
Industrial	10,987	20.7	10,647	20.5
Public commercial and bulk	21,421	40.3	21,096	40.6
Water pumping	3,015	5.7	3,029	5.8
Agriculture	1,730	3.3	1,614	3.1
Total	<b>53,062</b>	100	<b>52,037</b>	100

## 11. Seasonality:





- (a) The demand for electricity in the State of Israel is seasonal. The seasons of the year in this respect are defined as summer (July to August), winter (December to February), spring (March to June) and autumn (September to November) (spring and autumn are defined as transitional seasons). The demands are greater in the summer (because of the use of air conditioners) and in the winter (because of the use of heating devices), compared with the transitional seasons. In the winter and summer, the average electricity consumption is greater than that in the transitional seasons and is also characterized by days of high demand due to extreme conditions of cold or heat.
- (b) In addition, the Company's revenue in the different seasons is affected by the change in tariffs for customers paying by load and time of use ("TOU") which represents approximately 60% of the electricity consumption, because the TOU tariffs are higher on average in the summer compared with the TOU tariffs in the transitional seasons and winter.
- (c) TOU tariffs apply to high voltage, medium voltage customers or low voltage customers whose annual consumption is greater than 60,000 KWh per annum.

## 12. Employees

- (a) The following table sets forth the employee roster at the Company in the years 2010 and 2011:

Field	As of December 31, 2011	As of December 31, 2010
Generation	2,460	2,470
Transmission and transformation (including system administration)	470	459
Distribution (marketing and districts)	4,284 *	4,339 *
Headquarters (strategic resources, finances and economics, general administration)	1,520	1,548
Service (organization of logistics, security and emergency economy, supply and storage)	1,778	1,788
Engineering projects (planning and execution)	1,977 **	2,073 **
Total:	12,489	12,677

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

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





(b) On December 1, 2011, as part of the process of approving the Company's budget for 2012, the Board of Directors resolved to commence the implementation of the Company's efficiency plan, with a goal of reducing the number of Company employees by at least 400 during the second half of 2012. Such a reduction in the number of employees is an initial step in the Company's currently contemplated efficiency plan.

(c) The Employees' Organization:

The employees' union forms part of the Histadrut and is subject to its decisions. Almost all employees of the Company are members of the employees' union.

(d) The major activities of the employees' union are:

- (1) Representing the interests of the employees vis-à-vis Management;
- (2) Negotiating wage agreements;
- (3) Defending employees against arbitrary decisions;
- (4) Providing financial support to employees;
- (5) Subsidizing health and dental insurance;
- (6) Caring for the dependents of deceased employees;
- (7) Performing community and voluntary services and caring for the Company's pensioners.

(e) Employment Agreements:

(1) In addition to the Israeli employment law, the Company's relations with its employees are governed by certain general employment agreements and collective bargaining arrangements (the "Employment Agreements"). The Employment Agreements regulates the following matters:

- Wage and service conditions;
- Entitlement to free electricity up to a certain amount / quantity;
- Rest and employment hours including overtime and shifts;
- Paid absences;
- Disciplinary and dismissal procedures; and
- Retirement conditions.

(2) Changes and updates to the Employment Agreements are executed periodically, within the framework of an agreement





and following negotiations between Management, the General Federation of Labor and the national secretariat of the employees' union. Any renegotiation also requires the approval of the GCA and the Supervisor of Wages and Labor Agreements in the Ministry of Finance and the Board of Directors. The current wage agreement will expire on December 31, 2012.

(f) The Salary Agreement and the Pension Agreement

On January 31, 2011, two special collective agreements, the Salary Agreement and the Pension Agreement, were signed between the Company, the employees' union and the Histadrut, with the approval of Supervisor of Wages and Labor Agreements in the Finance Ministry and the GCA. The Salary Agreement is based on the salary agreement of employees in the public sector, signed on January 12, 2011, and entitles employees to a gradual salary increment of 5.75%, to be applied in stages until January 2013. This agreement also includes settlement of salary deviations, against a deduction of 0.5% of the corresponding salary increment of the public sector. The Pension Agreement is intended to change the pensions update mechanism of those included in the budgetary pension arrangement so that it will be linked to CPI.

(g) For additional information regarding *The Salary Agreement, The Pension Agreement, Trust Account, Labor Disputes and Pension Plan Disputes* ; and **Pension Contributions** see Financial Reports December 31, 2011 of IEC (<http://www.iec.co.il/EN/IR/Pages/default.aspx>).

### 13. Development and Capital Investment Plans

(a) The Company has long-term development plans (up to ten years) to expand the Company's generation, transmission and distribution capacity in order to meet the projected needs of the Israeli electricity sector. The Company's development plans seek to achieve optimum stability and economic efficiency in electricity supply over the short





and the long-term. The development plans serve as a basis for reaching decisions on the required additional generation units, including the type, capacity, date of commencement of operation, location, and fuel type, as well as the required additional transmission and distribution facilities.

(b) Demand Forecast:

- (1) Development in electricity consumption is affected by economical, climatic and demographical factors. The link between electricity consumption and these influential factors is expressed with the help of an econometric model, developed by an outside consultant jointly with the Company. Energy efficiency in electricity consumption over the years was included in the calculations of the future demand forecasts and subsequently in planning the generation system.
  - (2) The demand forecast model assumes an average GDP annual growth rate of 4%, which means an increase of 2.4% in GDP per capita, assuming a population increase by 1.6% per annum. Climatic uncertainty implicit in the forecast exceeds the uncertainty in economic development, and therefore, in order to reduce such climatic uncertainty, the forecast model uses three different summer climatic scenarios. The forecast used for long-range generation system planning purposes indicates an average growth rate of 3.3% for peak demand and 3.7% for energy production for the years 2012 to 2020.
- (c) The Company's current development plan through 2016 provides for the addition of approximately 427 km of circuit to the ultra high voltage (400 KV) transmission system, and approximately 742 km of circuit to the high voltage (161 KV) transmission system. In addition, approximately 903 km of circuit will be upgraded and relocated, and approximately 47 km of underground cable circuits will be added during the same period.
- (d) The Company's development plans require significant capital expenditures. Details on development plan regarding the Generation, Transmission Grid, Distribution Grid and Smart Metering System





appear in the Financial Reports December 31, 2011 of IEC (<http://www.iec.co.il/EN/IR/Pages/default.aspx>).

#### **14. The Planned Sector Reform as Reflected in the Electricity Sector Law**

The ESL provides for the separation of activities in Generation, Transmission, System Operator and Distribution among several entities through the decentralization. This policy has not been yet implemented in the Financial Reports December 31, 2011 of IEC (<http://www.iec.co.il/EN/IR/Pages/default.aspx>).

#### **15. Properties**

- (a) In addition to its generating plants, the Company occupies properties throughout the State of Israel, including sub-stations, transmission, distribution, storage and port facilities, office buildings and warehouses. Except as discussed below, these properties are owned by the Company or occupied by the Company under long-term lease agreements (primarily with two governmental authorities and certain private property owners), under short-term lease agreement or under rights of possession granted to the Company by the owners of the properties.
- (b) The Company's transmission lines (both above ground and underground) are situated on land owned by parties other than the Company in accordance with relevant laws. The Company receives rights of use and access from the owners of the land on which the facilities are situated, either pursuant to contract or following a procedure prescribed by law.
- (c) Certain real estate property used by the Company is leased from governmental agencies and authorities pursuant to lease agreements that expired at the end of the Concessions. These lease agreements will be subject to discussions on the term there under with the governmental agencies and authorities.





- (d) A substantial portion of the real estate in which the Company has rights to is not registered in the Israeli 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 various authorities, including the tax authorities, which prevent the procurement of the receipt of authorizations for registration in the Land Registry.
- (e) All of the power stations and properties owned by the Company (as well as other assets of the Company) are subject to floating charges in favor of the various creditors of the Company and will be subject to a floating charge in favor of the Charge Agent on behalf of the Note holders upon the issuance of the “Description of the Notes — Ranking.” In addition, certain properties of the Company are subject to a fixed charge in favor of the lender who financed these properties.
- (f) For further information relating to the Company’s properties, including the Assets Arrangement, see Financial Reports December 31, 2011 of IEC (<http://www.iec.co.il/EN/IR/Pages/default.aspx>).

## 16. Information Technology

- (a) The Company relies on a variety of information technology (“IT”) systems for its operations and success, which largely depend on the accuracy and proper use of these systems.
- (b) The Company’s IT systems’ architecture is based on several principles, one of which is reliability. This principle is implemented in the foundations of the IT architecture, including all the layers — physical, logical and governmental:
- (c) Most of the Company’s business processes are computerized. The majority of the applications are based on standard products (such as SAP, SAG, ORACLE and Microsoft) and tools, so no specific dependencies are created. This environment does not create a high level of reliance on any specific application.





## 17. Glossary

*Availability.* Availability represents the amount of time electricity was able to be generated at full capacity, expressed as a percentage of the entire period indicated.

*Available capacity.* Available capacity represents the combined peak output level that was actually available in any given period.

*Capacity.* Capacity represents the maximum rate at which a power plant can generate electric energy. Capacity is typically measured in watts (W), kilowatts (KW), megawatts (MW) or gigawatts (GW).

*Capacity factor.* Capacity factor represents the total number of KWh of electricity generated during a period, expressed as a percentage of the total number of KWh that would have been generated assuming continuous operation at installed capacity.

*Generation.* Electricity is produced in generating stations where a propulsion unit (e.g., a thermal or internal combustion unit) turns a large electric generator that produces electricity. A generating station may consist of several independent generating units.

*Installed capacity.* Installed capacity represents the level of output that may be sustained continuously without significant risk of damage to plant and equipment.

*Installed reserve factor.* Installed reserve factor represents the total installed capacity at the time of peak demand divided by peak demand during any given period.

*Load factor.* Load factor represents total generation of electricity in MWh divided by the product of peak demand and the total number of hours in any given period.

*Peak demand.* Peak demand represents the highest level of demand for electricity in any given period.

*Power station.* A particular building or complex of buildings containing one or more power generating units.





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*Unit.* Each of the independent generating units at a power station.