

CAPTION SHEET

CASE MANAGEMENT SYSTEM

- 1. REPORT DATE: 00/00/00
- 2. BUREAU: FUS
- 3. SECTION(S):
- 5. APPROVED BY: DIRECTOR: SUPERVISOR:
- 6. PERSON IN CHARGE:
- 8. DOCKET NO: A-310800 F0010
- 4. PUBLIC MEETING DATE: 00/00/00
- 7. DATE FILED: 09/29/06
- 9. EFFECTIVE DATE: 00/00/00

PARTY/COMPLAINANT: CITIZENS COMMUNICATIONS COMPANY

RESPONDENT/APPLICANT: COMMONWEALTH TELEPHONE CO.

COMP/APP COUNTY: UTILITY CODE: 310800

ALLEGATION OR SUBJECT

JOINT APPLICATION OF COMMONWEALTH TELEPHONE COMPANY, CTSI LLC, AND CTE TELECOM LLC D/B/A COMMONWEALTH LONG DISTANCE COMPANY FOR ALL APPROVALS UNDER THE PUBLIC UTILITY CODE FOR THE ACQUISITION BY CITIZENS COMMUNICATIONS COMPANY OF ALL OF THE STOCK OF THE JOINT APPLICANTS' CORPORATE PARENT, COMMONWEALTH TELEPHONE ENTERPRISES, INC. DOCKET NUMBERS: COMMONWEALTH TELEPHONE COMPANY: A-310800F0010; CTSI LLC: A-311095F0005 AND CTE TELECOM LLC D/B/A COMMONWEALTH LONG DISTANCE COMPANY: A-311225F0003.

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ORIGINAL

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  Sniscak &  
   Kennard LLP  
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September 29, 2006

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James J. McNulty, Secretary  
Pennsylvania Public Utility Commission  
Commonwealth Keystone Building  
400 North Street – Filing Room (2 North)  
Harrisburg, PA 17105-3265

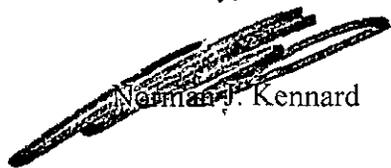
Re: Joint Application of Commonwealth Telephone Company CTSI, LLC and  
CTE Telecom, LLC d/b/a Commonwealth Long Distance Company For  
All Approvals Under The Public Utility Code for the Acquisition By  
Citizens Communications Company of All of the Stock of the Joint  
Applicants' Corporate Parent, Commonwealth Telephone Enterprises,  
Inc., Docket Nos. A-310800F0010, A-311095F0005 and A-311225F0003;  
**APPLICATION**

Dear Secretary McNulty:

Enclosed for filing please find an original and three (3) copies of the Joint  
Application of Commonwealth Telephone Company, CTSI, LLC and CTE Telecom,  
LLC d/b/a Commonwealth Long Distance Company For All Approvals Under The Public  
Utility Code for the Acquisition By Citizens Communications Company of All of the  
Stock of the Joint Applicants' Corporate Parent, Commonwealth Telephone Enterprises,  
Inc. Also enclosed is a check in the amount of \$350.00, which represents the filing fee.

Should you or any member of the Commission Staff have any questions or  
comments, please do not hesitate to contact me at your convenience.

Sincerely,

  
Norman J. Kennard

NJK/ajt  
Enclosure

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PA PUC

ORIGINAL

BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

In re Joint Application of

Commonwealth Telephone Company  
CTSI, LLC, and  
CTE Telecom, LLC d/b/a Commonwealth  
Long Distance Company

A-310800F0010  
A-311095F0005  
A-311225F0003

For All Approvals Under The Public Utility  
Code for the Acquisition By Citizens  
Communications Company of All of the Stock  
of the Joint Applicants' Corporate Parent,  
Commonwealth Telephone Enterprises, Inc.

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AND NOW COME, Commonwealth Telephone Company ("CTCo"), CTSI, LLC ("CTSI"), and CTE Telecom, LLC d/b/a Commonwealth Long Distance Company ("CLD"), (hereinafter collectively referred to as the "Applicants" or "Joint Applicants") and file, pursuant to the Pennsylvania Public Utility Code and the regulations of the Pennsylvania Public Utility Commission ("Commission"), this Joint Application ("Application"), as a single submittal under 52 Pa. Code §1.34, for all approvals required for the transaction described herein as evidenced by the issuance of a Certificate of Public Convenience and, in support thereof, state as follows:

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OVERVIEW

Applicants

1. The names and addresses of the Joint Applicants are:

Commonwealth Telephone Company  
39 Public Square  
Wilkes-Barre, PA 18702

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CTSI, LLC  
100 CTE Drive  
Dallas, PA 18612

CTE Telecom, LLC  
d/b/a Commonwealth Long Distance Company  
100 CTE Drive  
Dallas, PA 18612

2. The name and address of the Joint Applicants' attorney in this matter is:

Norman J. Kennard  
Hawke McKeon Sniscak & Kennard, LLP  
Harrisburg Energy Center  
100 North Tenth Street  
P.O. Box 1778  
Harrisburg, PA 17105  
(717) 236-1300 (Tel)  
(717) 236-4841 (Fax)

3. The Joint Applicants are wholly owned affiliates, either directly or indirectly, of:

Commonwealth Telephone Enterprises, Inc.  
100 CTE Drive  
Dallas, PA 18612

Commonwealth Telephone Enterprises, Inc. ("CTE"), a publicly traded Pennsylvania company (NASDAQ: CTCO), owns and controls all of the outstanding common stock of CTCO. In turn, CTCO owns and controls all of the stock of CTSI and CLD.

#### **Statement of Jurisdiction**

4. In 1994, the Commission formulated a Policy Statement applying the certification requirements of 66 Pa.C.S. §1102(a)(3) where a stock transaction or series of

stock transactions resulted in a change of control of a public utility “regardless of remoteness” (i.e., ownership tier).<sup>1</sup> The Commission determined that:

A transaction or series of transactions which results in a new “controlling interest” requires approval when the transaction results in a different entity becoming the beneficial holder of a largest voting interest in the utility or parent.

A transaction or series of transactions which results in the elimination of a “controlling interest” requires approval when the transaction or transactions results in the dissipation of the largest voting interest in a utility or parent.

The term “controlling interest” is defined to be any interest held by a person or group acting in concert which enables the beneficial holders to control at least 20% of the voting interest in the utility or its parent.<sup>2</sup>

### **The Transaction Generally**

5. This Application is filed as a result of the execution, on September 17, 2006, of an Agreement and Plan of Merger (“Merger Agreement”) pursuant to which Citizens Communications Company (“Citizens”) will acquire the stock of CTE and, indirectly, the stock of Applicants. That is, pursuant to the Merger Agreement, the Joint Applicants’ corporate parent, CTE, will become a wholly-owned, direct subsidiary of Citizens.

6. The transaction represents a change in indirect ownership only. Ownership of the Applicants will continue to reside in the parent company, CTE. The Joint Applicants will retain the same subsidiary corporate relationships to CTE as they did prior to the proposed stock transfer.

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<sup>1</sup> 52 Pa. Code § 69.901. While Policy Statements are not legally binding, they are intended to provide guidance regarding how the Commission would decide a particular question.

<sup>2</sup> 52 Pa. Code § 69.901(b)(2).

## **Designated Contacts**

7. In addition to the undersigned counsel, the designated contacts for questions and correspondence concerning this Application are:

### **For Commonwealth Telephone Enterprises:**

Raymond Ostroski, Esquire  
Senior Vice President, General Counsel and Secretary  
Commonwealth Telephone Enterprises, Inc.  
100 CTE Drive  
Dallas, PA 18612  
(570) 631-2802 (Tel)  
(570) 631-2895 (Fax)

### **For Citizens Communications:**

Hilary Glassman, Esquire  
Senior Vice President and General Counsel  
Citizens Communications Company  
3 High Ridge Park  
Stamford, Connecticut 06905  
(203) 614-5047 (Tel)  
(203) 614-4651 (Fax)

Lillian S. Harris, Esquire  
Hawke McKeon Sniscak & Kennard, LLP  
Harrisburg Energy Center  
100 North Tenth Street  
P.O. Box 1778  
Harrisburg, PA 17105  
(717) 236-1300 (Tel)  
(717) 236-4841 (Fax)

## **DESCRIPTION OF APPLICANTS**

8. CTCo, a rural local exchange carrier incorporated in Pennsylvania, provides local, vertical, regional long distance and broadband services over a network established in Berks, Bradford, Bucks, Carbon, Chester, Columbia, Dauphin, Lackawanna, Lancaster, Lehigh, Luzerne, Lycoming, Monroe, Northampton, Schuylkill,

Sullivan, Susquehanna, Tioga, Wyoming, and York Counties, an approximately 5,000-square-mile service territory. CTCo currently provides local exchange service to approximately 313,366 access lines in seventy-nine telephone exchanges. CTCo holds Letters Patent and Certificates of Public Convenience to offer telephone service in Pennsylvania at Commission Docket Nos. A-9610, A-76155, A-80433, A-81356, A-82106, A-83156, A-85690, A-96978, A-96933, A-99981, A-00101891, A-00102711, and A-310800. CTCo is a "Rural Telecommunications Carrier" as defined in section 3 of the Telecommunications Act of 1996 (Public Law 104-104, 110 Stat. 56) which this Commission has recognized in its Orders entered at Docket No. M-00960799,<sup>3</sup> and for the purposes of Act 183, 66 Pa. C.S. §3011 *et seq.*<sup>4</sup>

9. CTSI, a competitive local exchange carrier ("CLEC") operating in the service territories of Verizon Pennsylvania, Inc., Verizon North, Inc. and The United Telephone Company d/b/a Embarq Pennsylvania, is incorporated as a Pennsylvania corporation and is a full-service, facilities-based CLEC offering bundled local, long distance telephone, vertical services, DSL and Internet access. CTSI holds a Certificate of Public Convenience issued by this Commission at Docket No. A-311095 Order entered June 22, 2001. CTSI provides competitive local exchange service to approximately 137,821 access lines in 18 Pennsylvania counties.

10. CLD, organized as CTE Telecom, LLC in the Commonwealth of Pennsylvania, provides long distance telephone service as a switched-based reseller in portions of Pennsylvania pursuant to a Certificate of Public Convenience issued by Commission Order entered on December 23, 2002 at Docket No. A- 311225.

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<sup>3</sup> *Re: Implementation of the Telecommunication Act of 1996*, Docket No. M-00960799; Orders entered June 3, 1996 and September 9, 1996.

<sup>4</sup> See, CTCo Chapter 30 Plan at 1.

## CITIZENS

11. Citizens Communications Company, a publicly traded Delaware company (NYSE: CZN), is a highly-regarded, full-service communications service provider and the seventh largest local exchange telephone companies in the country. Citizens offers telephone, television and internet services, as well as bundled offerings, ESPN360 streaming video, security solutions and specialized bundles for small businesses and home offices.

12. Citizens is focused upon successfully operating telecommunications companies in small and medium-sized rural markets. During the last eight years, Citizens has grown to become a substantial presence in the rural local exchange carrier segment of the telecommunications market. Citizens currently owns incumbent local exchange carrier subsidiaries serving approximately 2,145,000 telephone access lines in twenty-four states: Alabama, Arizona, California, Florida, Georgia, Idaho, Illinois, Indiana, Iowa, Michigan, Minnesota, Mississippi, Montana, Nebraska, Nevada, New Mexico, New York, Ohio, Oregon, Pennsylvania, Tennessee, Utah, West Virginia and Wisconsin.<sup>5</sup> Branded as Frontier, Citizens services are provided primarily to residential customers and principally include access services, local services, long distance services, data and internet services, directory services, and television services.

13. In Pennsylvania, Citizens owns and operates five local exchange companies: Frontier Communications of Breezewood, LLC; Frontier Communications of Canton, LLC; Frontier Communications of Lakewood, LLC; Frontier Communications of Oswayo River, LLC; and Frontier Communications of Pennsylvania, LLC (collectively

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<sup>5</sup> Citizens Telecommunications Company of New York, Inc. an original subsidiary of Citizens, provides basic local exchange service in a small portion of Pennsylvania from a switch located in New York State.

the "Frontier Companies").<sup>6</sup> The smaller companies among these provide local service in portions of some of Pennsylvania's most rural areas, Potter, McKean, Schuylkill, Bedford, Bradford, Tioga, Lycoming and Fulton Counties and operate between one and four exchanges. Frontier Communications of Pennsylvania, Inc., the largest of the Frontier Companies, serves approximately 30,000 local access lines, divided into four exchanges, located predominantly in Lancaster County. Collectively, the Frontier Companies provide local telecommunications service to approximately 39,000 access lines in Pennsylvania. A sixth Citizens subsidiary, Frontier Communications of America, is certified by the Commission as an interexchange reseller, and a facilities-based and resale local exchange carrier.

14. Citizens has a strong income statement and balance sheet and is financially qualified to complete the CTE acquisition and to operate the acquired properties in a manner that is consistent with the public interest. A copy of Citizens' most recent Annual Report to Shareholders, which is the same as its Form 10K as filed with the Securities and Exchange Commission ("SEC"), is attached hereto as **Appendix**

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<sup>6</sup> Citizens' acquisition of Frontier Subsidiary Telco, LLC, the immediate parent of the five Frontier companies operating in Pennsylvania, was approved by the Commission by Order entered December 8, 2000. *Joint Application of Frontier Communications of Breezewood, Inc., Frontier Communications of Canton, Inc., Frontier Communications of Lakewood, Inc., Frontier Communications of Oswayo River, Inc., Frontier Communications of Pennsylvania, Inc., Frontier Communications of America, Inc., For All Approvals Under the Public Utility Code To Complete the Merger with and Transfer of all of the Utilities' Stock of the Corporate Parent, Frontier Subsidiary Telco, Inc. by Citizens Communications Co.*, Docket Nos. A-310400F003; A-310550F003; A-311750F003; A-312600F002; A-311250F003; and A-310153F003, Order entered December 8, 2000 ("Citizens Frontier Acquisition Order"). These companies are wholly owned by Frontier Subsidiary Telco, LLC by virtue of transactions previously approved by this Commission. Frontier Communications of Breezewood, Inc. (Docket No. A-310400F500, Dec. 18, 1986); Frontier Communications of Canton, Inc. (Docket No. A-310550F500, June 11, 1987); Frontier Communications of Lakewood, Inc. (Docket No. A-311750F500, Sept. 1, 1988); Frontier Communications of Oswayo River, Inc. (Docket No. A-105765F500, Dec. 7, 1984); and Frontier Communications of Pennsylvania, Inc. (Docket No. A-311250F500).

“A.”<sup>7</sup> Similarly, CTE is a financially sound corporation<sup>8</sup> and, combined, the companies will continue to be financially strong.

15. Upon closing of this transaction, the combined company will strengthen its standing as the 7th largest local telephone exchange company in the United States, with pro forma annual revenues of approximately \$2.4 billion and operations across twenty-four states. Operations under the brand name of Frontier will have approximately 2.6 million access lines, 388,000 High-Speed Internet subscribers and 6,600 employees.

16. As Citizens has stated in its 2005 Annual Report:

Our objective is to be the leading provider of communications services to homes and businesses in our service areas. We are committed to delivering innovative and reliable products and solutions with an emphasis on convenience, service and customer satisfaction. We offer a variety of voice, television and internet services that are available as bundled or package solutions or, for some products, a la carte. We believe that superior customer service and innovative product positioning will continue to differentiate us from our competitors in the marketplace.<sup>9</sup>

## **REQUEST FOR APPROVAL OF THE TRANSFER OF CONTROL**

### **Description of the Transaction**

17. On September 17, 2006, Citizens and CTE entered into an Agreement and Plan of Merger (“Merger Agreement”) whereby Citizens will acquire control of CTE and, indirectly, CTE’s utility subsidiaries, the Joint Applicants. As a result of the transaction, CTE will become a wholly owned, direct subsidiary of Citizens.

18. Under the Agreement, Citizens will assume the existing debt and acquire all outstanding shares of CTE for a total consideration of \$1.16 billion in a cash and

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<sup>7</sup> Citizen’s SEC Form 10Q for the most recent period (second quarter of 2006) is found at <http://czi.com/Invest/SECDocuments.aspx> and incorporated herein by reference.

<sup>8</sup> CTE’s SEC Form 10Q for the most recent period (second quarter of 2006) is found at [http://cte.com/investor/sec\\_filings.html](http://cte.com/investor/sec_filings.html) and incorporated herein by reference.

<sup>9</sup> Appendix “A” at 3.

stock transaction as determined by the arms length negotiation of the parties. Citizens intends to finance the cash portion of the purchase price with a combination of cash on hand and debt. Citizens has obtained a commitment from Citigroup for the financing necessary to complete the acquisition.

19. **Appendix "B"** hereto is a complete and accurate copy of the Agreement and Plan of Merger dated September 17, 2006 between Citizens and CTE. Approval of this Commission is requested for the entirety of the transactions set forth therein.

20. Organizational charts depicting the transactions described herein are attached as **Appendix "C."** These demonstrate that there is no change in direct ownership or organization of the Joint Applicants.

21. The transaction does not involve assignment or creation of any certificates of public convenience or tariffs held or published by CTE's operating utility subsidiaries. Rather, all shares of CTE will be transferred to Citizens, and Joint Petitioners, upon closing, will retain the same corporate status as they do today.

22. No securities issued by the Joint Applicants are affected. The current *financing and capital structure of the Joint Applicants will not be affected by the transaction.*

23. The books of account of the Joint Applicants will not be affected by the transaction. The income statements and balance sheets of Joint Applicants are not affected by the proposed transaction in any way.

24. No customers are proposed to be transferred by this transaction. Joint Applicants, including CTSI, the CLEC, will continue operation.

25. The transaction will be transparent to Joint Applicants' customers, who will enjoy the same or better level of service as they do today. All customers will continue to be served in the same manner they are served today, with the same high level of service quality. The Joint Applicants' customers will be notified of the change.

26. The Joint Applicants' rates will not be affected by the transaction.

27. The proposed transaction will not affect the regulatory authority of the Commission over the Joint Applicants.

#### **FINANCIAL INFORMATION AND CORPORATE AUTHORIZATIONS**

28. CTE's most recent Annual Report to Shareholders is attached hereto as **Appendix "D"**.

29. Certified copies of Board of Directors' Resolutions of CTE and Citizens authorizing the Merger Agreement are attached hereto as **Appendices "E" and "F,"** respectively.

30. All annual and other reports, tariffs, certificates of notification, applications for certificates of valuation, applications for approval of the issuance of securities, and securities certificates filed with the Commission by CTCo, CTSI, CLD, Citizens or their predecessor and constituent companies are made part hereof by reference.

## APPROVAL OF THIS APPLICATION IS IN THE PUBLIC INTEREST

31. The proposed stock acquisition is “necessary and proper for the service, accommodation, convenience and safety of the public.”<sup>10</sup> Moreover, the transaction “will affirmatively promote the service, accommodation, convenience, or safety of the public in some substantial way.”<sup>11</sup>

32. As noted by the Commission in its 2000 *Citizens Frontier Acquisition Order*, there are numerous positive benefits of horizontal alignment among rural local exchange carriers generally and specifically by Citizens:

Control of the Frontier Utilities will become controlled by a holding company the operational subsidiaries of which are primarily local utilities in many jurisdictions. The applicants have provided in their application evidence of Citizens’ financial strength together with evidence of Citizens’ experience in managing communications utilities in many states.

The applicants note in their filing that Citizens has specialized in providing local utility service to rural and suburban areas in many jurisdictions. The quality of service that Citizens and Frontier Telco have provided in the past through their jurisdictional subsidiaries promises that their intended expansion of services in Pennsylvania will contribute to more customers in outlying areas having available advanced services. The Chapter 30 Plans of the Frontier ILECs will remain unaffected by the proposed acquisitions, and the applicants aver that such services will include DSL service.<sup>12</sup>

These same positive attributes are inherent in the proposed acquisition by Citizens of a sixth rural Pennsylvania local exchange company, and its CLEC and long distance affiliates.

33. Citizens is a respected, long-time participant in the local exchange marketplace, focusing largely on rural and suburban communities. In recent years, Citizens has determined to emphasize its focus on rural and suburban communities, a

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<sup>10</sup> 66 Pa. C.S. §1103.

<sup>11</sup> *City of York v. Pa. P.U.C.*, 295 A.2d 825 (Pa. Supreme 1972).

<sup>12</sup> *Citizens Frontier Acquisition Order*, supra, at 4-5.

market, which it believes, has been underserved in the current telecommunications environment. The instant transaction will permit both Citizens and Joint Applicants to sharpen their focus on the areas where they are best able to provide their customers with innovative and value-added services, and the combined size and depth of expertise of the companies will enhance their abilities to provide these services in additional areas.

34. The service territories of the Frontier Companies and CTCo fit together exceptionally well. The combined size and depth of expertise of the companies will help create a “critical mass” of employees, customers and technology. The combined companies' increased size will give them an increased ability to focus on growing their customer base through new business opportunities, expansion of existing services, and new service bundling opportunities and offers.

35. The proposed acquisition of CTE by Citizens will positively benefit Joint Petitioners' local exchange operations and customers. The purchase by Citizens offers the Joint Applicants a larger, parent organization focused on the local exchange business that shares CTE's history of commitment to excellent customer service. The merger will be virtually transparent to CTCo's local telephone subscribers, that is, customers will continue to be physically served by the same people serving them today. Indeed, the proposed stock transfer will produce a more complete and robust set of services for Joint Applicants' customers.

36. One driving force behind the proposed transaction is the need to grow the business.. Applicants believe that the expanded business opportunities of the combined company will enable it to enhance and improve its overall presence in Pennsylvania.

37. Citizens is committed to meeting the needs and telecommunications requirements of small and medium-sized communities and ensuring that these communities become part of the information superhighway. The transaction will permit both Citizens and the Joint Applicants to sharpen their focus on the areas where they are best able to provide their customers with innovative and broad reaching services with bundling choice options. For example, Citizens has a higher penetration of high speed internet access (i.e., DSL) than does CTCo and, therefore, will seek to accomplish higher customer acceptance by CTCo customers, as well.

38. The two companies, in combination, will enhance the range of telecommunications services and choices, regulated and unregulated, available to customers more rapidly. For example, Citizens intends to immediately introduce CTCo subscribers to its ask.com co-branded portal, wireless modem, ESPN 360 (customized sporting event highlights) and Frontier Secure Connections (Computer Associates' firewall, virus and anti-spam software). Further, as bundled packages of telecommunications services are increasingly popular among customers, Citizens intends to improve the scope and value of bundled packages of services available to CTCo customers.

39. Citizens intends to use the Frontier logo in the CTCo, CLD and CTSI operations, thereby identifying customers' services with a well-known and respected national brand.

40. The combination with Citizens will help to ensure continuity of CTE's trend of prudent investment and the commitments that CTCo has made in its Chapter 30 Network Modernization Plan, which remain unaffected by the proposed acquisition.

Citizens is and will remain committed to providing new, advanced services to all of its customers wherever technologically feasible and economically reasonable. Citizens' presence will help the Joint Applicants to anticipate technology changes and build for an evolving marketplace.

41. The transaction will not be the cause of any request for rate increases. CTCo's price cap form of regulation remains unchanged by the transaction. The books and records of the Pennsylvania subsidiaries will continue to be maintained in conformance with the Commission's relevant rules and regulations. Following the proposed transaction, the Pennsylvania utilities will continue to be subject to the Commission's jurisdiction and Pennsylvania regulatory laws.

42. The increased size and depth of expertise of the combined companies will provide the resources needed to reduce the time to market of new service offerings.

43. The combination of the non-duplicative operations of the Frontier Companies with CTCo and CTSI will not adversely affect regulated, wireline local exchange competition, since none of the companies competes in the market areas served by the other and neither is a likely entrant into the other's geographic markets.

44. Competition for telecommunications service will be enhanced, as the combined size and depth of expertise of Citizens and CTE will enable them to compete more effectively with other facilities-based competitors, including cable telephony and wireless carriers.

45. The experience gained by Citizens, across its twenty-four state operation in responding to the forces of competition may enhance CLEC competition in CTCo's territory in two ways: (a) responding effectively to competition by providing new

services and pricing options to customers; and (b) ensuring that CLECs are treated appropriately in accordance with the complex regulatory rules that apply to transactions between ILECs and CLECs.

46. Moreover, by associating Citizens with CTSI, this Pennsylvania CLEC will be a stronger competitor in the telecommunications market. Citizens intends to continue ownership and operation of CTSI.

### **OTHER PROVISIONS**

47. The proposed transaction is effective subject to approval of this Commission and is conditioned upon meeting the requirements and/or receiving the approvals of all regulatory agencies having jurisdiction over the Joint Applicants and the contemplated transaction, as well as obtaining approval of the shareowners of CTE.

48. All Joint Applicants have paid the special and general assessments levied upon them by the Commission pursuant to the Public Utility Code and the Commission's regulations. Any and all lawful future assessments of the Commission, special and general, will be paid.

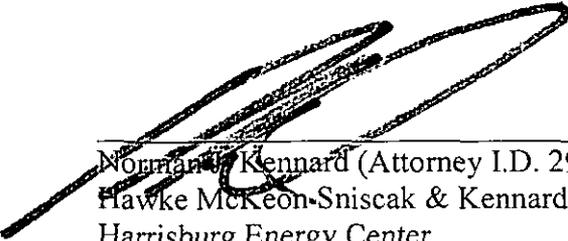
49. As indicated by the attached certificate of service, service of this Joint Application has been made upon the Commission's Office of Trial Staff ("OTS"), the Pennsylvania Office of the Consumer Advocate ("OCA"), and the Pennsylvania Office of the Small Business Advocate ("OSBA").

**PRAYER FOR RELIEF AND REQUEST FOR FINDINGS**

**WHEREFORE**, the *Joint Applicants* respectfully request that the Pennsylvania Public Utility Commission:

1. Find that the Joint Applicants have established that the transaction described by this Application provides affirmative public benefits and that approval of the transaction is in the public interest; and
2. Grant all approvals, as evidenced by the issuance of a Certificate of Public Convenience, required for Citizens and CTE to undertake the transaction described in this Application.

Respectfully submitted,



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Norman J. Kennard (Attorney I.D. 29921)  
Hawke McKeon-Sniscak & Kennard LLP  
Harrisburg Energy Center  
100 North Tenth Street  
P.O. Box 1778  
Harrisburg, PA 17105-1778  
Telephone: (717) 236-1300  
Facsimile: (717) 236-4841  
[njkenard@hmsk-law.com](mailto:njkennard@hmsk-law.com)

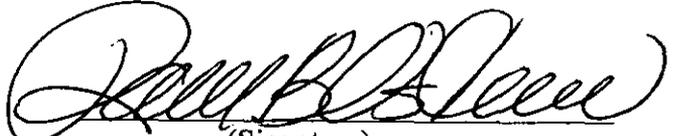
Counsel for Joint Applicants

DATED: September 29, 2006

**VERIFICATION**

I, Raymond B. Ostroski, Senior Vice President, General Counsel and Corporate Secretary, Commonwealth Telephone Enterprises, Inc. and the Joint Applicants, hereby state that the facts above set forth are true and correct to the best of my knowledge, information, and belief and that I expect to be able to prove the same at a hearing held in this matter. I understand that the statements herein are made subject to the penalties of 18 Pa. C.S. § 4904 (relating to unsworn falsification to authorities).

Date: 9/29/06

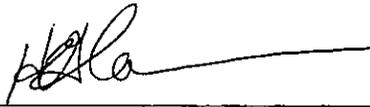
  
(Signature)

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*VERIFICATION*

I, Hilary E. Glassman, Senior VP and General Counsel, Citizens Communications Company, hereby state that the facts above set forth are true and correct to the best of my knowledge, information, and belief and that I expect to be able to prove the same at a hearing held in this matter. I understand that the statements herein are made subject to the penalties of 18 Pa. C.S. § 4904 (relating to unsworn falsification to authorities).

Date: 9/29/06

  
\_\_\_\_\_  
(Signature)

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**CERTIFICATE OF SERVICE**

I hereby certify that I have this day served a true copy of the foregoing document upon the participants, listed below, in accordance with the requirements of 52 Pa. Code § 1.54 (relating to service by participant).

**By First Class Mail**

Office of Consumer Advocate  
555 Walnut Street  
Forum Place, 5th Floor  
Harrisburg, PA 17101-1921

Office of Trial Staff  
Pennsylvania Public Utility Commission  
P.O. Box 3265  
Harrisburg, PA 17105-3265

Office of Small Business Advocate  
Suite 1102 Commerce Building  
300 North Second Street  
Harrisburg, PA 17101



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Norman J. Kennard

Dated this 29th day of September, 2006

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**CITIZENS COMMUNICATIONS COMPANY**

**2005 ANNUAL REPORT**

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10-K

(Mark one)

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

For the fiscal year ended December 31, 2005

OR

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

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

Commission file number 001-11001

**CITIZENS COMMUNICATIONS COMPANY**

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

06-0619596

(I.R.S. Employer Identification No.)

3 High Ridge Park

Stamford, Connecticut

(Address of principal executive offices)

06905

(Zip Code)

Registrant's telephone number, including area code: (203) 614-5600

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

Title of each class	Name of each exchange on which registered
Common Stock, par value \$.25 per share	New York Stock Exchange
Guarantee of Convertible Preferred Securities of Citizens Utilities Trust	New York Stock Exchange
Citizens Convertible Debentures	N/A
Guarantee of Partnership Preferred Securities of Citizens Utilities Capital L.P.	N/A

**Securities registered pursuant to Section 12(g) of the Act: NONE**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes  No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes  No

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes  No

The aggregate market value of common stock held by non-affiliates of the registrant on June 30, 2005 was approximately \$4,590,836,087 based on the closing price of \$13.44 per share.

The number of shares outstanding of the registrant's Common Stock as of January 31, 2006 was 328,457,505.

**DOCUMENT INCORPORATED BY REFERENCE**

Portions of the Proxy Statement for the Company's 2006 Annual Meeting of Stockholders to be held on May 25, 2006 are incorporated by reference into Part III of this Form 10-K.

# CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES

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# CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES

## PART I

### ITEM 1. BUSINESS

Citizens Communications Company and its subsidiaries (Citizens) will be referred to as the "Company," "we," "us" or "our" throughout this report. Citizens was incorporated in the state of Delaware in 1935 as Citizens Utilities Company.

We are a communications company providing services to rural areas and small and medium-sized towns and cities. We offer our services under the "Frontier" name. In addition, we provide competitive local exchange carrier, or CLEC, services to business customers and to other communications carriers in certain metropolitan areas in the western United States through Electric Lightwave, LLC, or ELI, our wholly-owned subsidiary. Revenue from our Frontier and ELI operations was \$2,003.3 million and \$159.2 million, respectively, in 2005. In February 2006, we entered into a definitive agreement to sell ELI and we expect the sale to close in the third quarter of 2006. Among the highlights for 2005:

- *Cash Generation*  
We continued to grow free cash flow through further growth of broadband and value added services, productivity improvements, and a disciplined capital expenditure program that emphasizes return on investment.
- *Stockholder Value*  
During 2005, we repurchased \$250.0 million of our common stock and we continued to pay an annual dividend of \$1.00 per common share. The share repurchase program was completed during the fourth quarter of 2005.
- *Growth*  
During 2005, we added approximately 99,000 new high-speed internet customers and almost 84,000 customers began buying a bundle or package of our services. At December 31, 2005, we had more than 311,000 high-speed data customers and almost 442,000 customers buying a bundle or package of services. During 2005, we also began offering a television product in partnership with Echostar's DISH Network, and at the end of 2005 we had approximately 32,000 customers buying a "triple play" package of telephone, television and high-speed internet service.

Our objective is to be the leading provider of communications services to homes and businesses in our service areas. We are committed to delivering innovative and reliable products and solutions with an emphasis on convenience, service and customer satisfaction. We offer a variety of voice, television and internet services that are available as bundled or package solutions or, for some products, a la carte. We believe that superior customer service and innovative product positioning will continue to differentiate us from our competitors in the marketplace.

### TELECOMMUNICATIONS SERVICES

As of December 31, 2005, we operated incumbent local exchange carriers in 23 states. Our CLEC services consist of a variety of integrated telecommunications products.

Frontier is typically the dominant incumbent carrier in the markets we serve and provides the "last mile" of telecommunications services to residential and business customers in these markets. As a CLEC, we provide telecommunications services to businesses and other carriers in competition with the incumbent. As a CLEC, we frequently obtain the "last mile" access to customers through arrangements with the applicable incumbent. Frontier and ELI are subject to different regulatory frameworks of the Federal Communications Commission (FCC). ELI does not compete with our Frontier business.

The telecommunications industry is undergoing significant changes and difficulties and our financial results reflect the impact of this challenging environment. As discussed in more detail in Management's Discussion & Analysis of Financial Condition and Results of Operations (MD&A), we operate in an increasingly challenging environment and our Frontier revenues have not been growing.

## CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES

### Frontier

Frontier accounted for \$2,003.3 million, or 93%, of our total revenues in 2005. Approximately 8% of our 2005 Frontier revenues came from federal and state subsidies and approximately 14% from regulated access charges.

Our Frontier business is primarily with residential customers and, to a lesser extent, non-residential customers. Our Frontier segment principally provides:

- access services,
- local services,
- long distance services,
- data and internet services,
- directory services, and
- television services.

### *Access services*

We provide both switched and non-switched network access services. Switched access services allow other carriers the use of our facilities to originate and terminate their long distance voice and data traffic. These services are generally offered on a month-to-month basis and the service is billed on a minutes-of-use basis and access charges are based on access rates filed with the FCC for interstate services and with the respective state regulatory agency for intrastate services. Non-switched network access services provide other carriers and high-volume commercial customers with dedicated high-capacity circuits. Such services are generally offered on a contract basis and the service is billed on a fixed monthly recurring charge basis. In addition, subsidies received from state and federal universal service funds based on the high cost of providing telephone service to certain rural areas are a part of our access services revenue.

Revenue is recognized when services are provided to customers or when products are delivered to customers. Monthly recurring network access service revenue is billed in advance. The unearned portion of this revenue is initially deferred on our balance sheet and recognized in revenue over the period that the services are provided. Non-recurring network access service revenue is billed in arrears. The earned but unbilled portion of this revenue is recognized in revenue in the period that the services are provided.

### *Local services*

We provide basic telephone wireline access services to residential and non-residential customers in our service areas. Our service areas are largely residential and are generally less densely populated than the primary service areas of the largest incumbent local exchange carriers. We also provide enhanced services to our customers by offering a number of calling features including call forwarding, conference calling, caller identification, voicemail and call waiting. We offer packages of communications services. These packages permit customers to bundle their basic telephone line with their choice of enhanced, long distance, television and internet services for a monthly fee and/or usage fee depending on the plan.

We intend to continue to increase the penetration of enhanced services. We believe that increased sales of such services will produce revenue with higher operating margins due to the relatively low marginal operating costs necessary to offer such services. We believe that our ability to integrate these services with other services will provide us with the opportunity to capture an increased percentage of our customers' communications expenditures.

### *Long distance services*

We offer long distance services in our territories to our customers. We believe that many customers prefer the convenience of obtaining their long distance service through their local telephone company and receiving a single bill. Long distance network service to and from points outside of our operating territories is provided by interconnection with the facilities of interexchange carriers, or IXC's.

## CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES

### *Data and internet services*

We offer data services including internet access (via dial up or high-speed internet access), frame relay, ethernet and asynchronous transfer mode (ATM) switching in portions of our system.

### *Directory services*

Directory services involves the provision of white and yellow page directories of residential and business listings. We provide this service through a third-party contractor and are paid a percentage of revenues from the sale of advertising in these directories. Our directory service also includes "Frontier Pages," an internet-based directory service which generates advertising revenue. We recognize the revenue from these services over the life of the related white or yellow pages book.

### *Television services*

During 2005, we began offering a television product in partnership with Echostar's DISH Network. We provide access to all-digital television channels featuring movies, sports, news, music, and high-definition TV programming. We offer packages that include 60, 120 or 180 channels, high-definition channels, family channels and ethnic channels.

### *Wireless and VOIP services*

During 2006, we expect to begin offering wireless data and voice services and commercial voice over internet protocol (VOIP) solutions in certain markets. Our wireless data and VOIP services utilize technologies that are relatively new, and we depend to some degree on the representations of equipment vendors, lab testing and the experiences of others who have been successful at deploying these new technologies. In addition, our success in offering wireless voice service will, to a great extent, be determined by the relationships we are developing with both wireless carriers and third-party wireless support organizations, and is also dependent on their capabilities.

The following table sets forth certain information with respect to our revenue generating units (RGUs), which consists of access lines plus high-speed internet subscribers, as of December 31, 2005 and 2004.

State	Frontier RGUs at December 31,	
	2005	2004
New York . . . . .	994,600	1,029,700
Minnesota . . . . .	293,600	289,300
Arizona . . . . .	191,400	182,000
California . . . . .	184,100	179,400
West Virginia . . . . .	169,100	165,000
Illinois . . . . .	129,200	128,600
Tennessee . . . . .	108,500	104,500
Wisconsin . . . . .	78,600	77,600
Iowa . . . . .	61,900	62,100
Nebraska . . . . .	54,500	54,400
All other states (13) . . . . .	264,400	260,400
Total . . . . .	<u>2,529,900</u>	<u>2,533,000</u>

Change in the number of our access lines is important to our revenue and profitability. We have lost access lines primarily because of competition, changing consumer behavior, economic conditions, changing technology and because some customers disconnect second lines when they add high-speed internet service. We lost approximately 102,000 access lines during the year ended December 31, 2005, but added over 99,000 high-speed internet subscribers during this same period. The loss of lines during 2005 was primarily among residential customers. The non-residential line losses were principally in Rochester, New York, while the residential losses were throughout our markets. We expect to continue to lose access lines but to increase high-speed internet subscribers during 2006. A continued loss of access lines, combined with increased competition and the other factors discussed in MD&A, may cause our profitability and cash flows to decrease during 2006.

## CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES

### ELI

In February 2006, we entered into a definitive agreement to sell all of the outstanding membership interests in ELI to Integra Telecom Holdings, Inc. (Integra), for \$247.0 million, including \$243.0 million in cash plus the assumption of approximately \$4.0 million in capital lease obligations, subject to customary adjustments under the terms of the agreement. This transaction is expected to close during the third quarter of 2006. The closing of the sale is subject to several conditions, including the funding of Integra's fully committed financing and regulatory approvals.

ELI provides a broad range of wireline communications products and services to businesses and other carriers in the western United States. ELI accounted for \$159.2 million, or 7%, of our total revenues in 2005. Our ELI revenues have declined from a peak of \$240.8 million in 2000, however 2005 revenues were higher than 2004.

ELI's facilities-based network consists of optical fiber and voice and data switches. ELI has a national internet and data network with switches and routers in key cities, linked by leased transport facilities. These assets are not being sold and will continue to be owned and utilized by Frontier to carry our customers' voice, internet and data traffic. In addition, ELI has a long-haul, fiber-optic network connecting the cities it serves in the western United States, which utilizes an optically self-healing Synchronous Optical Network (SONET) architecture. ELI currently provides the full range of its services in the following cities and their surrounding areas: Boise, Idaho; Portland, Oregon; Salt Lake City, Utah; Seattle, Washington; Spokane, Washington; Phoenix, Arizona; and Sacramento, California.

### REGULATORY ENVIRONMENT

#### Frontier Regulation

*The majority of our operations are regulated extensively by various state regulatory agencies, often called public service or utility commissions, and the FCC.*

Our Frontier segment revenue is subject to regulation by the FCC and various state regulatory agencies. We expect federal and state lawmakers to continue to review the statutes governing the level and type of regulation for telecommunications services.

The Telecommunications Act of 1996, or the 1996 Act, dramatically changed the telecommunications industry. The main purpose of the 1996 Act was to open local telecommunications marketplaces to competition. The 1996 Act preempts state and local laws to the extent that they prevent competition with respect to communications services. Under the 1996 Act, however, states retain authority to impose requirements on carriers necessary to preserve universal service, protect public safety and welfare, ensure quality of service and protect consumers. States are also responsible for mediating and arbitrating interconnection agreements between CLECs and ILECs if voluntary negotiations fail. In order to create an environment in which local competition is a practical possibility, the 1996 Act imposes a number of requirements for access to network facilities and interconnection on all local communications providers. All incumbent local carriers must interconnect with other carriers, unbundle some of their services at wholesale rates, permit resale of some of their services, enable collocation of equipment, provide local telephone number portability and dialing parity, provide access to poles, ducts, conduits and rights-of-way, and complete calls originated by competing carriers under termination arrangements.

At the federal level and in a number of the states in which we operate, we are subject to price cap or incentive regulation plans under which prices for regulated services are capped in return for the elimination or relaxation of earnings oversight. The goal of these plans is to provide incentives to improve efficiencies and increased pricing flexibility for competitive services while ensuring that customers receive reasonable rates for basic services. Some of these plans have limited terms and, as they expire, we may need to renegotiate with various states. These negotiations could impact rates, service quality and/or infrastructure requirements which could impact our earnings and capital expenditures. In the other states in which we operate, we are subject to rate of return regulation that limits levels of earnings and returns on investments. In some states, we have been required to refund customers as a result of exceeding earnings limitations. We continue to advocate our position of less regulation with various regulatory agencies.

For interstate services regulated by the FCC, we have elected a form of incentive regulation known as "price caps" for most of our operations. In May 2000, the FCC adopted a methodology for regulating the interstate access rates of price cap companies through May 2005. The program, known as the Coalition for Affordable Local and Long

## CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES

Distance Services, or CALLS plan, reduced prices for interstate-switched access services and phased out many of the implicit subsidies in interstate access rates. The CALLS program expired in 2005. The FCC may address future changes in interstate access charges during 2006 and such changes may adversely affect our revenues and profitability.

Another goal of the 1996 Act was to remove implicit subsidies from the rates charged by local telecommunications companies. The CALLS plan addressed this requirement for interstate services. State legislatures and regulatory agencies are beginning to reduce the implicit subsidies in intrastate rates. The most common subsidies are in access rates that historically have been priced above their costs to allow basic local rates to be priced below cost. Legislation has been considered in several states to require regulators to eliminate these subsidies and implement state universal service programs where necessary to maintain reasonable basic local rates. However, not all the reductions in access charges would be fully offset. We anticipate additional state legislative and regulatory pressure to lower intrastate access rates.

Some state legislatures and regulators are also examining the provision of telecommunications services to previously unserved areas. Since many unserved areas are located in rural markets, we could be required to expand our service territory into some of these areas.

### Recent and Potential Regulatory Developments

Wireline and wireless carriers are required to provide local number portability (LNP). LNP is the ability of customers to switch from a wireline or wireless carrier to another wireline or wireless carrier without changing telephone numbers. We are 100% LNP capable in our largest markets and over 98% of our exchanges are LNP capable. We will upgrade the remaining exchanges in response to bona fide requests as required by the FCC order.

LNP will promote further competition in an environment where the displacement of traditional wireline services has been increasing because of technological substitutions such as cell phones, e-mail, cable telephony and Internet phone calling.

In 1994, Congress passed the Communications Assistance for Law Enforcement Act (CALEA) to ensure that telecommunication networks can meet law enforcement wiretapping needs. We expect to be fully compliant by June 2006.

The FCC is expected to address issues involving inter-carrier compensation, the universal service fund and internet telephony in 2006. The FCC adopted a Further Notice of Proposed Rulemaking (FNPRM) addressing inter-carrier compensation on February 10, 2005. Some of the proposals being discussed with respect to inter-carrier compensation, such as "bill and keep" (under which switched access charges would be reduced or eliminated), could reduce our access revenues and our profitability. The universal service fund is under pressure as local exchange companies lose access lines and more entities, such as wireless companies, seek to receive monies from the fund. The rules surrounding the eligibility of Competitive Eligible Telecommunication Carriers, such as wireless companies, to receive universal service funds are expected to be clarified by the Federal-State Joint Board on Universal Service and the clarification of the rules may heighten the pressures on the fund. Changes in the funding or payout rules of the universal service fund could further reduce our subsidy revenues and our profitability. As discussed in MD&A, our access and subsidy revenues are important to our cash flows and both our access and subsidy revenues declined in 2005 compared to 2004. Our access revenues are likely to decline again in 2006.

The development and growth of internet telephony (also known as VOIP) by cable and other companies has increased the importance of regulators at both the federal and state levels addressing whether such services are subject to the same or different regulatory and financial schemes as traditional telephony. On November 9, 2004, the FCC issued an order in response to a petition by Vonage Holdings Corp. (Vonage), declaring that Vonage-style VOIP services are jurisdictionally interstate in nature and are thereby exempt from state telecommunications regulations. The FCC stated that its order was not limited to Vonage, but rather applied to all Vonage-type VOIP offerings provided over broadband services. The FCC did not address other related issues, such as: whether or under what terms VOIP traffic may be subject to intercarrier compensation; if VOIP services are subject to general state requirements relating to taxation and general commercial business requirements; or whether VOIP is subject to 911, universal service fund (USF), and CALEA obligations. The FCC is planning on addressing these open questions in subsequent orders in its ongoing "IP-Enabled Services Proceeding," which opened in February 2004.

## CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES

Internet telephony may have an advantage over our traditional services if it remains less regulated. We are actively participating in the FCC's consideration of all these issues. On June 3, 2005, the FCC issued an order requiring VOIP services interconnected to the public switched telephone network to include E-911 calling capabilities by November 28, 2005. Subsequently, the FCC issued a number of public notices detailing the steps that could be considered sufficient interim compliance. The FCC stated in a public notice that providers not in full compliance would not be required to disconnect existing subscribers but would be expected not to connect new subscribers in areas where they are not transmitting 911 calls in full compliance with the rules. On September 23, 2005, the FCC issued an order stating that both interconnected VOIP services and broadband internet access services will be required to comply with CALEA by May 12, 2007. Both the VOIP E-911 order and the CALEA order are subject to petitions for clarification and reconsideration and both have been appealed and are pending before federal courts.

The FCC's service outage reporting rules require telecommunications providers (regardless of whether they are cable, wireless or wireline communications providers) to report outages of at least a 30 minute duration that potentially affect at least 900,000 user-minutes. The initial FCC order, which included required reporting of certain non-service interrupting network outages, was partially stayed. The network modifications necessary to comply with the stayed portion of the order would cost us in excess of \$16.0 million. The New York Public Service Commission is also considering network reliability requirements. We and other carriers are opposing these proposed requirements.

Some state regulators (including New York and Illinois) have in the past considered imposing on regulated companies (including us) cash management practices that could limit the ability of a company to transfer cash between its subsidiaries or to its parent company. None of the existing state requirements materially affect our cash management but future changes by state regulators could affect our ability to freely transfer cash within our consolidated companies.

### **ELI Regulation**

As a CLEC, ELI is subject to federal, state and local regulation. However, the level of regulation is typically less than that experienced by an incumbent carrier. Local governments may require ELI to obtain licenses or franchises regulating the use of public rights-of-way necessary to install and operate its networks.

ELI has various interconnection agreements in the states in which it operates. These agreements govern reciprocal compensation relating to the transport and termination of traffic between the incumbent's and ELI's networks. The FCC has significantly reduced intercarrier compensation for internet service provider (ISP) traffic, also known as "reciprocal compensation." On December 15, 2004, the FCC adopted rules that will increase costs to ELI for services that it buys from incumbent carriers.

Most state public service commissions require competitive communications providers, such as ELI, to obtain operating authority prior to initiating intrastate services. Most states also require the filing of tariffs or price lists and/or customer-specific contracts. ELI is not currently subject to rate-of-return or price regulation. However, ELI is subject to state-specific quality of service, universal service, periodic reporting and other regulatory requirements, although the extent of these requirements is generally less than those applicable to incumbent carriers.

## **COMPETITION**

### **Frontier Competition**

Competition in the telecommunications industry is intense and increasing. We experience competition from many communications service providers including cable operators, wireless carriers, VOIP providers, long distance providers, competitive local exchange carriers, internet providers and other wireline carriers. We believe that competition will continue to intensify in 2006 across all products and in all of our markets. Our Frontier business experienced erosion in access lines and switched access minutes of use in 2005 as a result of competition. Competition in our markets may result in reduced revenues in 2006.

We are responding to this competitive environment with new product offers and by bundling products and services together with an end user contract term commitment. Revenues from data services and packages continue to increase as a percentage of our total revenues. There will continue to be price and margin pressures in our business that may result in less revenues and profitability.

## CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES

The telecommunications industry is undergoing significant changes. The market is extremely competitive, resulting in lower prices, and consumers are changing behavior, such as using wireless in place of wireline services and using e-mail instead of making calls. These trends are likely to continue and result in a challenging revenue environment. These factors could also result in more bankruptcies in the sector and therefore affect our ability to collect money owed to us by bankrupt carriers.

### **ELI Competition**

ELI faces significant competition from incumbents in each of its markets. Principal incumbent competitors include Qwest, at&t and Verizon. ELI also competes with all of the major IXCs, internet access providers and other CLECs. CLEC service providers have generally encountered intense competitive pressures, the result of which is the failure of a number of CLECs and substantial financial pressures on others.

Competitors in ELI's markets include, in addition to the incumbent providers: at&t, Sprint, Time Warner Telecom, Verizon, Integra Telecom and XO Communications. In each of the markets in which ELI operates, at least one other CLEC, and in some cases several other CLECs, offer many of the same services that ELI provides, generally at similar prices.

Competition is based on price, quality, network reliability, customer service, service features and responsiveness to the customer's needs. Many of our competitors have greater market presence and greater financial, technical, marketing and human resources, more extensive infrastructure and stronger customer and strategic relationships than are available to us. Competition in the CLEC industry is intense and pricing continues to decline. ELI's revenues have declined since 2000, however 2005 revenues were higher than 2004.

### **DIVESTITURE OF PUBLIC UTILITIES SERVICES**

In the past we provided public utilities services including natural gas transmission and distribution, electric transmission and distribution, water distribution and wastewater treatment services to primarily rural and suburban customers throughout the United States. In 1999, we announced a plan of divestiture for our public utilities services properties. Since then, we have divested all of our public utility operations for an aggregate of \$1.9 billion.

We have retained a potential payment obligation associated with our previous electric utility activities in the state of Vermont. The Vermont Joint Owners (VJO), a consortium of 14 Vermont utilities, including us, entered into a purchase power agreement with Hydro-Quebec in 1987. The agreement contains "step-up" provisions which state that if any VJO member defaults on its purchase obligation under the contract to purchase power from Hydro-Quebec, then the other VJO participants will assume responsibility for the defaulting party's share on a pro-rata basis. Our pro-rata share of the purchase power obligation is 10%. If any member of the VJO defaults on its obligations under the Hydro-Quebec agreement, the remaining members of the VJO, including us, may be required to pay for a substantially larger share of the VJO's total power purchase obligation for the remainder of the agreement (which runs through 2015). Paragraph 13 of FIN 45 requires that we disclose "the maximum potential amount of future payments (undiscounted) the guarantor could be required to make under the guarantee." Paragraph 13 also states that we must make such disclosure "... even if the likelihood of the guarantor's having to make any payments under the guarantee is remote..." As noted above, our obligation only arises as a result of default by another VJO member, such as upon bankruptcy. Therefore, to satisfy the "maximum potential amount" disclosure requirement we must assume that all members of the VJO simultaneously default, a highly unlikely scenario given that the two members of the VJO that have the largest potential payment obligations are publicly traded with credit ratings that are equal to or superior to ours, and that all VJO members are regulated utility providers with regulated cost recovery. Regardless, despite the remote chance that such an event could occur, or that the State of Vermont could or would allow such an event, assuming that all the members of the VJO defaulted on January 1, 2007 and remained in default for the duration of the contract (another 9 years), we estimate that our undiscounted purchase obligation for 2007 through 2015 would be approximately \$1.26 billion. In such a scenario we would then own the power and could seek to recover our costs. We would do this by seeking to recover our costs from the defaulting members and/or reselling the power to other utility providers or the northeast power grid. There is an active market for the sale of power. We could potentially lose money if we were unable to sell the power at cost. We caution that we cannot predict with any degree of certainty any potential outcome.

## CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES

### SEGMENT INFORMATION

Note 22 to Consolidated Financial Statements provides financial information about our industry segments, Frontier and ELI, for the last three fiscal years.

### FINANCIAL INFORMATION ABOUT FOREIGN AND DOMESTIC OPERATIONS AND EXPORT SALES

We have no foreign operations.

### GENERAL

Order backlog is not a significant consideration in our businesses. We have no material contracts or subcontracts that may be subject to renegotiation of profits or termination at the election of the Federal government. We hold no patents, licenses or concessions that are material.

### EMPLOYEES

As of December 31, 2005, we had 6,103 employees, 5,644 of whom were associated with Frontier operations and 459 were associated with ELI. At December 31, 2005, the total number of our employees affiliated with a union was 3,302, of which approximately 1,400 are covered by agreements set to expire during 2006. We consider our relations with our employees to be good.

### AVAILABLE INFORMATION

We make available on our website, free of charge, the periodic reports that we file with or furnish to the Securities and Exchange Commission, or SEC, as well as all amendments to these reports, as soon as reasonably practicable after such reports are filed with or furnished to the SEC. We also make available on our website, or in printed form upon request, free of charge, our Corporate Governance Guidelines, Code of Business Conduct and Ethics, and the charters for the Audit, Compensation, and Nominating and Corporate Governance committees of the Board of Directors. Stockholders may request printed copies of these materials by writing to: 3 High Ridge Park, Stamford, Connecticut 06905 Attention: Corporate Secretary. Our website address is <http://www.czn.net>.

### ITEM 1A. RISK FACTORS

Before you invest in our securities, you should carefully consider all the information we have included or incorporated by reference in this Form 10-K and our subsequent periodic filings with the SEC. In particular, you should carefully consider the risk factors described below and read the risks and uncertainties related to "forward-looking statements" as set forth in the "Management's Discussion and Analysis of Financial Condition and Results of Operations" section of this Form 10-K. The risks and uncertainties described below are not the only ones facing our company. Additional risks and uncertainties that are not presently known to us or that we currently deem immaterial or that are not specific to us, such as general economic conditions, may also adversely affect our business and operations.

### RISKS RELATED TO COMPETITION AND OUR INDUSTRY

**We face intense competition, which could adversely affect us.**

The telecommunications industry is extremely competitive and competition is increasing. The traditional dividing lines between long distance, local, wireless, cable and internet services are becoming increasingly blurred. Through mergers and various service expansion strategies, services providers are striving to provide integrated solutions both within and across geographic markets. Our competitors include CLECs and other providers (or potential providers) of services, such as internet service providers, or ISPs, wireless companies, neighboring incumbents, VOIP providers such as Vonage and cable companies that may provide services competitive with ours or services that we intend to introduce. Competition is intense and increasing and we cannot assure you that we will be able to compete effectively. For example, at December 31, 2005 we had 102,000 fewer access lines than we had at December 31, 2004 and we believe wireless and cable telephony providers have increased their market share in our markets. We expect to continue to lose access lines and that competition with respect to all our products and services will increase.

## CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES

We expect competition to intensify as a result of the entrance of new competitors and the development of new technologies, products and services. We cannot predict which of the many possible future technologies, products or services will be important to maintain our competitive position or what expenditures will be required to develop and provide these technologies, products or services. Our ability to compete successfully will depend on marketing and *on our ability to anticipate and respond to various competitive factors* affecting the industry, including a changing regulatory environment that may affect our competitors and us differently, new services that may be introduced, changes in consumer preferences, demographic trends, economic conditions and pricing strategies by competitors. Increasing competition may reduce our revenues and increase our costs as well as require us to increase our capital expenditures and thereby decrease our cash flow.

### **Some of our competitors have superior resources, which may place us at a cost and price disadvantage.**

Some of our current and potential competitors have market presence, engineering, technical and marketing capabilities, and financial, personnel and other resources substantially greater than ours. In addition, some of our competitors can raise capital at a lower cost than we can. Consequently, some competitors may be able to develop and expand their communications and network infrastructures more quickly, adapt more swiftly to new or emerging technologies and changes in customer requirements, take advantage of acquisition and other opportunities more readily and devote greater resources to the marketing and sale of their products and services than we can. Additionally, the greater brand name recognition of some competitors may require us to price our services at lower levels in order to retain or obtain customers. Finally, the cost advantages of some competitors may give them the ability to reduce their prices for an extended period of time if they so choose.

### **ELI faces substantial competition for its telecommunications services from larger companies.**

ELI's competitors for telecommunications services are primarily larger incumbents, CLECs and IXC's. Because it is not an incumbent provider, ELI's ability to succeed in the telecommunications services market depends to a large extent on its ability to provide differentiated services for business customers and to maintain its customer base and develop additional business customers.

We anticipate that general pricing competition and pressures for CLECs will increase, including ELI. We have not obtained significant market share in any of the areas where we offer our CLEC services, nor do we expect to do so given the size of our ELI markets, the intense competition therein and the diversity of customer requirements. There can be no assurance that ELI will be able to compete effectively in any of our markets. Furthermore, the bankruptcies and weakened financial position of a number of CLECs have resulted in a more demanding operating environment for CLECs, as both customers and suppliers are more concerned about each CLEC's creditworthiness.

## **RISKS RELATED TO OUR BUSINESS**

### **Decreases in certain types of our revenues will impact our profitability.**

Our Frontier business has been experiencing declining access lines, switched access minutes of use, long distance prices and related revenues because of economic conditions, increasing competition, changing consumer behavior (such as wireless displacement of wireline use, email use, instant messaging and increasing use of VOIP), technology changes and regulatory constraints. These factors are likely to cause our local network service, switched network access, long distance and subsidy revenues to continue to decline, and these factors, together with our increasing employee costs, and the potential need to increase our capital spending, may cause our cash generated by operations to decrease.

### **We may be unable to grow our revenue and cash flow despite the initiatives we have implemented.**

We must produce adequate cash flow that, when combined with funds available under our revolving credit facility, will be sufficient to service our debt, fund our capital expenditures, pay our taxes and maintain our current dividend policy. We have implemented several growth initiatives, including increasing our marketing expenditures and launching new products and services with a focus on areas that are growing or demonstrate meaningful demand such as high-speed internet. There is no assurance that these initiatives will result in an improvement in our financial position or our results of operations.

## CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES

**We may complete a significant business combination or other transaction that could increase our shares outstanding, affect our debt, result in a change in control, or both.**

From time to time we evaluate potential acquisitions and other arrangements that would extend our geographic markets, expand our services, enlarge the capacity of our networks or increase the types of services provided through our networks. If we complete any acquisition or other arrangement, we may require additional financing that could result in an increase in our shares outstanding and/or debt, result in a change in control, or both. There can be no assurance that we will enter into any transaction.

**Our business is sensitive to the creditworthiness of our wholesale customers.**

We have substantial business relationships with other telecommunications carriers for whom we provide service. During the past few years, several of our customers have filed for bankruptcy. While these bankruptcies have not had a material adverse effect on our business to date, future bankruptcies in our industry could result in our loss of significant customers, more price competition and uncollectible accounts receivable. As a result, our revenues and results of operations could be materially and adversely affected.

### **RISKS RELATED TO LIQUIDITY, FINANCIAL RESOURCES, AND CAPITALIZATION**

**Substantial debt and debt service obligations may adversely affect us.**

We have a significant amount of indebtedness. We may also obtain additional long-term debt and working capital lines of credit to meet future financing needs, subject to certain restrictions under our existing indebtedness, which would increase our total debt.

The significant negative consequences on our financial condition and results of operations that could result from our substantial debt include:

- limitations on our ability to obtain additional debt or equity financing;
- instances in which we are unable to meet the financial covenants contained in our debt agreements or to generate cash sufficient to make required debt payments, which circumstances have the potential of accelerating the maturity of some or all of our outstanding indebtedness;
- the allocation of a substantial portion of our cash flow from operations to service our debt, thus reducing the amount of our cash flow available for other purposes, including operating costs, dividends and capital expenditures that could improve our competitive position or results of operations;
- requiring us to sell debt or equity securities or to sell some of our core assets, possibly on unfavorable terms, to meet payment obligations;
- compromising our flexibility to plan for, or react to, competitive challenges in our business and the communications industry; and
- the possibility of our being put at a competitive disadvantage with competitors who do not have as much debt as us, and competitors who may be in a more favorable position to access additional capital resources.

**We will require substantial capital to upgrade and enhance our operations.**

Replacing or upgrading our infrastructure will result in significant capital expenditures. If this capital is not available when needed, our business will be adversely affected. Increasing competition, offering new services, improving the capabilities or reducing the maintenance costs of our plant may cause our capital expenditures to increase in the future. In addition, our ongoing annual dividend of \$1.00 per share under our current policy utilizes a significant portion of our cash generated by operations and therefore limits our operating and financial flexibility and our ability to significantly increase capital expenditures. While we believe that the amount of our dividend will allow for adequate amounts of cash flow for capital spending and other purposes, any material reduction in cash generated by operations and any increases in capital expenditures, interest expense or cash taxes would reduce the amount of cash generated in excess of dividends. Losses of access lines, increases in competition, lower subsidy and

## CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES

access revenues and the other factors described above may reduce our cash generated by operations and may require us to increase capital expenditures. In addition, we expect our cash paid for taxes to increase significantly over the next several years.

### RISKS RELATED TO REGULATION

#### **The access charge revenues we receive may be reduced at any time.**

A significant portion of our revenues is derived from access charges paid by IXCs for services we provide in originating and terminating intrastate and interstate traffic. The amount of access charge revenues we receive for these services is regulated by the FCC and state regulatory agencies. Recent rulings regarding access charges have lowered the amount of revenue we receive from this source. Additional actions by these agencies could further reduce the amount of access revenues we receive. In addition, a portion of our access revenues is received from state and federal universal service funds based upon the high cost of providing telephone service to certain rural areas. In the future, there may be proposals by state or federal regulatory agencies to eliminate or reduce these revenues. A material reduction in the revenues we receive from these funds would adversely affect our financial results.

#### **We are reliant on support funds provided under federal and state laws.**

We receive a significant portion of our revenues from the federal universal service fund and, to a lesser extent, state support funds. These governmental programs are reviewed and amended from time to time, and we cannot assure you that they will not be changed or impacted in a manner adverse to us.

#### **Our company and industry are highly regulated, imposing substantial compliance costs and restricting our ability to compete in our target markets.**

As an incumbent, we are subject to significant regulation from federal, state and local authorities. This regulation restricts our ability to change our rates, especially on our basic services, and imposes substantial compliance costs on us. Regulation restricts our ability to compete and, in some jurisdictions, it may restrict how we are able to expand our service offerings. In addition, changes to the regulations that govern us may have an adverse effect upon our business by reducing the allowable fees that we may charge, imposing additional compliance costs, or otherwise changing the nature of our operations and the competition in our industry.

Recent rule changes now allow customers to retain their wireline number when switching to another service provider. This is likely to increase the number of our customers who decide to disconnect their service from us. Other pending rulemakings, including those relating to intercarrier compensation, universal service and VOIP regulations, could have a substantial adverse impact on our operations.

### RISKS RELATED TO TECHNOLOGY

#### **In the future as competition intensifies within our markets, we may be unable to meet the technological needs or expectations of our customers, and may lose customers as a result.**

The telecommunications industry is subject to significant changes in technology. If we do not replace or upgrade technology and equipment, we will be unable to compete effectively because we will not be able to meet the needs or expectations of our customers. Replacing or upgrading our infrastructure could result in significant capital expenditures.

In addition, rapidly changing technology in the telecommunications industry may influence our customers to consider other service providers. For example, we may be unable to retain customers who decide to replace their wireline telephone service with wireless telephone service. In addition, VOIP technology, which operates on broadband technology, now provides our competitors with a low-cost alternative to provide voice services to our customers.

### ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

## CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES

### ITEM 2. PROPERTIES

Our principal corporate offices are located in leased premises at 3 High Ridge Park, Stamford, Connecticut.

An operations support office is currently located in leased premises at 180 South Clinton Avenue, Rochester, New York. In addition, our Frontier segment leases and owns space in various markets throughout the United States.

An operations support office for ELI is located in a building we own at 4400 NE 77th Avenue, Vancouver, Washington. In addition, our ELI segment leases local office space in various markets throughout the United States, and also maintains a warehouse facility in Portland, Oregon. Our ELI segment also leases network hub and network equipment installation sites in various locations throughout the areas in which it provides services. For additional information regarding obligations under lease, see Note 25 to Consolidated Financial Statements.

Our Frontier and ELI segments own telephone properties which include: connecting lines between customers' premises and the central offices; central office switching equipment; fiber-optic and microwave radio facilities; buildings and land; and customer premise equipment. The connecting lines, including aerial and underground cable, conduit, poles, wires and microwave equipment, are located on public streets and highways or on privately owned land. We have permission to use these lands pursuant to local governmental consent or lease, permit, franchise, easement or other agreement.

### ITEM 3. LEGAL PROCEEDINGS

The City of Bangor, Maine, filed suit against us on November 22, 2002, in the U.S. District Court for the District of Maine (City of Bangor v. Citizens Communications Company, Civ. Action No. 02-183-B-S). The City alleged, among other things, that we are responsible for the costs of cleaning up environmental contamination alleged to have resulted from the operation of a manufactured gas plant owned by Bangor Gas Company from 1852-1948 and by us from 1948-1963. In acquiring the operation in 1948 we acquired the stock of Bangor Gas Company and merged it into us. The City alleged the existence of extensive contamination of the Penobscot River and asserted that money damages and other relief at issue in the lawsuit could exceed \$50,000,000. The City also requested that punitive damages be assessed against us. We filed an answer denying liability to the City, and asserted a number of counterclaims against the City. In addition, we identified a number of other potentially responsible parties that may be liable for the damages alleged by the City and joined them as parties to the lawsuit. These additional parties include Honeywell Corporation, Guilford Transportation (operating as Maine Central Railroad), UGI Utilities, Inc. and Centerpoint Energy Resources Corporation. The Court dismissed all but two of the City's claims, including its claims for joint and several liability under the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) and the claim against us for punitive damages. Trial was conducted in September and October 2005 for the first (liability) phase of the case, and a decision from the court is anticipated by the end of the first quarter of 2006. We intend to continue to defend ourselves vigorously against the City's lawsuit. We have demanded that various of our insurance carriers defend and indemnify us with respect to the City's lawsuit, and on December 26, 2002, we filed a declaratory judgment action against those insurance carriers in the Superior Court of Penobscot County, Maine, for the purpose of establishing their obligations to us with respect to the City's lawsuit. We intend to vigorously pursue this lawsuit and to obtain from our insurance carriers indemnification for any damages that may be assessed against us in the City's lawsuit as well as to recover the costs of our defense of that lawsuit.

On June 7, 2004, representatives of Robert A. Katz Technology Licensing, LP, contacted us regarding possible infringement of several patents held by that firm. The patents cover a wide range of operations in which telephony is supported by computers, including obtaining information from databases via telephone, interactive telephone transactions, and customer and technical support applications. We were cooperating with the patent holder to determine if we are currently using any of the processes that are protected by its patents but have not had any communication with them on this issue since mid-2004. If we determine that we are utilizing the patent holder's intellectual property, we expect to commence negotiations on a license agreement.

On June 24, 2004, one of our subsidiaries, Frontier Subsidiary Telco Inc., received a "Notice of Indemnity Claim" from Citibank, N.A., that is related to a complaint pending against Citibank and others in the U.S. Bankruptcy Court for the Southern District of New York as part of the Global Crossing bankruptcy proceeding. Citibank bases its claim for indemnity on the provisions of a credit agreement that was entered into in October 2000 between

## CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES

Citibank and our subsidiary. We purchased Frontier Subsidiary Telco, Inc., in June 2001 as part of our acquisition of the Frontier telephone companies. The complaint against Citibank, for which it seeks indemnification, alleges that the seller improperly used a portion of the proceeds from the Frontier transaction to pay off the Citibank credit agreement, thereby defrauding certain debt holders of Global Crossing North America Inc. Although the credit agreement was paid off at the closing of the Frontier transaction, Citibank claims the indemnification obligation survives. Damages sought against Citibank and its co-defendants could exceed \$1.0 billion. In August 2004 we notified Citibank by letter that we believe its claims for indemnification are invalid and are not supported by applicable law. We have received no further communications from Citibank since our August 2004 letter.

We are party to other legal proceedings arising in the normal course of our business. The outcome of individual matters is not predictable. However, we believe that the ultimate resolution of all such matters, after considering insurance coverage, will not have a material adverse effect on our financial position, results of operations, or our cash flows.

### ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None in fourth quarter 2005.

### EXECUTIVE OFFICERS OF THE REGISTRANT

Our Executive Officers as of February 7, 2006 were:

<u>Name</u>	<u>Age</u>	<u>Current Position and Officer</u>
Mary Agnes Wilderotter . . . . .	51	Chairman of the Board and Chief Executive Officer
John H. Casey, III . . . . .	49	Executive Vice President
Jerry Elliott . . . . .	46	President and Acting Chief Financial Officer
Hilary E. Glassman . . . . .	43	Senior Vice President, General Counsel and Secretary
Peter B. Hayes . . . . .	48	Executive Vice President Sales, Marketing and Business Development
Robert J. Larson . . . . .	46	Senior Vice President and Chief Accounting Officer
Daniel J. McCarthy . . . . .	41	Executive Vice President and Chief Operating Officer
Cecilia K. McKenney . . . . .	43	Senior Vice President, Human Resources

There is no family relationship between directors or executive officers. The term of office of each of the foregoing officers of Citizens will continue until the next annual meeting of the Board of Directors and until a successor has been elected and qualified.

MARY AGNES WILDEROTTER has been associated with Citizens since November 2004. She was elected Chairman of the Board and Chief Executive Officer in December 2005. Previously, she was President and Chief Executive Officer from November 2004 to December 2005. Prior to joining Citizens, she was Senior Vice President – Worldwide Public Sector in 2004, Microsoft Corp. and Senior Vice President – Worldwide Business Strategy, Microsoft Corp., 2002 to 2004. Before that she was President and Chief Executive Officer, Wink Communications, 1997 to 2002.

JOHN H. CASEY, III has been associated with Citizens since November 1999. He is currently Executive Vice President. Previously, he was Executive Vice President and President and Chief Operating Officer of our ILEC Sector from July 2002 to December 2004. He was Vice President of Citizens, President and Chief Operating Officer, ILEC Sector from January 2002 to July 2002, Vice President and Chief Operating Officer, ILEC Sector from February 2000 to January 2002, and Vice President, ILEC Sector from December 1999 to February 2000.

JERRY ELLIOTT has been associated with Citizens since March 2002. He was elected President in December 2005 and remains Acting Chief Financial Officer until a successor Chief Financial Officer joins the Company. Previously, he was Executive Vice President and Chief Financial Officer from July 2004 to December 2005. He was Senior Vice President and Chief Financial Officer from December 2002 to July 2004 and Vice President and Chief Financial Officer from March 2002 to December 2002. Prior to joining Citizens, he was Managing Director of Morgan Stanley's Media and Communications Investment Banking Group.

## CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES

HILARY E. GLASSMAN has been associated with Citizens since July 2005. Prior to joining Citizens, from February 2003, she was associated with Sandler O'Neill & Partners, L.P., an investment bank with a specialized financial institutions practice, first as Managing Director, Associate General Counsel and then as Managing Director, Deputy General Counsel. From February 2000 through February 2003, Ms. Glassman was Vice President and General Counsel of Newview Technologies, Inc. (formerly e-Steel Corporation), a privately-held software company.

PETER B. HAYES has been associated with Citizens since February 2005. He is currently Executive Vice President, Sales, Marketing and Business Development. Previously, he was Senior Vice President, Sales, Marketing and Business Development from February 2005 to December 2005. Prior to joining Citizens, he was associated with Microsoft Corp. and served as Vice President, Public Sector, Europe, Middle East, Africa from 2003 to 2005 and Vice President and General Manager, Microsoft U.S. Government from 1997 to 2003.

ROBERT J. LARSON has been associated with Citizens since July 2000. He was elected Senior Vice President and Chief Accounting Officer of Citizens in December 2002. Previously, he was Vice President and Chief Accounting Officer from July 2000 to December 2002. Prior to joining Citizens, he was Vice President and Controller of Century Communications Corp.

DANIEL J. McCARTHY has been associated with Citizens since December 1990. He is currently Executive Vice President and Chief Operating Officer. Previously, he was Senior Vice President, Field Operations from December 2004 to December 2005. He was Senior Vice President Broadband Operations from January 2004 to December 2004, President and Chief Operating Officer of Electric Lightwave from January 2002 to December 2004, President and Chief Operating Officer, Public Services Sector from November 2001 to January 2002, Vice President and Chief Operating Officer, Public Services Sector from March 2001 to November 2001 and Vice President, Citizens Arizona Energy from April 1998 to March 2001.

CECILIA K. McKENNEY has been associated with Citizens since February 2006. Prior to joining Citizens, she was the Group Vice President, Headquarters Human Resources of The Pepsi Bottling Group (PBG) from 2004 to 2005. Previously at PBG, Ms. McKenney was the Vice President, Headquarters Human Resources from 2000 to 2004.

**CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES**

**PART II**

**ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES**

**PRICE RANGE OF COMMON STOCK**

Our common stock is traded on the New York Stock Exchange under the symbol CZN. The following table indicates the high and low prices per share during the periods indicated.

	2005		2004	
	High	Low	High	Low
First Quarter .....	\$14.05	\$12.25	\$13.25	\$11.37
Second Quarter .....	\$13.74	\$12.16	\$13.54	\$12.06
Third Quarter .....	\$13.98	\$13.05	\$14.80	\$12.04
Fourth Quarter .....	\$13.57	\$12.08	\$14.63	\$13.11

As of January 31, 2006, the approximate number of security holders of record of our common stock was 26,226. This information was obtained from our transfer agent.

**DIVIDENDS**

The amount and timing of dividends payable on our common stock are within the sole discretion of our Board of Directors. In 2004, we paid a special, non-recurring dividend of \$2.00 per share of common stock, and instituted a regular annual dividend of \$1.00 per share of common stock to be paid quarterly. Cash dividends paid to shareholders were approximately \$338.4 million and \$832.8 million in 2005 and 2004, respectively. There are no material restrictions on our ability to pay dividends. The table below sets forth dividends paid during the periods indicated.

	2005	2004
First Quarter .....	\$ 0.25	\$ —
Second Quarter .....	\$ 0.25	\$ —
Third Quarter .....	\$ 0.25	\$ 2.25
Fourth Quarter .....	\$ 0.25	\$ 0.25

**RECENT SALES OF UNREGISTERED SECURITIES, USE OF PROCEEDS FROM REGISTERED SECURITIES**

None.

**CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES**

**ISSUER PURCHASES OF EQUITY SECURITIES**

The following tables display issuer purchases of equity securities for the years ended December 31, 2005 and 2004.

Period	(a) Total Number of Shares Purchased	(b) Average Price Paid per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	(d) Maximum Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs
<b>January 1, 2005 to January 31, 2005</b>				
Share Repurchase Program <sup>(1)</sup> .....	—	\$ —	—	\$ —
Employee Transactions <sup>(2)</sup> .....	—	\$ —	N/A	N/A
<b>February 1, 2005 to February 28, 2005</b>				
Share Repurchase Program <sup>(1)</sup> .....	—	\$ —	—	\$ —
Employee Transactions <sup>(2)</sup> .....	—	\$ —	N/A	N/A
<b>March 1, 2005 to March 31, 2005</b>				
Share Repurchase Program <sup>(1)</sup> .....	—	\$ —	—	\$ —
Employee Transactions <sup>(2)</sup> .....	128,049	\$ 12.62	N/A	N/A
<b>Totals January 1, 2005 to March 31, 2005</b>				
Share Repurchase Program <sup>(1)</sup> .....	—	\$ —	—	\$ —
Employee Transactions <sup>(2)</sup> .....	128,049	\$ 12.62	N/A	N/A
<b>April 1, 2005 to April 30, 2005</b>				
Share Repurchase Program <sup>(1)</sup> .....	—	\$ —	—	\$ —
Employee Transactions <sup>(2)</sup> .....	—	\$ —	N/A	N/A
<b>May 1, 2005 to May 31, 2005</b>				
Share Repurchase Program <sup>(1)</sup> .....	—	\$ —	—	\$ —
Employee Transactions <sup>(2)</sup> .....	—	\$ —	N/A	N/A
<b>June 1, 2005 to June 30, 2005</b>				
Share Repurchase Program <sup>(1)</sup> .....	1,400,000	\$ 13.28	1,400,000	\$ 231,400,000
Employee Transactions <sup>(2)</sup> .....	—	\$ —	N/A	N/A
<b>Totals April 1, 2005 to June 30, 2005</b>				
Share Repurchase Program <sup>(1)</sup> .....	1,400,000	\$ 13.28	1,400,000	\$ 231,400,000
Employee Transactions <sup>(2)</sup> .....	—	\$ —	N/A	N/A
<b>July 1, 2005 to July 31, 2005</b>				
Share Repurchase Program <sup>(1)</sup> .....	—	\$ —	—	\$ 231,400,000
Employee Transactions <sup>(2)</sup> .....	—	\$ —	N/A	N/A
<b>August 1, 2005 to August 31, 2005</b>				
Share Repurchase Program <sup>(1)</sup> .....	6,576,100	\$ 13.68	6,576,100	\$ 141,500,000
Employee Transactions <sup>(2)</sup> .....	—	\$ —	N/A	N/A
<b>September 1, 2005 to September 30, 2005</b>				
Share Repurchase Program <sup>(1)</sup> .....	4,680,400	\$ 13.56	4,680,400	\$ 78,000,000
Employee Transactions <sup>(2)</sup> .....	629	\$ 13.51	N/A	N/A

**CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES**

<u>Period</u>	<u>(a) Total Number of Shares Purchased</u>	<u>(b) Average Price Paid per Share</u>	<u>(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs</u>	<u>(d) Maximum Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs</u>
Totals July 1, 2005 to September 30, 2005				
Share Repurchase Program <sup>(1)</sup> . . . . .	11,256,500	\$ 13.62	11,256,500	\$ 78,000,000
Employee Transactions <sup>(2)</sup> . . . . .	629	\$ 13.51	N/A	N/A
October 1, 2005 to October 31, 2005				
Share Repurchase Program <sup>(1)</sup> . . . . .	—	\$ —	—	\$ 78,000,000
Employee Transactions <sup>(2)</sup> . . . . .	—	\$ —	N/A	N/A
November 1, 2005 to November 30, 2005				
Share Repurchase Program <sup>(1)</sup> . . . . .	375,000	\$ 13.06	375,000	\$ 73,100,000
Employee Transactions <sup>(2)</sup> . . . . .	12,435	\$ 12.17	N/A	N/A
December 1, 2005 to December 31, 2005				
Share Repurchase Program <sup>(1)</sup> . . . . .	5,743,656	\$ 12.73	5,743,656	\$ —
Employee Transactions <sup>(2)</sup> . . . . .	1,155	\$ 12.85	N/A	N/A
Totals October 1, 2005 to December 31, 2005				
Share Repurchase Program <sup>(1)</sup> . . . . .	6,118,656	\$ 12.75	6,118,656	\$ —
Employee Transactions <sup>(2)</sup> . . . . .	13,590	\$ 12.23	N/A	N/A
Totals January 1, 2005 to December 31, 2005				
Share Repurchase Program <sup>(1)</sup> . . . . .	18,775,156	\$ 13.32	18,775,156	\$ —
Employee Transactions <sup>(2)</sup> . . . . .	142,268	\$ 12.59	N/A	N/A
January 1, 2004 to January 31, 2004				
Share Repurchase Program <sup>(1)</sup> . . . . .	—	\$ —	—	\$ —
Employee Transactions <sup>(2)</sup> . . . . .	—	\$ —	N/A	N/A
February 1, 2004 to February 28, 2004				
Share Repurchase Program <sup>(1)</sup> . . . . .	—	\$ —	—	\$ —
Employee Transactions <sup>(2)</sup> . . . . .	—	\$ —	N/A	N/A
March 1, 2004 to March 31, 2004				
Share Repurchase Program <sup>(1)</sup> . . . . .	—	\$ —	—	\$ —
Employee Transactions <sup>(2)</sup> . . . . .	3,123	\$ 12.64	N/A	N/A
Totals January 1, 2004 to March 31, 2004				
Share Repurchase Program <sup>(1)</sup> . . . . .	—	\$ —	—	\$ —
Employee Transactions <sup>(2)</sup> . . . . .	3,123	\$ 12.64	N/A	N/A
April 1, 2004 to April 30, 2004				
Share Repurchase Program <sup>(1)</sup> . . . . .	—	\$ —	—	\$ —
Employee Transactions <sup>(2)</sup> . . . . .	—	\$ —	N/A	N/A
May 1, 2004 to May 31, 2004				
Share Repurchase Program <sup>(1)</sup> . . . . .	—	\$ —	—	\$ —
Employee Transactions <sup>(2)</sup> . . . . .	—	\$ —	N/A	N/A

**CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES**

Period	(a) Total Number of Shares Purchased	(b) Average Price Paid per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	(d) Maximum Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs
<b>June 1, 2004 to June 30, 2004</b>				
Share Repurchase Program <sup>(1)</sup> .....	—	\$ —	—	\$ —
Employee Transactions <sup>(2)</sup> .....	—	\$ —	N/A	N/A
<b>Totals April 1, 2004 to June 30, 2004</b>				
Share Repurchase Program <sup>(1)</sup> .....	—	\$ —	—	\$ —
Employee Transactions <sup>(2)</sup> .....	—	\$ —	N/A	N/A
<b>July 1, 2004 to July 31, 2004</b>				
Share Repurchase Program <sup>(1)</sup> .....	—	\$ —	—	\$ —
Employee Transactions <sup>(2)</sup> .....	—	\$ —	N/A	N/A
<b>August 1, 2004 to August 31, 2004</b>				
Share Repurchase Program <sup>(1)</sup> .....	—	\$ —	—	\$ —
Employee Transactions <sup>(2)</sup> .....	1,503,748	\$ 14.32	N/A	N/A
<b>September 1, 2004 to September 30, 2004</b>				
Share Repurchase Program <sup>(1)</sup> .....	—	\$ —	—	\$ —
Employee Transactions <sup>(2)</sup> .....	—	\$ —	N/A	N/A
<b>Totals July 1, 2004 to September 30, 2004</b>				
Share Repurchase Program <sup>(1)</sup> .....	—	\$ —	—	\$ —
Employee Transactions <sup>(2)</sup> .....	1,503,748	\$ 14.32	N/A	N/A
<b>October 1, 2004 to October 31, 2004</b>				
Share Repurchase Program <sup>(1)</sup> .....	—	\$ —	—	\$ —
Employee Transactions <sup>(2)</sup> .....	—	\$ —	N/A	N/A
<b>November 1, 2004 to November 30, 2004</b>				
Share Repurchase Program <sup>(1)</sup> .....	—	\$ —	—	\$ —
Employee Transactions <sup>(2)</sup> .....	—	\$ —	N/A	N/A
<b>December 1, 2004 to December 31, 2004</b>				
Share Repurchase Program <sup>(1)</sup> .....	—	\$ —	—	\$ —
Employee Transactions <sup>(2)</sup> .....	—	\$ —	N/A	N/A
<b>Totals October 1, 2004 to December 31, 2004</b>				
Share Repurchase Program <sup>(1)</sup> .....	—	\$ —	—	\$ —
Employee Transactions <sup>(2)</sup> .....	—	\$ —	N/A	N/A
<b>Totals January 1, 2004 to December 31, 2004</b>				
Share Repurchase Program <sup>(1)</sup> .....	—	\$ —	—	\$ —
Employee Transactions <sup>(2)</sup> .....	1,506,871	\$ 14.32	N/A	N/A

<sup>(1)</sup> On May 25, 2005, our Board of Directors authorized the Company to repurchase up to \$250.0 million of the Company's common stock, either in the open market or through negotiated transactions. This share repurchase program commenced on June 13, 2005 and was completed during December of 2005.

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- (2) Includes restricted shares withheld (under the terms of grants under employee stock compensation plans) to offset minimum tax withholding obligations that occur upon the vesting of restricted shares. The Company's stock compensation plans provide that the value of shares withheld shall be the average of the high and low price of the Company's common stock on the date the relevant transaction occurs.

**ITEM 6. SELECTED FINANCIAL DATA**

(\$ in thousands, except per share amounts)	Year Ended December 31,				
	2005	2004	2003	2002	2001
Revenue <sup>(1)</sup> . . . . .	\$ 2,162,479	\$ 2,168,422	\$ 2,424,174	\$ 2,647,671	\$ 2,435,489
Income (loss) from continuing operations before extraordinary expense and cumulative effect of changes in accounting principle <sup>(2)</sup> . . . . .	\$ 200,168	\$ 66,919	\$ 117,703	\$ (828,140)	\$ (68,434)
Net income (loss) . . . . .	\$ 202,375	\$ 72,150	\$ 187,852	\$ (682,897)	\$ (89,682)
Basic income (loss) per share of common stock from continuing operations before extraordinary expense and cumulative effect of changes in accounting principle <sup>(2)</sup> . . . . .	\$ 0.59	\$ 0.22	\$ 0.42	\$ (2.95)	\$ (0.30)
Available for common shareholders per basic share . . . . .	\$ 0.60	\$ 0.24	\$ 0.67	\$ (2.43)	\$ (0.38)
Available for common shareholders per diluted share . . . . .	\$ 0.60	\$ 0.23	\$ 0.64	\$ (2.43)	\$ (0.38)
Cash dividends declared (and paid) per common share . . . . .	\$ 1.00	\$ 2.50	\$ —	\$ —	\$ —

	As of December 31,				
	2005	2004	2003	2002	2001
Total assets . . . . .	\$ 6,412,109	\$ 6,668,419	\$ 7,445,545	\$ 8,144,502	\$ 10,551,351
Long-term debt . . . . .	\$ 3,999,376	\$ 4,266,998	\$ 4,195,626	\$ 4,957,338	\$ 5,534,867
Equity units <sup>(3)</sup> . . . . .	\$ —	\$ —	\$ 460,000	\$ 460,000	\$ 460,000
Company Obligated Mandatorily Redeemable Convertible Preferred Securities <sup>(4)</sup> . . . . .	\$ —	\$ —	\$ 201,250	\$ 201,250	\$ 201,250
Shareholders' equity . . . . .	\$ 1,041,809	\$ 1,362,240	\$ 1,415,183	\$ 1,172,139	\$ 1,946,142

- (1) Represents revenue from continuing operations. Revenue from acquisitions contributed \$569.8 million for the year ended December 31, 2001. Revenue from gas operations sold was \$137.7 million in 2003 and \$218.8 million in 2001. Revenue from electric operations sold was \$9.7 million, \$67.4 million, \$76.6 million and \$94.3 million in 2004, 2003, 2002 and 2001, respectively. Total revenue associated with these operations is available in Note 22, "Segment Information."
- (2) Extraordinary expense represents an extraordinary after tax expense of \$43.6 million related to the discontinuance of the application of Statement of Financial Accounting Standards No. 71 to our local exchange telephone operations in 2001. The cumulative effect of changes in accounting principles represents the \$65.8 million after tax non-cash gain resulting from the adoption of Statement of Financial Accounting Standards No. 143 in 2003, and the write-off of ELI's goodwill of \$39.8 million resulting from the adoption of Statement of Financial Accounting Standards No. 142 in 2002.
- (3) On August 17, 2004, we issued common stock to equity unit holders in settlement of the equity purchase contract.
- (4) The consolidation of this item changed effective January 1, 2004 as a result of the adoption of FIN 46R, "Consolidation of Variable Interest Entities." See Note 15 for a complete discussion.

## CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES

### ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

#### FORWARD-LOOKING STATEMENTS

This annual report on Form 10-K contains forward-looking statements that are subject to risks and uncertainties that could cause actual results to differ materially from those expressed or implied in the statements. Statements that are not historical facts are forward-looking statements made pursuant to the Safe Harbor Provisions of the Litigation Reform Act of 1995. Words such as "believes," "anticipates," "expects" and similar expressions are intended to identify forward-looking statements. Forward-looking statements (including oral representations) are only predictions or statements of current plans, which we review continuously. *Forward-looking statements may differ from actual future results due to, but not limited to, and our future results may be materially affected by, any of the following possibilities:*

- Changes in the number of our revenue generating units, which consists of access lines plus high-speed internet subscribers;
- The effects of competition from wireless, other wireline carriers (through voice over internet protocol (VOIP) or otherwise), high speed cable modems and cable telephony;
- The effects of general and local economic and employment conditions on our revenues;
- Our ability to effectively manage our operations, costs, capital spending, regulatory compliance and service quality;
- Our ability to successfully introduce new product offerings including our ability to offer bundled service packages on terms that are both profitable to us and attractive to our customers;
- Our ability to sell enhanced and data services in order to offset ongoing declines in revenue from local services, access services and subsidies;
- Our ability to comply with Section 404 of the Sarbanes-Oxley Act of 2002, which requires management to assess its internal control systems and disclose whether the internal control systems are effective, and the identification of any material weaknesses in our internal control over financial reporting;
- Changes in accounting policies or practices adopted voluntarily or as required by generally accepted accounting principles or regulators;
- The effects of changes in regulation in the communications industry as a result of federal and state legislation and regulation, including potential changes in access charges and subsidy payments, and regulatory network upgrade and reliability requirements;
- Our ability to comply with federal and state regulation (including state rate of return limitations on our earnings) and our ability to successfully renegotiate state regulatory plans as they expire or come up for renewal from time to time;
- Our ability to manage our operating expenses, capital expenditures, pay dividends and reduce or refinance our debt;
- Adverse changes in the ratings given to our debt securities by nationally accredited ratings organizations, which could limit or restrict the availability, and/or increase the cost of financing;
- The effects of greater than anticipated competition requiring new pricing, marketing strategies or new product offerings and the risk that we will not respond on a timely or profitable basis;
- The effects of bankruptcies in the telecommunications industry which could result in more price competition and potential bad debts;
- The effects of technological changes and competition on our capital expenditures and product and service offerings, including the lack of assurance that our ongoing network improvements will be sufficient to meet or exceed the capabilities and quality of competing networks;

## CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES

- The effects of increased medical, retiree and pension expenses and related funding requirements;
- Changes in income tax rates, tax laws, regulations or rulings, and/or federal or state tax assessments;
- The effect of changes in the communications market, including significantly increased price and service competition;
- The effects of state regulatory cash management policies on our ability to transfer cash among our subsidiaries and to the parent company;
- Our ability to successfully renegotiate expiring union contracts covering approximately 1,400 employees that are scheduled to expire during 2006;
- Our ability to pay a \$1.00 per common share dividend annually may be affected by our cash flow from operations, amount of capital expenditures, debt service requirements, cash paid for income taxes (which will increase in the future) and our liquidity;
- The effects of any future liabilities or compliance costs in connection with worker health and safety matters;
- The effects of any unfavorable outcome with respect to any of our current or future legal, governmental, or regulatory proceedings, audits or disputes; and
- The effects of more general factors, including changes in economic, business and industry conditions.

Any of the foregoing events, or other events, could cause financial information to vary from management's forward-looking statements included in this report. You should consider these important factors, as well as the risks set forth under Item 1A. "Risk Factors" above, in evaluating any statement in this Form 10-K or otherwise made by us or on our behalf. The following information is unaudited and should be read in conjunction with the consolidated financial statements and related notes included in this report. We have no obligation to update or revise these forward-looking statements.

### OVERVIEW

We are a communications company providing services to rural areas and small and medium-sized towns and cities as an incumbent local exchange carrier, or ILEC. We offer our ILEC services under the "Frontier" name. In addition, we provide competitive local exchange carrier, or CLEC, services to business customers and to other communications carriers in certain metropolitan areas in the western United States through Electric Lightwave, LLC, or ELI, our wholly-owned subsidiary. In February 2006, we entered into a definitive agreement to sell ELI and we expect the sale to close in the third quarter of 2006.

Competition in the telecommunications industry is intense and increasing. We experience competition from many telecommunications service providers including cable operators, wireless carriers, voice over internet protocol (VOIP) providers, long distance providers, competitive local exchange carriers, internet providers and other wireline carriers. We believe that competition will continue to intensify in 2006 across all products and in all of our markets. Our Frontier business experienced erosion in access lines and switched access minutes in 2005 as a result of competition. Competition in our markets may result in reduced revenues in 2006.

The communications industry is undergoing significant changes. The market is extremely competitive, resulting in lower prices. Demand and pricing for certain CLEC services have decreased substantially, particularly for long-haul services. These trends are likely to continue and result in a challenging revenue environment. These factors could also result in more bankruptcies in the sector and therefore affect our ability to collect money owed to us by carriers.

Revenues from data and internet services such as high-speed internet continue to increase as a percentage of our total revenues and revenues from services such as local line and access charges and subsidies are decreasing as a percentage of our revenues. These factors, along with increasing operating costs, could cause our profitability and our cash generated by operations to decrease.

## CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES

### **(a) LIQUIDITY AND CAPITAL RESOURCES**

For the year ended December 31, 2005, we used cash flows from continuing operations, the proceeds from the sale of non-strategic assets, stock option exercises and cash and cash equivalents to fund capital expenditures, dividends, interest payments, debt repayments and stock repurchases. As of December 31, 2005, we had cash and cash equivalents aggregating \$265.8 million.

For the year ended December 31, 2005, our capital expenditures were \$268.5 million, including \$252.2 million for the Frontier segment, \$16.1 million for the ELI segment and \$0.2 million of general capital expenditures. We continue to closely scrutinize all of our capital projects, emphasize return on investment and focus our capital expenditures on areas and services that have the greatest opportunities with respect to revenue growth and cost reduction. For example, we will allocate significant capital to services such as high-speed internet in areas that are growing or demonstrate meaningful demand as well as the launch of new products such as wireless and VOIP services.

Increasing competition, offering new services such as wireless and VOIP, and improving the capabilities or reducing the maintenance costs of our plant may cause our capital expenditures to increase in the future. For 2006, we expect our capital expenditures to increase in order to build wireless data networks and expand the capabilities of our data networks.

As of December 31, 2005, we have available lines of credit with financial institutions in the aggregate amount of \$250.0 million. Associated facility fees vary, depending on our debt leverage ratio, and are 0.375% per annum as of December 31, 2005. The expiration date for the facility is October 29, 2009. During the term of the facility we may borrow, repay and reborrow funds. The credit facility is available for general corporate purposes but may not be used to fund dividend payments. We have never borrowed any money under the facility.

Our ongoing annual dividends of \$1.00 per share under our current policy utilize a significant portion of our cash generated by operations and therefore limits our operating and financial flexibility. While we believe that the amount of our dividends will allow for adequate amounts of cash flow for other purposes, any reduction in cash generated by operations and any increases in capital expenditures, interest expense or cash taxes would reduce the amount of cash generated in excess of dividends. Losses of access lines, increases in competition, lower subsidy and access revenues and the other factors described above are expected to reduce our cash generated by operations and may require us to increase capital expenditures. The downgrades in our credit ratings in July 2004 to below investment grade may make it more difficult and expensive to refinance our maturing debt. We have in recent years paid relatively low amounts of cash taxes. We expect that over the next several years our cash taxes will increase substantially.

We believe our operating cash flows, existing cash balances, and credit facilities will be adequate to finance our working capital requirements, fund capital expenditures, make required debt payments through 2007, pay taxes, pay dividends to our shareholders in accordance with our dividend policy, and support our short-term and long-term operating strategies. We have approximately \$227.8 million, \$37.9 million and \$701.1 million of debt maturing in 2006, 2007 and 2008, respectively.

### **Share Repurchase Programs**

On May 25, 2005, our Board of Directors authorized us to repurchase up to \$250.0 million of our common stock. This share repurchase program commenced on June 13, 2005. As of December 31, 2005, we completed the repurchase program and had repurchased a total of 18,775,156 common shares at an aggregate cost of \$250.0 million. In February 2006, our Board of Directors authorized us to repurchase up to \$300.0 million of our common stock in public or private transactions over the following twelve-month period. We may in the future purchase additional shares of our common stock.

### **Issuance of Common Stock**

On August 17, 2004 we issued 32,073,633 shares of common stock, including 3,591,000 treasury shares, to our equity unit holders in settlement of the equity purchase contract component of the equity units. With respect to the \$460.0 million senior note component of the equity units, we repurchased \$300.0 million principal amount of these notes in July 2004. The remaining \$160.0 million of the senior notes were repriced and a portion was remarketed on August 12, 2004 as our 6.75% notes due August 17, 2006.

## CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES

### Issuance of Debt Securities

On November 8, 2004, we issued an aggregate \$700.0 million principal amount of 6.25% senior notes due January 15, 2013 through a registered underwritten public offering. Proceeds from the sale were used to redeem our outstanding \$700.0 million of 8.50% Notes due 2006.

### Debt Reduction and Debt Exchanges

For the year ended December 31, 2005, we retired an aggregate principal amount of \$36.4 million of debt, including \$30.0 million of 5% Company Obligated Mandatorily Redeemable Convertible Preferred Securities due 2036 (EPPICS) that were converted into our common stock. During the second quarter of 2005, we entered into two debt-for-debt exchanges of our debt securities. As a result, \$50.0 million of our 7.625% notes due 2008 were exchanged for approximately \$52.2 million of our 9.00% notes due 2031. The 9.00% notes are callable on the same general terms and conditions as the 7.625% notes exchanged. No cash was exchanged in these transactions, however a non-cash pre-tax loss of approximately \$3.2 million was recognized in accordance with EITF No. 96-19, "Debtor's Accounting for a Modification or Exchange of Debt Instruments," which is included in other income (loss), net. In February 2006, our Board of Directors authorized us to repurchase up to \$150.0 million of our outstanding debt securities over the following twelve-month period. These repurchases may require us to pay premiums, which would result in pre-tax losses to be recorded in other income (loss), net.

For the year ended December 31, 2004, we retired an aggregate \$1,362.0 million of debt (including \$148.0 million of EPPICS conversions), representing approximately 28% of total debt outstanding at December 31, 2003.

During August and September 2004, we repurchased an additional \$108.2 million of our 6.75% notes which, in addition to the \$300.0 million we purchased in July, resulted in a pre-tax charge of approximately \$20.1 million during the third quarter of 2004, but resulted in an annual reduction in interest expense of about \$27.6 million per year. See the discussion below concerning EPPICS conversions for further information regarding the issuance of common stock.

We may from time to time repurchase our debt in the open market, through tender offers or privately negotiated transactions. We may also exchange existing debt obligations for newly issued debt obligations.

### Interest Rate Management

In order to manage our interest expense, we have entered into interest rate swap agreements. Under the terms of the agreements, which qualify for hedge accounting, we make semi-annual, floating rate interest payments based on six month LIBOR and receive a fixed rate on the notional amount. The underlying variable rate on these swaps is set in arrears.

The notional amounts of fixed-rate indebtedness hedged as of December 31, 2005 and December 31, 2004 were \$500.0 million and \$300.0 million, respectively. Such contracts require us to pay variable rates of interest (average pay rates of approximately 8.60% and 6.12% as of December 31, 2005 and 2004, respectively) and receive fixed rates of interest (average receive rates of 8.46% and 8.44% as of December 31, 2005 and 2004, respectively). All swaps are accounted for under SFAS No. 133 (as amended) as fair value hedges. For the years ended December 31, 2005 and 2004, the cash interest savings resulting from these interest rate swaps totaled approximately \$2.5 million and \$9.4 million, respectively.

During September 2005, we entered into a series of forward rate agreements that fixed the underlying variable rate component of some of our swaps at the market rate as of the date of execution for certain future rate-setting dates. At December 31, 2005, the rates obtained under these forward rate agreements were below market rates. Changes in the fair value of these forward rate agreements, which do not qualify for hedge accounting, are recorded in other income (loss), net. Gains of \$1.3 million and \$0.6 million, respectively, were recorded during the third and fourth quarters of 2005.

## CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES

### Sale of Non-Strategic Investments

In February 2006, we entered into a definitive agreement to sell all of the outstanding membership interests in ELI to Integra Telecom Holdings, Inc. (Integra) for \$247.0 million, including \$243.0 million in cash plus the assumption of approximately \$4.0 million in capital lease obligations, subject to customary adjustments under the terms of the agreement. We anticipate the recognition of a pre-tax gain on the sale of ELI of approximately \$130.0 million. The transaction is expected to close in the third quarter of 2006 and is subject to regulatory and other customary approvals and conditions, as well as the funding of Integra's fully committed financing. We expect that for periods subsequent to December 31, 2005, ELI will be accounted for as a discontinued operation.

On February 1, 2005, we sold shares of Prudential Financial, Inc. for approximately \$1.1 million in cash, and we recognized a pre-tax gain of approximately \$0.5 million that is included in other income (loss), net.

On March 15, 2005, we completed the sale of our conferencing business for approximately \$43.6 million in cash. The pre-tax gain on the sale of CCUSA was \$14.1 million.

In June 2005, we sold for cash our interests in certain key man life insurance policies on the lives of Leonard Tow, our former Chairman and Chief Executive Officer, and his wife, a former director. The cash surrender value of the policies purchased by Dr. Tow totaled approximately \$24.2 million, and we recognized a pre-tax gain of approximately \$457,000 that is included in other income (loss), net.

During 2005, we sold shares of Global Crossing Limited for approximately \$1.1 million in cash, and we recognized a pre-tax gain for the same amount that is included in other income (loss), net.

### Off-Balance Sheet Arrangements

We do not maintain any off-balance sheet arrangements, transactions, obligations or other relationship with unconsolidated entities that would be expected to have a material current or future effect upon our financial statements.

### Future Commitments

A summary of our future contractual obligations and commercial commitments as of December 31, 2005 is as follows:

<u>Contractual Obligations:</u> ( <u>\$ in thousands</u> )	<u>Payment due by period</u>				
	<u>Total</u>	<u>Less than 1 year</u>	<u>1-3 years</u>	<u>3-5 years</u>	<u>More than 5 years</u>
Long-term debt obligations, excluding interest (see Note 11) <sup>(1)</sup> . . . . .	\$ 4,201,730	\$ 227,693	\$ 738,709	\$ 5,393	\$ 3,229,935
ELI capital lease obligations (see Note 25) . . . . .	4,287	41	236	310	3,700
Operating lease obligations (see Note 25) . . . . .	92,088	19,062	24,445	19,307	29,274
Purchase obligations (see Note 25) . . . . .	76,384	30,619	29,354	11,296	5,115
Other long-term liabilities <sup>(2)</sup> . . . . .	33,785	—	—	—	33,785
Total . . . . .	<u>\$ 4,408,274</u>	<u>\$ 277,415</u>	<u>\$ 792,744</u>	<u>\$ 36,306</u>	<u>\$ 3,301,809</u>

<sup>(1)</sup> Includes interest rate swaps \$(8.7) million).

<sup>(2)</sup> Consists of our Equity Providing Preferred Income Convertible Securities (EPPICS) reflected on our balance sheet.

At December 31, 2005, we have outstanding performance letters of credit totaling \$22.4 million.

## CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES

### Management Succession and Strategic Alternatives Expenses

On July 11, 2004, our Board of Directors announced that it completed its review of our financial and strategic alternatives. In 2004, we expensed \$90.6 million of costs related to management succession and our exploration of financial and strategic alternatives. Included are \$36.6 million of non-cash expenses for the acceleration of stock benefits, cash expenses of \$19.2 million for advisory fees, \$19.3 million for severance and retention arrangements and \$15.5 million primarily for tax reimbursements.

### EPPICS

In 1996, our consolidated wholly-owned subsidiary, Citizens Utilities Trust (the Trust), issued, in an underwritten public offering, 4,025,000 shares of 5% Company Obligated Mandatorily Redeemable Convertible Preferred Securities due 2036 (Trust Convertible Preferred Securities or EPPICS), representing preferred undivided interests in the assets of the Trust, with a liquidation preference of \$50 per security (for a total liquidation amount of \$201.3 million). These securities have an adjusted conversion price of \$11.46 per Citizens common share. The conversion price was reduced from \$13.30 to \$11.46 during the third quarter of 2004 as a result of our \$2.00 per share special, non-recurring dividend paid on our common stock. The proceeds from the issuance of the Trust Convertible Preferred Securities and a Company capital contribution were used to purchase \$207.5 million aggregate liquidation amount of 5% Partnership Convertible Preferred Securities due 2036 from another wholly owned consolidated subsidiary, Citizens Utilities Capital L.P. (the Partnership). The proceeds from the issuance of the Partnership Convertible Preferred Securities and a Company capital contribution were used to purchase from us \$211.8 million aggregate principal amount of 5% Convertible Subordinated Debentures due 2036. The sole assets of the Trust are the Partnership Convertible Preferred Securities, and our Convertible Subordinated Debentures are substantially all the assets of the Partnership. Our obligations under the agreements related to the issuances of such securities, taken together, constitute a full and unconditional guarantee by us of the Trust's obligations relating to the Trust Convertible Preferred Securities and the Partnership's obligations relating to the Partnership Convertible Preferred Securities.

In accordance with the terms of the issuances, we paid the annual 5% interest in quarterly installments on the Convertible Subordinated Debentures in 2005, 2004 and 2003. Only cash was paid (net of investment returns) to the Partnership in payment of the interest on the Convertible Subordinated Debentures. The cash was then distributed by the Partnership to the Trust and then by the Trust to the holders of the EPPICS.

As of December 31, 2005, EPPICS representing a total principal amount of \$178.0 million had been converted into 14,237,807 shares of our common stock, and a total of \$23.3 million remains outstanding to third parties. Our long-term debt footnote indicates \$33.8 million of EPPICS outstanding at December 31, 2005 of which \$10.5 million is intercompany debt. Our accounting treatment of the EPPICS debt is in accordance with FIN 46R (see Notes 2 and 15).

We adopted the provisions of FASB Interpretation No. 46R (revised December 2003) (FIN 46R), "Consolidation of Variable Interest Entities," effective January 1, 2004. Accordingly, the Trust holding the EPPICS and the related Citizens Utilities Capital L.P. are deconsolidated.

### Covenants

The terms and conditions contained in our indentures and credit facility agreement include the timely payment of principal and interest when due, the maintenance of our corporate existence, keeping proper books and records in accordance with GAAP, restrictions on the allowance of liens on our assets and the provision of guarantees of debt by our subsidiaries, and restrictions on asset sales and transfers, mergers and other changes in corporate control. We currently have no restrictions on the payment of dividends either by contract, rule or regulation.

Our \$200.0 million term loan facility with the Rural Telephone Finance Cooperative (RTFC) contains a maximum leverage ratio covenant. Under the leverage ratio covenant, we are required to maintain a ratio of (i) total indebtedness minus cash and cash equivalents in excess of \$50.0 million to (ii) consolidated adjusted EBITDA (as defined in the agreements) over the last four quarters of no greater than 4.00 to 1.

Our \$250.0 million credit facility contains a maximum leverage ratio covenant. Under the leverage ratio covenant, we are required to maintain a ratio of (i) total indebtedness minus cash and cash equivalents in excess of \$50.0 million to (ii) consolidated adjusted EBITDA (as defined in the agreement) over the last four quarters of no

## CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES

greater than 4.50 to 1. Although the credit facility is unsecured, it will be equally and ratably secured by certain liens and equally and ratably guaranteed by certain of our subsidiaries if we issue debt that is secured or guaranteed. We are in compliance with all of our debt and credit facility covenants.

### Divestitures

On August 24, 1999, our Board of Directors approved a plan of divestiture for our public utilities services businesses, which included gas, electric and water and wastewater businesses. We have sold all of these properties. All of the agreements relating to the sales provide that we will indemnify the buyer against certain liabilities (typically liabilities relating to events that occurred prior to sale), including environmental liabilities, for claims made by specified dates and that exceed threshold amounts specified in each agreement.

In February 2006, we entered into a definitive agreement to sell ELI. We anticipate the recognition of a pre-tax gain on the sale of ELI of approximately \$130.0 million. ELI had revenues of \$159.2 million and operating income of \$18.3 million for the year ended December 31, 2005. At December 31, 2005, ELI's net assets totaled \$123.1 million.

### Discontinued Operations

On March 15, 2005, we completed the sale of Conference Call USA, LLC (CCUSA) for \$43.6 million in cash, subject to adjustments under the terms of the agreement. The pre-tax gain on the sale of CCUSA was \$14.1 million. Our after-tax gain was \$1.2 million. The book income taxes recorded upon sale are primarily attributable to a low tax basis in the assets sold.

### Rural Telephone Bank

In August 2005, the Board of Directors of the Rural Telephone Bank (RTB) voted to dissolve the bank. In November 2005, the Administration approved the appropriate provisions in the 2006 federal budget necessary for dissolution of the RTB. We expect to receive during the second quarter of 2006 approximately \$64.6 million in cash from the dissolution of the RTB, which would result in a pre-tax gain of approximately \$62.0 million when we receive the cash.

### Critical Accounting Policies and Estimates

We review all significant estimates affecting our consolidated financial statements on a recurring basis and record the effect of any necessary adjustment prior to their publication. Uncertainties with respect to such estimates and assumptions are inherent in the preparation of financial statements; accordingly, it is possible that actual results could differ from those estimates and changes to estimates could occur in the near term. The preparation of our financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of the contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Estimates and judgments are used when accounting for allowance for doubtful accounts, impairment of long-lived assets, intangible assets, depreciation and amortization, employee benefit plans, income taxes, contingencies, and pension and postretirement benefits expenses among others.

### Telecommunications Bankruptcies

Our estimate of anticipated losses related to telecommunications bankruptcies is a "critical accounting estimate." We have significant on-going normal course business relationships with many telecom providers, some of which have filed for bankruptcy. We generally reserve approximately 95% of the net outstanding pre-bankruptcy balances owed to us and believe that our estimate of the net realizable value of the amounts owed to us by bankrupt entities is appropriate. In 2005 and 2004, we had no "critical estimates" related to telecommunications bankruptcies.

### Asset Impairment

In 2005 and 2004, we had no "critical estimates" related to asset impairments.

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### Depreciation and Amortization

The calculation of depreciation and amortization expense is based on the estimated economic useful lives of the underlying property, plant and equipment and identifiable intangible assets. An independent study of the estimated useful lives of our plant assets was completed in 2005. We adopted the lives proposed in that study effective October 1, 2005.

### Intangibles

Our indefinite lived intangibles consist of goodwill and trade name, which resulted from the purchase of ILEC properties. We test for impairment of these assets annually, or more frequently, as circumstances warrant. All of our ILEC properties share similar economic characteristics and as a result, our reporting unit is the ILEC segment. In determining fair value of goodwill during 2005 we compared the net book value of the ILEC assets to trading values of our publicly traded common stock. Additionally, we utilized a range of prices to gauge sensitivity. Our test determined that fair value exceeded book value of goodwill. An independent third party appraiser analyzed trade name.

### Pension and Other Postretirement Benefits

Our estimates of pension expense, other post retirement benefits including retiree medical benefits and related liabilities are "critical accounting estimates." We sponsor a noncontributory defined benefit pension plan covering a significant number of our employees and other post retirement benefit plans that provide medical, dental, life insurance benefits and other benefits for covered retired employees and their beneficiaries and covered dependents. The accounting results for pension and post retirement benefit costs and obligations are dependent upon various actuarial assumptions applied in the determination of such amounts. These actuarial assumptions include the following: discount rates, expected long-term rate of return on plan assets, future compensation increases, employee turnover, healthcare cost trend rates, expected retirement age, optional form of benefit and mortality. We review these assumptions for changes annually with its outside actuaries. We consider our discount rate and expected long-term rate of return on plan assets to be our most critical assumptions.

The discount rate is used to value, on a present basis, our pension and post retirement benefit obligation as of the balance sheet date. The same rate is also used in the interest cost component of the pension and post retirement benefit cost determination for the following year. The measurement date used in the selection of our discount rate is the balance sheet date. Our discount rate assumption is determined annually with assistance from our actuaries based on the duration of our pension and postretirement benefit liabilities, the pattern of expected future benefit payments and the prevailing rates available on long-term, high quality corporate bonds that approximate the benefit obligation. In making this determination we consider, among other things, the yields on the Citigroup Pension Discount Curve and Bloomberg Finance. This rate can change from year-to-year based on market conditions that impact corporate bond yields. Our discount rate declined from 6.00% at year-end 2004 to 5.625% at year-end 2005.

The expected long-term rate of return on plan assets is applied in the determination of periodic pension and post retirement benefit cost as a reduction in the computation of the expense. In developing the expected long-term rate of return assumption, we considered published surveys of expected market returns, 10 and 20 year actual returns of various major indices, and our own historical 5-year and 10-year investment returns. The expected long-term rate of return on plan assets is based on an asset allocation assumption of 30% to 45% in fixed income securities, 45% to 55% in equity securities and 5% to 15% in alternative investments. We review our asset allocation at least annually and make changes when considered appropriate. In 2005, we did not change our expected long-term rate of return from the 8.25% used in 2004. Our pension plan assets are valued at actual market value as of the measurement date.

Accounting standards require that we record an additional minimum pension liability when the plan's "accumulated benefit obligation" exceeds the fair market value of plan assets at the pension plan measurement (balance sheet) date. In the fourth quarter of 2004, mainly due to a decrease in the year-end discount rate, we recorded an additional minimum pension liability in the amount of \$17.4 million with a corresponding charge to shareholders' equity of \$10.7 million, net of taxes of \$6.7 million. In the fourth quarter of 2005, primarily due to

## CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES

another decrease in the year-end discount rate, we recorded an additional minimum pension liability in the amount of \$36.4 million with a corresponding charge to shareholders' equity of \$22.5 million, net of taxes of \$13.9 million. These adjustments did not impact our net income or cash flows.

Actual results that differ from our assumptions are added or subtracted to our balance of unrecognized actuarial gains and losses. For example, if the year-end discount rate used to value the plan's projected benefit obligation decreases from the prior year-end then the plan's actuarial loss will increase. If the discount rate increases from the prior year-end then the plan's actuarial loss will decrease. Similarly, the difference generated from the plan's actual asset performance as compared to expected performance would be included in the balance of unrecognized gains and losses.

The impact of the balance of accumulated actuarial gains and losses are recognized in the computation of pension cost only to the extent this balance exceeds 10% of the greater of the plan's projected benefit obligation or market value of plan assets. If this occurs, that portion of gain or loss that is in excess of 10% is amortized over the estimated future service period of plan participants as a component of pension cost. The level of amortization is affected each year by the change in actuarial gains and losses and could potentially be eliminated if the gain/loss activity reduces the net accumulated gain/loss balance to a level below the 10% threshold.

We expect that our pension and other postretirement benefit expenses for 2006 will be \$15.0 million to \$18.0 million (they were \$19.0 million in 2005) and that no contribution will be required to be made by us to the pension plan in 2006. No contribution was made to our pension plan during 2005.

### **Income Taxes**

Our effective tax rate is below statutory rate levels as a result of the completion of audits with federal and state taxing authorities and changes in the structure of certain of our subsidiaries.

Management has discussed the development and selection of these critical accounting estimates with the Audit Committee of our Board of Directors and our Audit Committee has reviewed our disclosures relating to them.

### **New Accounting Pronouncements**

#### **Accounting for Asset Retirement Obligations**

In June 2001, the FASB issued SFAS No. 143, "Accounting for Asset Retirement Obligations." SFAS No. 143 applies to fiscal years beginning after June 15, 2002, and addresses financial accounting and reporting obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. We adopted SFAS No. 143 effective January 1, 2003. The standard applies to legal obligations associated with the retirement of long-lived assets that result from acquisition, construction, development or normal use of the assets and requires that a legal liability for an asset retirement obligation be recognized when incurred, recorded at fair value and classified as a liability in the balance sheet. When the liability is initially recorded, the entity will capitalize the cost and increase the carrying value of the related long-lived asset. The liability is then accreted to its present value each period and the capitalized cost is depreciated over the estimated useful life of the related asset. At the settlement date, we will settle the obligation for our recorded amount or recognize a gain or loss upon settlement.

Depreciation expense for our wireline operations had historically included an additional provision for cost of removal. Effective with the adoption of SFAS No. 143, on January 1, 2003, the Company ceased recognition of the cost of removal provision in depreciation expense and eliminated the cumulative cost of removal included in accumulated depreciation, as the Company has no legal obligation to remove certain long-lived assets. The cumulative effect of retroactively applying these changes to periods prior to January 1, 2003, resulted in an after tax non-cash gain of approximately \$65.8 million recognized in 2003.

#### **Stock-Based Compensation**

In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation – Transition and Disclosure, an amendment of FASB Statement No. 123, "Accounting for Stock-Based Compensation." SFAS No. 148 provides alternative methods of transition for a voluntary change to the fair value based method of accounting

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for stock-based compensation and amends the disclosure requirements of SFAS No. 123 to require prominent disclosures in both annual and interim financial statements. This statement is effective for fiscal years ending after December 15, 2002. We have adopted the expanded disclosure requirements of SFAS No. 148.

In December 2004, the FASB issued SFAS No. 123 (revised 2004), "Share-Based Payment," (SFAS No. 123R). SFAS No. 123R requires that stock-based employee compensation be recorded as a charge to earnings. In April 2005, the Securities and Exchange Commission required adoption of SFAS No. 123R for annual periods beginning after June 15, 2005. Accordingly, we will adopt SFAS 123R commencing January 1, 2006 and expect to recognize approximately \$2.8 million of expense related to the non-vested portion of previously granted stock options for the year ended December 31, 2006.

### Variable Interest Entities

In December 2003, the FASB issued FASB Interpretation No. 46 (revised December 2003) (FIN 46R), "Consolidation of Variable Interest Entities," which addresses how a business enterprise should evaluate whether it has a controlling financial interest in an entity through means other than voting rights and accordingly should consolidate the entity. FIN 46R replaces FASB Interpretation No. 46, "Consolidation of Variable Interest Entities," which was issued in January 2003. We are required to apply FIN 46R to variable interests in variable interest entities, or VIEs, created after December 31, 2003. For any VIEs that must be consolidated under FIN 46R that were created before January 1, 2004, the assets, liabilities and noncontrolling interests of the VIE initially would be measured at their carrying amounts with any difference between the net amount added to the balance sheet and any previously recognized interest being recognized as the cumulative effect of an accounting change. If determining the carrying amounts is not practicable, fair value at the date FIN 46R first applies may be used to measure the assets, liabilities and noncontrolling interest of the VIE. We reviewed all of our investments and determined that the Trust Convertible Preferred Securities (EPPICS), issued by our consolidated wholly-owned subsidiary, Citizens Utilities Trust and the related Citizens Utilities Capital L.P., were our only VIEs. Except as described in Note 15, the adoption of FIN 46R on January 1, 2004 did not have a material impact on our financial position or results of operations.

### Investments

In March 2004, the FASB issued EITF Issue No. 03-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments" (EITF 03-1) which provides new guidance for assessing impairment losses on debt and equity investments. Additionally, EITF 03-1 includes new disclosure requirements for investments that are deemed not to be temporarily impaired. In September 2004, the FASB delayed the accounting provisions of EITF 03-1; however, the disclosure requirements remain effective and were adopted for our year ended December 31, 2004. Although we have no material investments at the present time, we will evaluate the effect, if any, of EITF 03-1 when final guidance is released.

### Exchanges of Productive Assets

In December 2004, the FASB issued SFAS No. 153, "Exchanges of Nonmonetary Assets," an amendment of APB Opinion No. 29. SFAS No. 153 addresses the measurement of exchanges of certain non-monetary assets (except for certain exchanges of products or property held for sale in the ordinary course of business). The Statement requires that non-monetary exchanges be accounted for at the fair value of the assets exchanged, with gains or losses being recognized, if the fair value is determinable within reasonable limits and the transaction has commercial substance. SFAS No. 153 is effective for nonmonetary exchanges occurring in fiscal periods beginning after June 15, 2005. We do not expect the adoption of the new standard to have a material impact on our financial position, results of operations and cash flows.

### Accounting for Conditional Asset Retirement Obligations

In March 2005, the FASB issued FIN 47, "Accounting for Conditional Asset Retirement Obligations," an interpretation of FASB No. 143. FIN 47 clarifies that the term conditional asset retirement obligation as used in FASB No. 143 refers to a legal obligation to perform an asset retirement activity in which the timing or method of settlement are conditional on a future event that may or may not be within the control of the entity. FIN 47 also clarifies when an entity would have sufficient information to reasonably estimate the fair value of an asset retirement

## CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES

obligation. Although a liability exists for the removal of poles and asbestos, sufficient information is not available currently to estimate our liability, as the range of time over which we may settle these obligations is unknown or cannot be reasonably estimated. The adoption of FIN 47 during the fourth quarter of 2005 had no impact on our financial position or results of operations.

### Accounting Changes and Error Corrections

In May 2005, the FASB issued SFAS No. 154, "Accounting Changes and Error Corrections," a replacement of APB Opinion No. 20 and FASB Statement No. 3. SFAS No. 154 changes the accounting for, and reporting of, a change in accounting principle. SFAS No. 154 requires retrospective application to prior period's financial statements of voluntary changes in accounting principle, and changes required by new accounting standards when the standard does not include specific transition provisions, unless it is impracticable to do so. SFAS No. 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005.

### Partnerships

In June 2005, the FASB issued EITF No. 04-5, "Determining Whether a General Partner, or the General Partners as a Group, Controls a Limited Partnership or Similar Entity When the Limited Partners Have Certain Rights," which provides new guidance on how general partners in a limited partnership should determine whether they control a limited partnership. EITF No. 04-5 is effective for fiscal periods beginning after December 15, 2005. The Company does not expect the adoption of EITF No. 04-5 to have a material impact on our financial position, results of operations or cash flows.

## **(b) RESULTS OF OPERATIONS**

### REVENUE

Frontier revenue is generated primarily through the provision of local, network access, long distance and data services. Such services are provided under either a monthly recurring fee or based on usage at agreed upon rates and are not dependent upon significant judgments by management, with the exception of a determination of a provision for uncollectible amounts.

CLEC revenue is generated through local, long distance, data and long-haul services. These services are primarily provided under a monthly recurring fee or based on usage at agreed upon rates and are not dependent upon significant judgments by management with the exception of the determination of a provision for uncollectible amounts and realizability of reciprocal compensation. CLEC usage based revenue includes amounts determined under reciprocal compensation agreements. While this revenue is governed by specific contracts with the counterparty, management defers recognition of disputed portions of such revenue until realizability is assured. Revenue earned from long-haul contracts is recognized over the term of the related agreement.

Consolidated revenue decreased \$5.9 million in 2005. The decrease in 2005 is primarily due to a \$9.7 million decrease resulting from the sale in 2004 of our electric utility property, partially offset by an increase of \$3.8 million in ILEC and ELJ revenue.

Consolidated revenue decreased \$255.8 million, or 11% in 2004. The decrease in 2004 was primarily due to \$228.9 million of decreased gas and electric revenue primarily due to the disposition of our Arizona gas and electric operations, The Gas Company in Hawaii and our Vermont electric division and \$26.9 million of decreased telecommunications revenue.

Consolidated revenue decreased \$223.5 million, or 8% in 2003. The decrease in 2003 was primarily due to \$192.7 million of decreased gas and electric revenue primarily due to the disposition of our Arizona gas and electric operations and The Gas Company in Hawaii division and \$30.8 million of decreased telecommunications revenue.

On March 15, 2005, we completed the sale of our conferencing service business. As a result of the sale, we have classified the results of operations as discontinued operations in our consolidated statement of operations and restated prior periods.

## CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES

On April 1, 2003, we sold approximately 11,000 telephone access lines in North Dakota. The revenues related to these access lines totaled \$1.9 million for the year ended December 31, 2003.

Change in the number of our access lines is important to our revenue and profitability. We have lost access lines primarily because of competition, changing consumer behavior, economic conditions, changing technology, and by some customers disconnecting second lines when they add high-speed internet or cable modem service. We lost approximately 102,000 access lines during 2005 but added approximately 99,000 high-speed internet subscribers during this same period. The loss of lines during 2005 was primarily among residential customers. The non-residential line losses were principally in Rochester, New York, while the residential losses were throughout our markets. We expect to continue to lose access lines but to increase high-speed internet subscribers during 2006. A continued loss of access lines, combined with increased competition and the other factors discussed in MD&A, may cause our revenues, profitability and cash flows to decrease in 2006.

### Telecommunications Revenue

(\$ in thousands)	2005			2004			2003
	Amount	\$ Change	% Change	Amount	\$ Change	% Change	Amount
Access services . . . . .	\$ 623,918	\$ (10,278)	-2 %	\$ 634,196	\$(32,846)	-5 %	\$ 667,042
Local services . . . . .	829,801	(21,376)	-3 %	851,177	(7,825)	-1 %	859,002
Long distance services . . . . .	169,496	(14,127)	-8 %	183,623	(15,759)	-8 %	199,382
Data and internet services . . . . .	175,026	36,795	27 %	138,231	30,779	29 %	107,452
Directory services . . . . .	113,092	2,469	2 %	110,623	3,689	3 %	106,934
Other . . . . .	91,985	7,178	8 %	84,807	4,448	6 %	80,359
ILEC revenue . . . . .	2,003,318	661	0 %	2,002,657	(17,514)	-1 %	2,020,171
ELI . . . . .	159,161	3,131	2 %	156,030	(9,359)	-6 %	165,389
	<u>\$2,162,479</u>	<u>\$ 3,792</u>	0 %	<u>\$2,158,687</u>	<u>\$(26,873)</u>	-1 %	<u>\$2,185,560</u>

### Access Services

Access services revenue for the year ended December 31, 2005 decreased \$10.3 million or 2%, as compared with the prior year. Switched access revenue decreased \$9.5 million, as compared with the prior year period, primarily due to a decline in minutes of use. Access service revenue includes subsidy payments we receive from federal and state agencies. Subsidy revenue decreased \$15.9 million primarily due to decreased Universal Service Fund (USF) support of \$19.2 million because of increases in the national average cost per loop (NACPL) and a decrease of \$2.0 million related to changes in measured factors, partially offset by an increase of \$6.4 million in USF surcharge rates. Special access revenue increased \$15.1 million primarily due to growth in high-capacity circuits.

Access services revenue for the year ended December 31, 2004 decreased \$32.8 million or 5%, as compared with the prior year. Switched access revenue decreased \$19.6 million primarily due to \$8.3 million attributable to a decline in minutes of use, the \$7.4 million effect of federally mandated access rate reductions and \$2.7 million associated with state intrastate access rate reductions. Subsidies revenue decreased \$12.8 million primarily due to an \$8.3 million decline in federal USF support because of increases in the NACPL, including a \$3.5 million accrual recorded during the third quarter of 2004 for mistakes made during 2002 and 2003 by the agency that calculates subsidy payments and true-ups related to 2002. The decreases were partially offset by an increase in USF surcharge revenue of \$2.1 million resulting from a rate increase.

Increases in the number of competitive communications companies (including wireless companies) receiving federal subsidies may lead to further increases in the NACPL, thereby resulting in further decreases in our subsidy revenue in the future. The FCC and state regulators are currently considering a number of proposals for changing the manner in which eligibility for federal subsidies is determined as well as the amounts of such subsidies. The FCC is also reviewing the mechanism by which subsidies are funded. We cannot predict when or how these matters will be decided nor the effect on our subsidy revenues. Future reductions in our subsidy and access revenues are not expected to be accompanied by proportional decreases in our costs, so any further reductions in those revenues will directly affect our profitability and cash flow.

## CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES

### Local Services

Local services revenue for the year ended December 31, 2005 decreased \$21.4 million or 3% as compared with the prior year. This decline is comprised of \$18.8 million related to the continued loss of access lines and \$4.0 million related to a reserve associated with state rate of return limitations on earnings. Enhanced services revenue increased \$5.9 million, as compared with the prior year, primarily due to sales of additional product packages. Economic conditions or increasing competition could make it more difficult to sell our packages and bundles and cause us to lower our prices for those products and services, which would adversely affect our revenues and profitability and cash flow.

Local services revenue for the year ended December 31, 2004 decreased \$7.8 million or 1% as compared with the prior year. Local revenue decreased \$17.9 million primarily due to \$4.7 million related to continued losses of access lines, \$2.2 million as a result of refunds to customers because of state earnings limitations, the termination of an operator services contract of \$3.4 million, \$3.5 million in decreased local measured service revenue and a decline of \$2.0 million in certain business services revenue. Enhanced services revenue increased \$10.1 million, primarily due to sales of additional product packages.

### Long Distance Services

Long distance services revenue for the year ended December 31, 2005 decreased \$14.1 million or 8%, as compared with the prior year primarily due to a decline in the average rates we bill for long distance services. Our long distance minutes of use increased slightly during 2005. Our long distance revenues may continue to decrease in the future due to lower rates and/or minutes of use. Competing services such as wireless, VOIP, and cable telephony are resulting in a loss of customers, minutes of use and further declines in the rates we charge our customers. We expect these factors will continue to adversely affect our long distance revenues during 2006.

Long distance services revenue for the year ended December 31, 2004 decreased \$15.8 million or 8%, as compared with the prior year primarily due to a decline in the average rate per minute. Our long distance minutes of use increased during 2004.

### Data and Internet Services

Data and internet services revenue for the years ended December 31, 2005 and 2004 increased \$36.8 million, or 27%, and \$30.8 million, or 29%, respectively, as compared with the prior year primarily due to growth in data and high-speed internet services.

### Directory Services

Directory revenue for the years ended December 31, 2005 and 2004 increased \$2.5 million, or 2%, and \$3.7 million, or 3%, respectively, as compared with the prior year due to growth in yellow pages advertising.

### Other

Other revenue for the year ended December 31, 2005 increased \$7.2 million, or 8%, compared with the prior year primarily due to a \$4.8 million decrease in bad debt expense and sales of television service.

Other revenue for the year ended December 31, 2004 increased \$4.4 million or 6%, as compared with the prior year primarily due to a \$4.1 million carrier dispute settlement, a decline in bad debt expense of \$3.2 million and an increase in service activation revenue of \$2.5 million, partially offset by decreases of \$3.6 million in sales of customer premise equipment (CPE) and \$1.5 million in call center services revenue.

### ELI

ELI revenue for the year ended December 31, 2005 increased \$3.1 million, or 2%, primarily due to increased demand and growth in local and data services. For the year ended December 31, 2004, ELI revenue decreased \$9.4 million, or 6%, primarily due to lower demand and prices for long-haul services and lower reciprocal compensation revenues.

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**GAS AND ELECTRIC REVENUE**

(\$ in thousands)	2005			2004			2003
	Amount	\$ Change	% Change	Amount	\$ Change	% Change	Amount
Gas revenue . . . . .	\$ —	\$ —	0%	\$ —	\$ (137,686)	-100%	\$ 137,686
Electric revenue . . . . .	\$ —	\$ (9,735)	-100%	\$ 9,735	\$ (91,193)	-90%	\$ 100,928

**Gas revenue**

We did not have any gas operations in the years ended December 31, 2005 and 2004.

**Electric revenue**

Electric revenue for the year ended December 31, 2005 decreased \$9.7 million as compared with the prior year due to the sale of our Vermont electric division on April 1, 2004. Electric revenue for the year ended December 31, 2004 decreased \$91.2 million, or 90%, as compared with the prior year. We have sold all of our electric operations and as a result will have no operating results in future periods for these businesses.

**COST OF SERVICES**

(\$ in thousands)	2005			2004			2003
	Amount	\$ Change	% Change	Amount	\$ Change	% Change	Amount
Network access . . . . .	\$ 195,491	\$ 2,076	1%	\$ 193,415	\$ (26,006)	-12%	\$ 219,421
Gas purchased . . . . .	—	—	0%	—	(82,311)	-100%	82,311
Electric energy and fuel oil purchased . . . . .	—	(5,523)	-100%	5,523	(58,308)	-91%	63,831
	<u>\$ 195,491</u>	<u>\$ (3,447)</u>	<u>-2%</u>	<u>\$ 198,938</u>	<u>\$ (166,625)</u>	<u>-46%</u>	<u>\$ 365,563</u>

**Network access**

Network access expenses for the year ended December 31, 2005 increased \$2.1 million, or 1%, as compared with the prior year primarily due to increased costs in circuit expense due to more data traffic associated with increased high-speed internet customers and greater long distance minutes of use in the Frontier sector, and higher costs at ELI due to increased demand. As we continue to increase our sales of data products such as high-speed internet and expand the availability of our unlimited long distance calling plans, our network access expense is likely to increase.

Network access expenses for the year ended December 31, 2004 decreased \$26.0 million, or 12%, as compared with the prior year primarily due to decreased costs in long distance access expense related to rate changes partially offset by increased circuit expense associated with additional high-speed internet customers. ELI costs declined due to a drop in demand coupled with improved network cost efficiencies.

**Gas purchased**

We did not have any gas operations in the years ended December 31, 2005 and 2004.

**Electric energy and fuel oil purchased**

Electric energy and fuel oil purchased for the year ended December 31, 2005 decreased \$5.5 million as compared with the prior year due to the sale of our Vermont electric division on April 1, 2004. Electric energy and fuel oil purchased for the year ended December 31, 2004 decreased \$58.3 million, or 91%, as compared with the prior year. We have sold all of our electric operations and as a result will have no operating results in future periods for these businesses.

**CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES**

**OTHER OPERATING EXPENSES**

(\$ in thousands)	2005			2004			2003
	Amount	\$ Change	% Change	Amount	\$ Change	% Change	Amount
Operating expenses . . . . .	\$ 607,581	\$(15,436)	-2%	\$ 623,017	\$(61,952)	-9%	\$ 684,969
Taxes other than income							
taxes . . . . .	93,115	(771)	-1%	93,886	(2,870)	-3%	96,756
Sales and marketing . . . . .	117,484	2,448	2%	115,036	2,653	2%	112,383
	<u>\$ 818,180</u>	<u>\$(13,759)</u>	-2%	<u>\$ 831,939</u>	<u>\$(62,169)</u>	-7%	<u>\$ 894,108</u>

**Operating Expenses**

Operating expenses for the year ended December 31, 2005 decreased \$15.4 million, or 2%, as compared with the prior year primarily due to lower billing expenses as a result of the conversion of one of our billing systems in 2004 partially offset by rate increases for federal USF mandated contributions and annual fees to regulatory agencies. We routinely review our operations, personnel and facilities to achieve greater efficiencies. These reviews may result in reductions in personnel and an increase in severance costs. As a result of early retirement being offered to certain of our employees during the first quarter of 2006 we expect to recognize \$3.5 million to \$4.0 million of severance costs in the first quarter of 2006.

Operating expenses for the year ended December 31, 2004 decreased \$62.0 million, or 9%, as compared with the prior year primarily due to decreased operating expenses in the public services sector due to the sales of our utilities and increased operating efficiencies and a reduction of personnel in our communications business.

Operating expenses in 2004 include \$4.2 million of expenses attributable to our efforts to comply with the internal control requirements of the Sarbanes-Oxley Act of 2002.

Included in operating expenses is stock compensation expense. Stock compensation expense was \$8.4 million and \$11.0 million for the years ended December 31, 2005 and 2004, respectively. In 2006, we expect to begin expensing the cost of the unvested portion of outstanding stock options pursuant to SFAS No. 123R. We expect to recognize approximately \$2.8 million of stock option expense related to the non-vested portion of previously granted stock options for the year ended December 31, 2006.

Included in operating expenses is pension and other postretirement benefit expenses. In future periods, if the value of our pension assets decline and/or projected benefit costs increase, we may have increased pension expenses. Based on current assumptions and plan asset values, we estimate that our pension and other postretirement benefit expenses will decrease from \$19.0 million in 2005 to approximately \$15.0 million to \$18.0 million in 2006 and that no contribution will be required to be made by us to the pension plan in 2006. No contribution was made to our pension plan during 2005.

**Taxes Other than Income Taxes**

Taxes other than income taxes for the year ended December 31, 2004 decreased \$2.9 million, or 3%, as compared with the prior year primarily due to decreased property taxes in the public services sector of \$11.6 million due to the sales of our utilities and lower gross receipts taxes of \$3.7 million in the Frontier sector that were partially offset by higher payroll, property and franchise taxes of \$13.0 million.

**Sales and Marketing**

Sales and marketing expenses for the year ended December 31, 2005 increased \$2.4 million, or 2%, as compared with the prior year primarily due to increased marketing and advertising in an increasingly competitive environment and the launch of new products. As our markets become more competitive and we launch new products, we expect that our marketing costs will increase.

Sales and marketing expenses for the year ended December 31, 2004 increased \$2.7 million, or 2%, as compared with the prior year primarily due to increased costs in the Frontier sector.

**CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES**

**DEPRECIATION AND AMORTIZATION EXPENSE**

(\$ in thousands)	2005			2004			2003
	Amount	\$ Change	% Change	Amount	\$ Change	% Change	Amount
Depreciation expense . . . . .	\$ 415,581	\$(28,707)	-6%	\$ 444,288	\$(22,035)	-5%	\$ 466,323
Amortization expense . . . . .	126,378	(142)	0%	126,520	(318)	0%	126,838
	<u>\$ 541,959</u>	<u>\$(28,849)</u>	<u>-5%</u>	<u>\$ 570,808</u>	<u>\$(22,353)</u>	<u>-4%</u>	<u>\$ 593,161</u>

Depreciation expense for the years ended December 31, 2005 and 2004 decreased \$28.7 million, or 6%, and \$22.0 million, or 5%, respectively, as compared with the prior years due to a declining asset base. Effective with the completion of an independent study of the estimated useful lives of our plant assets we adopted new lives beginning October 1, 2005. Based on the study and our planned capital expenditures, we expect that our depreciation expense will decline in 2006 by approximately 12.5% compared to 2005. The decline is principally the result of extending the remaining useful lives of our copper facilities from approximately 16 years to a range of 26 to 30 years.

**RESERVE FOR TELECOMMUNICATIONS BANKRUPTCIES/RESTRUCTURING AND OTHER EXPENSES/MANAGEMENT SUCCESSION AND STRATEGIC ALTERNATIVES EXPENSES**

(\$ in thousands)	2005			2004			2003
	Amount	\$ Change	% Change	Amount	\$ Change	% Change	Amount
Reserve for (recovery of) telecommunications bankruptcies . . . . .	\$ —	\$ —	0%	\$ —	\$ 4,377	-100%	\$ (4,377)
Restructuring and other expenses . . . . .	\$ —	\$ —	0%	\$ —	\$(9,687)	-100%	\$ 9,687
Management succession and strategic alternatives expenses . . . . .	\$ —	\$(90,632)	-100%	\$ 90,632	\$ —	0%	\$ 90,632

On July 11, 2004, our Board of Directors announced that it completed its review of our financial and strategic alternatives. In 2004, we expensed \$90.6 million of costs related to management succession and our exploration of financial and strategic alternatives. Included are \$36.6 million of non-cash expenses for the acceleration of stock benefits, cash expenses of \$19.2 million for advisory fees, \$19.3 million for severance and retention arrangements and \$15.5 million primarily for tax reimbursements.

During the fourth quarter of 2003, an agreement with WorldCom/MCI was approved by the bankruptcy court settling all pre-bankruptcy petition obligations and receivables. This settlement resulted in reduction to our reserve of approximately \$6.6 million in the fourth quarter of 2003. During the second quarter of 2003, we reserved approximately \$2.3 million of trade receivables with Touch America as a result of Touch America's filing for bankruptcy. These receivables were generated as a result of providing ordinary course telecommunication services. If other telecommunications companies file for bankruptcy, we may have additional significant reserves in future periods.

Restructuring and other expenses for 2003 primarily consisted of severance expenses related to reductions in personnel at our telecommunications operations and the write-off of software no longer used.

**LOSS ON IMPAIRMENT**

(\$ in thousands)	2003
	Amount
Loss on impairment . . . . .	\$ 15,300

**CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES**

During the third and fourth quarters of 2003, we recognized additional pre-tax impairment losses of \$4.0 million and \$11.3 million related to our Vermont property to write down assets to be sold to our best estimate of their net realizable value upon sale.

**INVESTMENT AND OTHER INCOME (LOSS), NET / INTEREST EXPENSE /  
INCOME TAX EXPENSE (BENEFIT)**

(\$ in thousands)	2005			2004			2003
	Amount	\$ Change	% Change	Amount	\$ Change	% Change	Amount
Investment income . . . . .	\$ 18,236	\$(15,380)	-46%	\$ 33,616	\$ 23,198	-223%	\$ 10,418
Other income (loss), net . . . . .	\$ (1,674)	\$ 51,685	-97%	\$ (53,359)	\$ (97,418)	-221%	\$ 44,059
Interest expense . . . . .	\$ 338,903	\$(40,118)	-11%	\$ 379,021	\$ (37,499)	-9%	\$ 416,520
Income tax expense . . . . .	\$ 84,340	\$ 73,918	709%	\$ 10,422	\$ (54,354)	84%	\$ 64,776

**Investment Income**

Investment income for the year ended December 31, 2005 decreased \$15.4 million, or 46%, as compared with the prior year primarily due to the sale in 2004 of our investments in D & E Communications, Inc. (D & E) and Hungarian Telephone and Cable Corp. (HTCC), partially offset by higher income in 2005 from short-term investments.

Investment income for the year ended December 31, 2004 increased \$23.2 million as compared with the prior year primarily due to the sale of our investments in D & E and HTCC and higher income from short-term investments.

**Other Income (Loss), net**

Other income, net for the year ended December 31, 2005 increased \$51.7 million, or 97%, as compared to prior year. The increase is primarily due to a pre-tax loss from the early extinguishment of debt of \$66.5 million in 2004 and a net loss on sales of assets of \$1.9 million, which is primarily attributable to the loss on the sale of our corporate aircraft, partially offset by \$25.3 million in income from the expiration of certain retained liabilities at less than face value, which are associated with customer advances for construction from our disposed water properties. In addition, during 2005 \$7.0 million was reserved in the fourth quarter in connection with a lawsuit, and during the second quarter we incurred a \$3.2 million loss on the exchange of debt, partially offset by gains on our forward rate agreements

Other loss, net for the year ended December 31, 2004 increased \$97.4 million as compared to prior year primarily due to a pre-tax loss from the early extinguishment of debt of \$66.5 million in 2004, and the recognition in 2003 of \$69.5 million in non-cash pre-tax gains related to a capital lease termination and a capital lease restructuring at ELI, partially offset in 2004 by \$25.3 million in income from the expiration of certain retained liabilities at less than face value, which are associated with customer advances for construction from our disposed water properties and a net loss on sales of assets in 2004 of \$1.9 million, which is primarily attributable to the loss on the sale of our corporate aircraft, compared to a net loss on sales of assets in 2003 of \$20.5 million.

**Interest Expense**

Interest expense for the year ended December 31, 2005 decreased \$40.1 million, or 11%, as compared with the prior year primarily due to the retirement and refinancing of debt. Our composite average borrowing rate for the year ended December 31, 2005 as compared with the prior year was 2 basis points lower, decreasing from 7.96% to 7.94%.

Interest expense for the year ended December 31, 2004 decreased \$37.5 million, or 9%, as compared with the prior year primarily due to the retirement of debt. Our composite average borrowing rate for the year ended December 31, 2004 as compared with the prior year was 11 basis points lower, decreasing from 8.07% to 7.96%.

## CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES

### Income Taxes

Income taxes for the year ended December 31, 2005 increased \$73.9 million, as compared with the prior year primarily due to changes in taxable income and the effective tax rate. The effective tax rate for 2005 was 29.6% as compared with 13.5% for 2004. Our effective tax rate was below statutory rates in both years as a result of the completion of audits with federal and state taxing authorities and changes in the structure of certain of our subsidiaries.

Income taxes for the year ended December 31, 2004 decreased \$54.4 million, or 84%, as compared with the prior year primarily due to changes in taxable income (loss). The effective tax rate for 2004 was 13.5% as compared with an effective tax rate of 34.3% for 2003.

### CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE

(\$ in thousands)	2003
	Amount
Cumulative effect of change in accounting principle . . . . .	\$ 65,769

During the first quarter of 2003, as a result of our adoption of SFAS No. 143, "Accounting for Asset Retirement Obligations," we recognized an after tax non-cash gain of approximately \$65.8 million.

### DISCONTINUED OPERATIONS

(\$ in thousands)	2005	2004	2003
	Amount	Amount	Amount
Revenue . . . . .	\$ 4,607	\$24,558	\$20,764
Operating income . . . . .	\$ 1,489	\$ 8,188	\$ 6,820
Income taxes . . . . .	\$ 449	\$ 2,957	\$ 2,440
Net income . . . . .	\$ 1,040	\$ 5,231	\$ 4,380

On March 15, 2005, we completed the sale of CCUSA for \$43.6 million in cash. The pre-tax gain on the sale of CCUSA was \$14.1 million. Our after-tax gain was \$1.2 million. The book income taxes recorded upon sale are primarily attributable to a low tax basis in the assets sold.

## ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

### DISCLOSURE OF PRIMARY MARKET RISKS AND HOW THEY ARE MANAGED

We are exposed to market risk in the normal course of our business operations due to ongoing investing and funding activities, including those associated with our pension assets. Market risk refers to the potential change in fair value of a financial instrument as a result of fluctuations in interest rates and equity and commodity prices. We do not hold or issue derivative instruments, derivative commodity instruments or other financial instruments for trading purposes. As a result, we do not undertake any specific actions to cover our exposure to market risks and we are not party to any market risk management agreements other than in the normal course of business or to hedge long-term interest rate risk.

### INTEREST RATE EXPOSURE

Our exposure to market risk for changes in interest rates relates primarily to the interest-bearing portion of our investment portfolio and interest on our long-term debt and capital lease obligations. The long-term debt and capital lease obligations include various instruments with various maturities and weighted average interest rates.

Our objectives in managing our interest rate risk are to limit the impact of interest rate changes on earnings and cash flows and to lower our overall borrowing costs. To achieve these objectives, a majority of our borrowings have fixed interest rates. Consequently, we have limited material future earnings or cash flow exposures from changes in interest rates on our long-term debt and capital lease obligations. A hypothetical 10% adverse change in interest rates

## CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES

would increase the amount that we pay on our variable obligations and could result in fluctuations in the fair value of our fixed rate obligations. Based upon our overall interest rate exposure at December 31, 2005, a near-term change in interest rates would not materially affect our consolidated financial position, results of operations or cash flows.

In order to manage our interest expense, we have entered into interest rate swap agreements. Under the terms of the agreements, which qualify for hedge accounting, we make semi-annual, floating rate interest payments based on six month LIBOR and receive a fixed rate on the notional amount. The underlying variable rate for these interest rate swaps is set in arrears. For the years ended December 31, 2005 and 2004, the cash interest savings resulting from these interest rate swaps totaled approximately \$2.5 million and \$9.4 million, respectively.

During September 2005, we entered into a series of forward rate agreements that fixed the underlying variable rate component of some of our swaps at the market rate as of the date of execution for certain future rate-setting dates. At December 31, 2005, the rates obtained under these forward rate agreements were below market rates. A gain for the changes in the fair value of these forward rate agreements of \$1.9 million is included in other income (loss) net for the year ended December 31, 2005.

### **Sensitivity analysis of interest rate exposure**

At December 31, 2005, the fair value of our long-term debt and capital lease obligations was estimated to be approximately \$4.0 billion, based on our overall weighted average borrowing rate of 8.05% and our overall weighted maturity of 12 years. There has been no material change in the weighted average maturity since December 31, 2004.

The overall weighted average interest rate increased in 2005 by approximately 22 basis points. A hypothetical increase of 81 basis points in our weighted average interest rate (10% of our overall weighted average borrowing rate) would result in an approximate \$210.3 million decrease in the fair value of our fixed rate obligations.

### **EQUITY PRICE EXPOSURE**

Our exposure to market risks for changes in equity prices as of December 31, 2005 is limited to our investment in Adelphia, and our pension assets of \$762.2 million.

As of December 31, 2005 and December 31, 2004, we owned 3,059,000 shares of Adelphia common stock. The stock price of Adelphia was \$0.04 and \$0.39 at December 31, 2005 and December 31, 2004, respectively.

### **Sensitivity analysis of equity price exposure**

At December 31, 2005, the fair value of the equity portion of our investment portfolio was estimated to be \$0.1 million. A hypothetical 10% decrease in quoted market prices would result in an approximate \$12,000 decrease in the fair value of the equity portion of our investment portfolio.

### **Disclosure of limitations of sensitivity analysis**

Certain shortcomings are inherent in the method of analysis presented in the computation of fair value of financial instruments. Actual values may differ from those presented should market conditions vary from assumptions used in the calculation of the fair value. This analysis incorporates only those exposures that exist as of December 31, 2005. It does not consider those exposures or positions which could arise after that date. As a result, our ultimate exposure with respect to our market risks will depend on the exposures that arise during the period and the fluctuation of interest rates and quoted market prices.

## **ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

The following documents are filed as part of this Report:

1. Financial Statements, See Index on page F-1.
2. Supplementary Data, Quarterly Financial Data is included in the Financial Statements (see 1. above).

## **ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**

None.

## CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES

### ITEM 9A. CONTROLS AND PROCEDURES

#### (i) Disclosure Controls and Procedures

We carried out an evaluation, under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, regarding the effectiveness of the design and operation of our disclosure controls and procedures. Based upon this evaluation, our principal executive officer and principal financial officer concluded, as of the end of the period covered by this report, December 31, 2005, that our disclosure controls and procedures are effective.

#### (ii) Internal Control Over Financial Reporting

##### (a) Management's annual report on internal control over financial reporting

Our management report on internal control over financial reporting appears on page F-2 and is incorporated by reference.

##### (b) Attestation report of registered public accounting firm

The attestation report of KPMG LLP, our independent registered public accounting firm, on management's assessment of the effectiveness of our internal control over financial reporting appears on page F-3 and is incorporated by reference.

##### (c) Changes in internal control over financial reporting

We reviewed our internal control over financial reporting at December 31, 2005. There has been no change in our internal control over financial reporting during the last fiscal quarter of 2005 that materially affected or is reasonably likely to materially affect our internal control over financial reporting.

### ITEM 9B. OTHER INFORMATION

None.

## PART III

### ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

The information required by this Item is incorporated by reference from our definitive proxy statement for the 2006 Annual Meeting of Stockholders to be filed with the SEC pursuant to Regulation 14A within 120 days after December 31, 2005. See "Executive Officers of the Registrant" in Part I of this Report following Item 4 for information relating to executive officers.

### ITEM 11. EXECUTIVE COMPENSATION

The information required by this Item is incorporated by reference from our definitive proxy statement for the 2006 Annual Meeting of Stockholders to be filed with the SEC pursuant to Regulation 14A within 120 days after December 31, 2005.

### ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information required by this Item is incorporated by reference from our definitive proxy statement for the 2006 Annual Meeting of Stockholders to be filed with the SEC pursuant to Regulation 14A within 120 days after December 31, 2005.

### ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The information required by this Item is incorporated by reference from our definitive proxy statement for the 2006 Annual Meeting of Stockholders to be filed with the SEC pursuant to Regulation 14A within 120 days after December 31, 2005.

## CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES

### ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information required by this Item is incorporated by reference from our definitive proxy statement for the 2006 Annual Meeting of Stockholders to be filed with the SEC pursuant to Regulation 14A within 120 days after December 31, 2005.

### PART IV

### ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

List of Documents Filed as a Part of This Report:

(1) Index to Consolidated Financial Statements:

Independent Auditors' Report

Consolidated balance sheets as of December 31, 2005 and 2004

Consolidated statements of operations for the years ended  
December 31, 2005, 2004 and 2003

Consolidated statements of shareholders' equity for the years ended  
December 31, 2005, 2004 and 2003

Consolidated statements of comprehensive income (loss) for the years ended  
December 31, 2005, 2004 and 2003

Consolidated statements of cash flows for the years ended  
December 31, 2005, 2004 and 2003

Notes to consolidated financial statements

(2) Index to Financial Statement Schedules:

Schedule II – Valuation and Qualifying Accounts

All other schedules have been omitted because the required information is included in the consolidated financial statements or the notes thereto, or is not applicable or required.

(3) Index to Exhibits:

<u>Exhibit No.</u>	<u>Description</u>
3.1	Restated Certificate of Incorporation of Citizens Communications Company, (incorporated by reference to Exhibit 3.200.1 to the Registrant's Quarterly Report on Form 10-Q for the six months ended June 30, 2000, File No. 001-11001).
3.2	By-laws of Citizens Communications Company, as amended (incorporated by reference to Exhibit 3.200.5 to the Registrant's Quarterly Report on Form 10-Q for the nine months ended September 30, 2004, File No. 001-11001).
4.1	Certificate of Trust of Citizens Communications Trust dated as of April 27, 2001 (incorporated by reference to Exhibit 4.5 of the Registrant's Amendment No.1 to Form S-3 filed May 7, 2001 (Registration No. 333-58044)).
4.2	Trust Agreement of Citizens Capital Trust I, dated as of April 27, 2001 (incorporated by reference to Exhibit 4.6 of the Registrant's Amendment No.1 to Form S-3 filed May 7, 2001 (Registration No. 333-58044)).
4.3	Form of Senior Note due 2011 (incorporated by reference to Exhibit 4.4 of the Registrant's Current Report on Form 8-K filed on May 24, 2001, File No. 001-11001).

## CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES

- 4.5 Form of Senior Note due 2008 and due 2031 (incorporated by reference to Exhibit 4.1 of the Registrant's Current Report on Form 8-K filed on August 22, 2001, File No. 001-11001).
- 4.6 Form of Senior Note due 2013 (incorporated by reference to Exhibit 4.2 of the Registrant's Current Report on Form 8-K filed on November 12, 2004, File No. 001-11001).
- 4.7 5% Convertible Subordinated Debenture due 2036 (incorporated by reference to Exhibit A to Exhibit 4.200.2 to the Registrant's Form 8-K Current Report filed May 28, 1996, File No. 001-11001).
- 4.8 Amended and Restated Declaration of Trust dated as of January 15, 1996, of Citizens Utilities Trust (incorporated by reference to Exhibit 4.200.4 to the Registrant's Form 8-K Current Report filed May 28, 1996, File No. 001-11001).
- 4.9 Convertible Preferred Security Certificate (incorporated by reference to Exhibit A-1 to Exhibit 4.200.4 to the Registrant's Form 8-K Current Report filed May 28, 1996, File No. 001-11001).
- 4.10 Amended and Restated Limited Partnership Agreement dated as of January 15, 1996 of Citizens Utilities Capital L.P. (incorporated by reference to Exhibit 4.200.6 to the Registrant's Form 8-K Current Report filed May 28, 1996, File No. 001-11001).
- 4.11 Partnership Preferred Security Certificate (incorporated by reference to Annex A to Exhibit 4.200.6 to the Registrant's Form 8-K Current Report filed May 28, 1996, File No. 001-11001).
- 4.12 Convertible Preferred Securities Guarantee Agreement dated as of January 15, 1996 between Citizens Communications Company (f/k/a Citizens Utilities Company) and JPMorgan Chase Bank, N.A. (as successor to Chemical Bank), as guarantee trustee (incorporated by reference to Exhibit 4.200.8 to the Registrant's Form 8-K Current Report filed May 28, 1996, File No. 001-11001).
- 4.13 Partnership Preferred Securities Guarantee Agreement dated as of January 15, 1996 between Citizens Communications Company (f/k/a Citizens Utilities Company) and JPMorgan Chase Bank, N.A. (as successor to Chemical Bank), as guarantee trustee (incorporated by reference to Exhibit 4.200.9 to the Registrant's Form 8-K Current Report filed May 28, 1996, File No. 001-11001).
- 4.14 Letter of Representations dated January 18, 1996, from Citizens Communications Company (f/k/a Citizens Utilities Company) and JPMorgan Chase Bank, N.A. (as successor to Chemical Bank), as trustee, to DTC, for deposit of Convertible Preferred Securities with DTC (incorporated by reference to Exhibit 4.200.10 to the Registrant's Form 8-K Current Report filed May 28, 1996, File No. 001-11001).
- 4.15 Indenture of Securities, dated as of August 15, 1991, and JPMorgan Chase Bank, N.A. (as successor to Chemical Bank), as Trustee (incorporated by reference to Exhibit 4.100.1 to the Registrant's Quarterly Report on Form 10-Q for the nine months ended September 30, 1991, File No. 001-11001).
- 4.16 Indenture, dated as of January 15, 1996, between Citizens Communications Company (f/k/a Citizens Utilities Company) and JPMorgan Chase Bank, N.A. (as successor to Chemical Bank), as indenture trustee (incorporated by reference to Exhibit 4.200.1 to the Registrant's Form 8-K Current Report filed May 28, 1996, File No. 001-11001).
- 4.16 First Supplemental Indenture, dated as of January 15, 1996, between Citizens Communications Company (f/k/a Citizens Utilities Company) and JPMorgan Chase Bank, N.A. (as successor to Chemical Bank), as indenture trustee (incorporated by reference to Exhibit 4.200.2 to the Registrant's Form 8-K Current Report filed May 28, 1996, File No. 001-11001).
- 4.17 Third Supplemental Indenture, dated April 15, 1994, to JPMorgan Chase Bank, N.A. (as successor to Chemical Bank), as Trustee (incorporated by reference to Exhibit 4.100.6 to the Registrant's Form 8-K Current Report filed July 5, 1994, File No. 001-11001).
- 4.18 Fourth Supplemental Indenture, dated October 1, 1994, to JPMorgan Chase Bank, N.A. (as successor to Chemical Bank), as Trustee (incorporated by reference to Exhibit 4.100.7 to Registrant's Form 8-K Current Report filed January 3, 1995, File No. 001-11001).
- 4.19 Fifth Supplemental Indenture, dated as of June 15, 1995, to JPMorgan Chase Bank, N.A. (as successor to Chemical Bank), as Trustee (incorporated by reference to Exhibit 4.100.8 to Registrant's Form 8-K Current Report filed March 29, 1996, File No. 001-11001).
- 4.20 Sixth Supplemental Indenture, dated as of October 15, 1995, to JPMorgan Chase Bank, N.A. (as successor to Chemical Bank), as Trustee (incorporated by reference to Exhibit 4.100.9 to Registrant's Form 8-K Current Report filed March 29, 1996, File No. 001-11001).

## CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES

- 4.21 Seventh Supplemental Indenture, dated as of June 1, 1996 to JPMorgan Chase Bank, N.A. (as successor to Chemical Bank), (incorporated by reference to Exhibit 4.100.11 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 1996, File No. 001-11001).
- 4.22 Eighth Supplemental Indenture, dated as of December 1, 1996 to JPMorgan Chase Bank, N.A. (as successor to Chemical Bank), (incorporated by reference to Exhibit 4.100.12 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 1996, File No. 001-11001).
- 4.23 Senior Indenture, dated as of May 23, 2001, between Citizens Communications Company and JPMorgan Chase Bank, N.A. (as successor to The Chase Manhattan Bank), as trustee (incorporated by reference to Exhibit 4.1 of the Registrant's Current Report on Form 8-K filed on May 24, 2001, File No. 001-11001).
- 4.24 First Supplemental Indenture, dated as of May 23, 2001, to Senior Indenture, (incorporated by reference to Exhibit 4.2 of the Registrant's Current Report on Form 8-K filed on May 24, 2001, File No. 001-11001).
- 4.25 Second Supplemental Indenture, dated as of June 19, 2001, to Senior Indenture, dated as of May 23, 2001 (incorporated by reference to Exhibit 4.3 of the Registrant's Current Report on Form 8-K filed on June 21, 2001, File No. 001-11001).
- 4.26 Third Supplemental Indenture, dated as of November 12, 2004, to Senior Indenture, dated as of May 23, 2001 (incorporated by reference to Exhibit 4.1 of the Registrant's Current Report on Form 8-K filed on November 12, 2004, File No. 001-11001).
- 4.27 Indenture, dated as of August 16, 2001, between Citizens Communications Company and JPMorgan Chase Bank, N.A. (as successor to The Chase Manhattan Bank), as Trustee (incorporated by reference to Exhibit 4.1 of the Registrant's Current Report on Form 8-K filed on August 22, 2001, File No. 001-11001).
- 4.28 Underwriting Agreement dated November 8, 2004, between Citizens Communications Company and J.P. Morgan Securities Inc., as Representative of the several listed Underwriters, relating to the sale of \$700,000,000 principal amount of the 6¼% Senior Notes due 2013 (incorporated by reference to Exhibit 4.1 of the Registrant's Current Report on Form 8-K filed on November 12, 2004, File No. 001-11001).
- 10.1 Competitive Advance and Revolving Credit Facility Agreement for \$250,000,000 dated October 29, 2004 (incorporated by reference to Exhibit 10.19 to the Registrant's Quarterly Report on Form 10-Q for the nine months ended September 30, 2004, File No. 001-11001).
- 10.2 Amended and Restated Non-Employee Directors' Deferred Fee Equity Plan dated as of May 18, 2004, (incorporated by reference to Exhibit 10.1.2 to the Registrant's Quarterly Report on Form 10-Q for the three months ended June 30, 2004, File No. 001-11001).
- 10.3 Amendment No. 1 to the Citizens Communications Company (f/k/a Citizens Utilities Company) Non-Employee Directors' Deferred Fee Equity Plan (incorporated by reference to Exhibit 10.2 to the Registrant's Current Report on Form 8-K, filed on December 20, 2005, File No. 001-11001).
- 10.4 Separation Agreement between Citizens Communications Company and Leonard Tow effective July 10, 2004 (incorporated by reference to Exhibit 10.2.4 of the Registrants' Quarterly Report on Form 10-Q for the six months ended June 30, 2004, File No. 001-11001).
- 10.5 Incentive Award Agreement between Citizens Communications Company and Scott N. Schneider, effective March 11, 2004 (incorporated by reference to Exhibit 10.3 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2003, File No. 001-11001).
- 10.6 Citizens Executive Deferred Savings Plan dated January 1, 1996 (incorporated by reference to Exhibit 10.19 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 1999, File No. 001-11001).
- 10.7 Citizens Incentive Plan restated as of March 21, 2000 (incorporated by reference to Exhibit 10.19 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 1999, File No. 001-11001).
- 10.8 1996 Equity Incentive Plan (incorporated by reference to Appendix A to the Registrant's definitive proxy statement on Schedule 14A filed on March 29, 1996, File No. 001-11001).
- 10.8.1 2000 Equity Incentive Plan, as amended (incorporated by reference to Appendix A to the Registrant's definitive proxy statement on Schedule 14A filed on April 20, 2005, File No. 001-11001).
- 10.9 Amendment to 1996 Equity Incentive Plan (incorporated by reference to Exhibit B to the Registrant's definitive proxy statement on Schedule 14A filed on March 31, 1997, File No. 001-11001).

## CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES

- 10.10 Amendment to 1996 Equity Incentive Plan (effective March 4, 2005) (incorporated by reference to Exhibit 10.1 to the Registrant's Quarterly Report on Form 10-Q for the three months ended March 31, 2005, File No. 001-11001).
- 10.11 Citizens 401(K) Savings Plan effective as of January 1, 1997, as amended (incorporated by reference to Exhibit 10.37 to the Registrant's Quarterly Report on Form 10-Q for the six months ended June 30, 2001, File No. 001-11001).
- 10.12 Loan Agreement between Citizens Communications Company and Rural Telephone Finance Cooperative for \$200,000,000 dated October 24, 2001 (incorporated by reference to Exhibit 10.39 to the Registrant's Quarterly Report on Form 10-Q for the nine months ended September 30, 2001, File No. 001-11001).
- 10.13 Amendment No. 1, dated as of March 31, 2003, to Loan Agreement between Citizens Communications Company and Rural Telephone Finance Cooperative (incorporated by reference to Exhibit 10.1 to the Registrant's Quarterly Report on Form 10-Q for the three months ended March 31, 2003, File No. 001-11001).
- 10.14 Employment Agreement between Citizens Communications Company and Mary Agnes Wilderotter, effective November 1, 2004 (incorporated by reference to Exhibit 10.16 to the Registrant's Quarterly Report on Form 10-Q for the nine months ended September 30, 2004, File No. 001-11001).
- 10.15 Employment Agreement between Citizens Communications Company and Jerry Elliott, effective September 1, 2004 (incorporated by reference to Exhibit 10.17 to the Registrant's Quarterly Report on Form 10-Q for the nine months ended September 30, 2004, File No. 001-11001).
- 10.16 Employment Agreement between Citizens Communications Company and Robert Larson, effective September 1, 2004 (incorporated by reference to Exhibit 10.18 to the Registrant's Quarterly Report on Form 10-Q for the nine months ended September 30, 2004, File No. 001-11001).
- 10.17 Employment Agreement between Citizens Communications Company and John H. Casey, III, effective February 15, 2005 (incorporated by reference to Exhibit 10.20 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2004, File No. 001-11001).
- 10.18 Offer of Employment Letter between Citizens Communications Company and Peter B. Hayes, effective February 1, 2005 (incorporated by reference to Exhibit 10.23 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2004, File No. 001-11001).
- 10.19 Separation Agreement between Citizens Communications Company and L. Russell Mitten dated July 13, 2005 (incorporated by reference to Exhibit 10.24 to the Registrant's Quarterly Report on Form 10-Q for the nine months ended September 30, 2005, File No. 001-11001).
- 10.20 Amendment to the Separation Agreement between Citizens Communications Company and L. Russell Mitten dated August 31, 2005 (incorporated by reference to Exhibit 10.24.1 to the Registrant's Quarterly Report on Form 10-Q for the nine months ended September 30, 2005, File No. 001-11001).
- 10.21 Summary of Compensation Arrangements for Named Executive Officers Outside of Employment Agreements (incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed February 28, 2006, File No. 001-11001).
- 10.22 Summary of Non-Employee Directors' Compensation Arrangements Outside of Formal Plans, as amended, effective December 15, 2005 (incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on December 20, 2005, File No. 001-11001).
- 10.23 Membership Interest Purchase Agreement between Citizens Communications Company and Integra Telecom Holdings, Inc. dated February 6, 2006 (incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on February 9, 2006, File No. 001-11001).
- 10.24 Stock Redemption Agreement between Citizens Utilities Rural Company, Inc. and The Rural Telephone Bank effective November 10, 2005 (including schedule of substantially identical agreements with other Subsidiaries of the Registrant).
- 12.1 Computation of ratio of earnings to fixed charges (this item is included herein for the sole purpose of incorporation by reference).
- 21.1 Subsidiaries of the Registrant
- 23.1 Auditors' Consent

## CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES

- 31.1 Certification of Principal Executive Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934.
- 31.2 Certification of Principal Financial Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934.
- 32.1 *Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.*
- 32.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Exhibits 10.2, 10.3, 10.4, 10.5, 10.6, 10.7, 10.8, 10.8.1, 10.9, 10.10, 10.11, 10.14, 10.15, 10.16, 10.17, 10.18, 10.20, 10.21 and 10.22 are management contracts or compensatory plans or arrangements.

# CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

### CITIZENS COMMUNICATIONS COMPANY

(Registrant)

By: /s/ MARY AGNES WILDEROTTER

MARY AGNES WILDEROTTER

*Chairman of the Board and Chief Executive Officer*

March 1, 2006

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities indicated on the 1st day of March 2006.

<u>Signature</u>	<u>Title</u>
<u>/s/ LEROY T. BARNES, JR.</u> (LEROY T. BARNES, JR.)	<i>Director</i>
<u>/s/ JERRY ELLIOTT</u> (JERRY ELLIOTT)	<i>President: Acting Chief Financial Officer and Director</i>
<u>/s/ JERI B. FINARD</u> (JERI B. FINARD)	<i>Director</i>
<u>/s/ LAWTON FITT</u> (LAWTON FITT)	<i>Director</i>
<u>/s/ STANLEY HARFENIST</u> (STANLEY HARFENIST)	<i>Director</i>
<u>/s/ WILLIAM KRAUS</u> (WILLIAM KRAUS)	<i>Director</i>
<u>/s/ ROBERT J. LARSON</u> (ROBERT J. LARSON)	<i>Senior Vice President and Chief Accounting Officer</i>
<u>/s/ HOWARD L. SCHROTT</u> (HOWARD L. SCHROTT)	<i>Director</i>
<u>/s/ LARRAINE D. SEGIL</u> (LARRAINE D. SEGIL)	<i>Director</i>
<u>/s/ BRADLEY E. SINGER</u> (BRADLEY E. SINGER)	<i>Director</i>
<u>/s/ EDWIN TORNBERG</u> (EDWIN TORNBERG)	<i>Director</i>
<u>/s/ DAVID H. WARD</u> (DAVID H. WARD)	<i>Director</i>
<u>/s/ MYRON A. WICK, III</u> (MYRON A. WICK, III)	<i>Director</i>
<u>/s/ MARY AGNES WILDEROTTER</u> (MARY AGNES WILDEROTTER)	<i>Chairman and Chief Executive Officer</i>

**CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES**  
**Index to Consolidated Financial Statements**

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## MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

The Board of Directors and Shareholders  
Citizens Communications Company:

The management of Citizens Communications Company and subsidiaries is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f) and 15d-15(f).

Under the supervision and with the participation of our management, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our evaluation our management concluded that our internal control over financial reporting was effective as of December 31, 2005 and for the period then ended.

Our management's assessment of the effectiveness of our internal control over financial reporting as of December 31, 2005 has been audited by KPMG LLP, an independent registered public accounting firm, as stated in their report which is included herein.

Stamford, Connecticut  
March 1, 2006

Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders  
Citizens Communications Company:

We have audited management's assessment, included in the accompanying Management's Report on Internal Control Over Financial Reporting, that Citizens Communications Company and subsidiaries maintained effective internal control over financial reporting as of December 31, 2005, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Citizens Communications Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether of internal control over financial reporting was maintained in all material respects. Our audit included obtain understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluate design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control 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 dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject 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.

In our opinion, management's assessment that Citizens Communications Company and subsidiaries maintained effective internal control over financial reporting as of December 31, 2005, is fairly stated, in all material respects, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Also, in our opinion, Citizens Communications Company and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2005, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Citizens Communications Company and subsidiaries as of December 31, 2005 and 2004, and the related consolidated statements of operations, shareholders' equity and comprehensive income (loss), and cash flows for each of the years in the three-year period ended December 31, 2005, and our report dated March 1, 2006 expressed an unqualified opinion on those consolidated financial statements.

**KPMG LLP**

Stamford, Connecticut  
March 1, 2006

Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders  
Citizens Communications Company:

We have audited the accompanying consolidated balance sheets of Citizens Communications Company and subsidiaries as of December 31, 2005 and 2004, and the related consolidated statements of operations, shareholders' equity, comprehensive income (loss) and cash flows for each of the years in the three-year period ended December 31, 2005. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). 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 management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Citizens Communications Company and subsidiaries as of December 31, 2005 and 2004 and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2005, in conformity with U.S. generally accepted accounting principles. As discussed in Note 2 to the consolidated financial statements, the Company adopted Statement of Financial Accounting Standards No. 143, "Accounting for Asset Retirement Obligations" as of January 1, 2003.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Citizens Communications Company and subsidiaries internal control over financial reporting as of December 31, 2005, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 1, 2006 expressed an unqualified opinion on management's assessment of, and the effective operation of, internal control over financial reporting.

**KPMG LLP**

Stamford, Connecticut  
March 1, 2006

**CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES**

**CONSOLIDATED BALANCE SHEETS**

**December 31, 2005 and 2004**

(\$ in thousands)

	<u>2005</u>	<u>2004</u>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents .....	\$ 265,775	\$ 163,759
Accounts receivable, less allowances of \$32,408 and \$35,996, respectively . . .	229,107	233,690
Prepaid expenses .....	27,449	30,551
Other current assets .....	19,764	18,758
Assets of discontinued operations .....	—	24,122
Total current assets .....	<u>542,095</u>	<u>470,880</u>
Property, plant and equipment, net. ....	3,186,465	3,335,850
Goodwill, net .....	1,921,465	1,921,465
Other intangibles, net .....	558,733	685,111
Investments .....	19,136	23,062
Other assets .....	184,215	232,051
Total assets .....	<u>\$ 6,412,109</u>	<u>\$ 6,668,419</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Long-term debt due within one year. ....	\$ 227,734	\$ 6,380
Accounts payable .....	152,081	169,754
Advanced billings .....	29,245	29,446
Income taxes accrued .....	5,776	27,446
Other taxes accrued .....	28,970	30,179
Interest accrued .....	101,030	82,534
Other current liabilities .....	71,806	71,046
Liabilities of discontinued operations .....	—	735
Total current liabilities .....	<u>616,642</u>	<u>417,520</u>
Deferred income taxes .....	325,084	232,766
Other liabilities .....	429,198	388,895
Long-term debt .....	3,999,376	4,266,998
Shareholders' equity:		
Common stock, \$0.25 par value (600,000,000 authorized shares; 328,168,000 and 339,633,000 outstanding and 343,956,000 and 339,635,000 issued at December 31, 2005 and 2004, respectively) .....	85,989	84,909
Additional paid-in capital .....	1,374,610	1,664,627
Accumulated deficit .....	(85,344)	(287,719)
Accumulated other comprehensive loss, net of tax .....	(123,242)	(99,569)
Treasury stock .....	(210,204)	(8)
Total shareholders' equity .....	<u>1,041,809</u>	<u>1,362,240</u>
Total liabilities and shareholders' equity .....	<u>\$ 6,412,109</u>	<u>\$ 6,668,419</u>

The accompanying Notes are an integral part of these Consolidated Financial Statements.

**CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF OPERATIONS**

**For The Years Ended December 31, 2005, 2004 and 2003**

(\$ in thousands, except for per-share amounts)

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Revenue .....	\$ 2,162,479	\$ 2,168,422	\$ 2,424,174
Operating expenses:			
Cost of services (exclusive of depreciation and amortization) .....	195,491	198,938	365,563
Other operating expenses .....	818,180	831,939	894,108
Depreciation and amortization .....	541,959	570,808	593,161
Recovery of telecommunications bankruptcies .....	—	—	(4,377)
Restructuring and other expenses .....	—	—	9,687
Loss on impairment .....	—	—	15,300
Management succession and strategic alternatives expenses (see Note 13) .....	—	90,632	—
Total operating expenses .....	<u>1,555,630</u>	<u>1,692,317</u>	<u>1,873,442</u>
Operating income .....	606,849	476,105	550,732
Investment income .....	18,236	33,616	10,418
Other income (loss), net .....	(1,674)	(53,359)	44,059
Interest expense .....	<u>338,903</u>	<u>379,021</u>	<u>416,520</u>
Income from continuing operations before income taxes, dividends on convertible preferred securities and cumulative effect of change in accounting principle .....	284,508	77,341	188,689
Income tax expense .....	<u>84,340</u>	<u>10,422</u>	<u>64,776</u>
Income from continuing operations before dividends on convertible preferred securities and cumulative effect of change in accounting principle .....	200,168	66,919	123,913
Dividends on convertible preferred securities, net of income tax benefit of \$(3,853)* .....	—	—	6,210
Income from continuing operations before cumulative effect of change in accounting principle .....	200,168	66,919	117,703
Discontinued operations (see Note 8):			
Income from operations of discontinued conferencing business (including gain on disposal of \$14,061 in 2005) .....	15,550	8,188	6,820
Income tax expense .....	<u>13,343</u>	<u>2,957</u>	<u>2,440</u>
Income from discontinued operations .....	<u>2,207</u>	<u>5,231</u>	<u>4,380</u>
Income before cumulative effect of change in accounting principle .....	202,375	72,150	122,083
Cumulative effect of change in accounting principle, net of tax of \$0, \$0 and \$41,591, respectively .....	—	—	65,769
Net income available for common shareholders .....	<u>\$ 202,375</u>	<u>\$ 72,150</u>	<u>\$ 187,852</u>
Basic income per common share:			
Income from continuing operations before cumulative effect of change in accounting principle .....	\$ 0.59	\$ 0.22	\$ 0.42
Income from discontinued operations .....	0.01	0.02	0.02
Income from cumulative effect of change in accounting principle .....	—	—	0.23
Net income per common share available for common shareholders .....	<u>\$ 0.60</u>	<u>\$ 0.24</u>	<u>\$ 0.67</u>
Diluted income per common share:			
Income from continuing operations before cumulative effect of change in accounting principle .....	\$ 0.59	\$ 0.22	\$ 0.41
Income from discontinued operations .....	0.01	0.01	0.01
Income from cumulative effect of change in accounting principle .....	—	—	0.22
Net income per common share available for common shareholders .....	<u>\$ 0.60</u>	<u>\$ 0.23</u>	<u>\$ 0.64</u>

\* The consolidation of this item changed effective January 1, 2004 as a result of the application of a newly mandated accounting standard "FIN 46R." See Note 15 for a complete discussion.

The accompanying Notes are an integral part of these Consolidated Financial Statements.

**CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY**

**For The Years Ended December 31, 2005, 2004 and 2003**

(\$ in thousands, except for per-share amounts)

	Common Stock		Additional Paid-In Capital	Retained Earnings (Deficit)	Accumulated Other Comprehensive Income (Loss)	Treasury Stock		Total Shareholders' Equity
	Shares	Amount				Shares	Amount	
Balance December 31, 2002.	294,080	\$ 73,520	\$ 1,943,406	\$ (553,033)	\$ (102,169)	(11,598)	\$ (189,585)	\$ 1,172,139
Stock plans .....	1,354	338	9,911	—	—	873	14,450	24,699
Net income .....	—	—	—	187,852	—	—	—	187,852
Other comprehensive income, net of tax and reclassifications adjustments .....	—	—	—	—	30,493	—	—	30,493
Balance December 31, 2003.	295,434	73,858	1,953,317	(365,181)	(71,676)	(10,725)	(175,135)	1,415,183
Stock plans .....	4,821	1,206	14,236	—	—	6,407	106,823	122,265
Conversion of EPPICS .....	10,897	2,724	133,621	—	—	725	11,646	147,991
Conversion of Equity Units .	28,483	7,121	396,221	—	—	3,591	56,658	460,000
Dividends on common stock of \$2.50 per share .....	—	—	(832,768)	—	—	—	—	(832,768)
Net income .....	—	—	—	72,150	—	—	—	72,150
Tax benefit on equity forward contracts .....	—	—	—	5,312	—	—	—	5,312
Other comprehensive loss, net of tax and reclassifications adjustments .....	—	—	—	—	(27,893)	—	—	(27,893)
Balance December 31, 2004.	339,635	84,909	1,664,627	(287,719)	(99,569)	(2)	(8)	1,362,240
Stock plans .....	2,096	524	24,039	—	—	2,598	34,689	59,252
Conversion of EPPICS .....	2,225	556	24,308	—	—	391	5,115	29,979
Dividends on common stock of \$1.00 per share .....	—	—	(338,364)	—	—	—	—	(338,364)
Shares repurchased .....	—	—	—	—	—	(18,775)	(250,000)	(250,000)
Net income .....	—	—	—	202,375	—	—	—	202,375
Other comprehensive loss, net of tax and reclassifications adjustments .....	—	—	—	—	(23,673)	—	—	(23,673)
Balance December 31, 2005.	<u>343,956</u>	<u>\$ 85,989</u>	<u>\$ 1,374,610</u>	<u>\$ (85,344)</u>	<u>\$ (123,242)</u>	<u>(15,788)</u>	<u>\$ (210,204)</u>	<u>\$ 1,041,809</u>

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)**

**For The Years Ended December 31, 2005, 2004 and 2003**

(\$ in thousands, except for per-share amounts)

	2005	2004	2003
Net income .....	\$ 202,375	\$ 72,150	\$ 187,852
Other comprehensive income (loss), net of tax and reclassifications adjustments* .....	(23,673)	(27,893)	30,493
Total comprehensive income .....	<u>\$ 178,702</u>	<u>\$ 44,257</u>	<u>\$ 218,345</u>

\* Consists of unrealized holding (losses)/gains of marketable securities, realized gains taken to income as a result of the sale of securities and minimum pension liability (see Note 21).

The accompanying Notes are an integral part of these Consolidated Financial Statements.

**CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

**For The Years Ended December 31, 2005, 2004 and 2003**

(\$ in thousands)

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Cash flows provided by (used in) operating activities:			
Net income .....	\$ 202,375	\$ 72,150	\$ 187,852
Deduct: Gain on sale of discontinued operations .....	(1,167)	—	—
Income from discontinued operations .....	(1,040)	(5,231)	(4,380)
Cumulative effect of change in accounting principle for the adoption of SFAS No. 143 .....	—	—	(65,769)
Adjustments to reconcile income to net cash provided by operating activities:			
Depreciation and amortization expense .....	541,959	570,808	593,161
Gain on expiration/settlement of customer advance .....	(681)	(25,345)	(6,165)
Gain on capital lease termination/restructuring .....	—	—	(69,512)
Stock based compensation expense .....	8,427	47,581	8,956
Loss on debt exchange .....	3,175	—	—
Loss on extinguishment of debt .....	—	66,480	10,851
Investment gains .....	(492)	(12,066)	—
Gain on sales of assets .....	—	1,945	20,492
Loss on impairment .....	—	—	15,300
Other non-cash adjustments .....	20,481	30,397	20,091
Deferred taxes .....	100,636	24,016	74,508
Change in accounts receivable .....	4,583	11,895	69,619
Change in accounts payable and other liabilities .....	(33,399)	(67,499)	(113,532)
Change in other current assets .....	(640)	(3,694)	748
Net cash provided by operating activities .....	<u>844,217</u>	<u>711,437</u>	<u>742,220</u>
Cash flows provided from (used by) investing activities:			
Proceeds from sales of assets, net of selling expenses .....	24,195	30,959	388,079
Proceeds from sale of discontinued operations .....	43,565	—	—
Capital expenditures .....	(268,459)	(275,204)	(277,371)
Securities purchased .....	—	—	(1,680)
Securities sold .....	1,112	26,514	—
Other asset (purchased) distributions received .....	5,724	(28,110)	68
Net cash provided from (used by) investing activities .....	<u>(193,863)</u>	<u>(245,841)</u>	<u>109,096</u>
Cash flows provided from (used by) financing activities:			
Repayment of customer advances for construction and contributions in aid of construction .....	(1,662)	(2,089)	(10,030)
Long-term debt borrowings .....	—	700,000	—
Debt issuance costs .....	—	(15,502)	—
Long-term debt payments .....	(6,433)	(1,214,018)	(653,442)
Premium to retire debt .....	—	(66,480)	(10,851)
Issuance of common stock .....	47,550	544,562	13,209
Shares repurchased .....	(250,000)	—	—
Dividends paid .....	(338,364)	(832,768)	—
Net cash used by financing activities .....	<u>(548,909)</u>	<u>(886,295)</u>	<u>(661,114)</u>
Cash flows of discontinued operations			
Operating cash flows .....	578	1,361	956
Investing cash flows .....	(7)	(571)	(644)
Financing cash flows .....	—	(3)	(20)
	<u>571</u>	<u>787</u>	<u>292</u>
Increase (decrease) in cash and cash equivalents .....	102,016	(419,912)	190,494
Cash and cash equivalents at January 1, .....	163,759	583,671	393,177
Cash and cash equivalents at December 31, .....	<u>\$ 265,775</u>	<u>\$ 163,759</u>	<u>\$ 583,671</u>
Cash paid during the period for:			
Interest .....	\$ 318,638	\$ 370,128	\$ 418,561
Income taxes (refunds) .....	\$ 4,711	\$ (4,901)	\$ (2,532)
Non-cash investing and financing activities:			
Change in fair value of interest rate swaps .....	\$ (13,193)	\$ (6,135)	\$ (6,057)
Conversion of EPPICS .....	\$ 29,980	\$ 147,991	\$ —
Debt-for-debt exchange .....	\$ 2,171	\$ —	\$ —
Investment write-downs .....	\$ —	\$ 5,286	\$ —

The accompanying Notes are an integral part of these Consolidated Financial Statements.

# CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES

## Notes to Consolidated Financial Statements

### (1) DESCRIPTION OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

#### (a) Description of Business:

Citizens Communications Company and its subsidiaries are referred to as “we,” “us,” the “Company,” or “our” in this report. We are a communications company providing services to rural areas and small and medium-sized towns and cities as an incumbent local exchange carrier, or ILEC. We offer our ILEC services under the “Frontier” name. In addition, we provide competitive local exchange carrier, or CLEC, services to business customers and to other communications carriers in certain metropolitan areas in the western United States through Electric Lightwave, LLC, or ELI, our wholly-owned subsidiary. In February 2006, we entered into a definitive agreement to sell ELI and we expect the sale to close in the third quarter of 2006.

#### (b) Principles of Consolidation and Use of Estimates:

Our consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). Certain reclassifications of balances previously reported have been made to conform to the current presentation. All significant intercompany balances and transactions have been eliminated in consolidation.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions which affect the amounts of assets, liabilities, revenue and expenses we have reported and our disclosure of contingent assets and liabilities at the date of the financial statements. Actual results may differ from those estimates. We believe that our critical estimates are depreciation rates, pension assumptions, calculations of impairment amounts, reserves established for receivables, income taxes and contingencies.

#### (c) Cash Equivalents:

We consider all highly liquid investments with an original maturity of three months or less to be cash equivalents.

#### (d) Revenue Recognition:

*Frontier* – Revenue is recognized when services are provided or when products are delivered to customers. Revenue that is billed in advance includes: monthly recurring network access services, special access services and monthly recurring local line charges. The unearned portion of this revenue is initially deferred as a component of other liabilities on our consolidated balance sheet and recognized in revenue over the period that the services are provided. Revenue that is billed in arrears includes: non-recurring network access services, switched access services, non-recurring local services and long-distance services. The earned but unbilled portion of this revenue is recognized in revenue in our statement of operations and accrued in accounts receivable in the period that the services are provided. Excise taxes are recognized as a liability when billed. Installation fees and their related direct and incremental costs are initially deferred and recognized as revenue and expense over the average term of a customer relationship. We recognize as current period expense the portion of installation costs that exceeds installation fee revenue.

*Electric Lightwave, LLC (ELI)* – Revenue is recognized when the services are provided. Revenue from long-term prepaid network services agreements including Indefeasible Rights to Use (IRU), are deferred and recognized on a straight-line basis over the terms of the related agreements. Installation fees and their related direct and incremental costs are initially deferred and recognized as revenue and expense over the average term of a customer relationship. We recognize as current period expense the portion of installation costs that exceeds installation fee revenue.

#### (e) Property, Plant and Equipment:

Property, plant and equipment are stated at original cost or fair market value for our acquired properties, including capitalized interest. Maintenance and repairs are charged to operating expenses as incurred. The gross book value of routine property, plant and equipment retired is charged against accumulated depreciation.

# CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES

## Notes to Consolidated Financial Statements

### (f) Goodwill and Other Intangibles:

Intangibles represent the excess of purchase price over the fair value of identifiable tangible assets acquired. We undertake studies to determine the fair values of assets and liabilities acquired and allocate purchase prices to assets and liabilities, including property, plant and equipment, goodwill and other identifiable intangibles. We annually (during the fourth quarter) examine the carrying value of our goodwill and trade name to determine whether there are any impairment losses and have determined for the year ended December 31, 2005 that there was no impairment (see Notes 2 and 7). All intangibles at December 31, 2005 are associated with the Frontier segment, which is the reporting unit.

SFAS No. 142 also requires that intangible assets with estimated useful lives be amortized over those lives and be reviewed for impairment in accordance with SFAS No. 144, "Accounting for Impairment or Disposal of Long-Lived Assets" to determine whether any changes to these lives are required. We periodically reassess the useful life of our intangible assets with estimated useful lives to determine whether any changes to those lives are required.

### (g) Impairment of Long-Lived Assets and Long-Lived Assets to Be Disposed Of:

We review long-lived assets to be held and used and long-lived assets to be disposed of, including intangible assets with estimated useful lives, for impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. Recoverability of assets to be held and used is measured by comparing the carrying amount of the asset to the future undiscounted net cash flows expected to be generated by the asset. Recoverability of assets held for sale is measured by comparing the carrying amount of the assets to their estimated fair market value. If any assets are considered to be impaired, the impairment is measured by the amount by which the carrying amount of the assets exceeds the estimated fair value (see Note 5).

### (h) Derivative Instruments and Hedging Activities:

We account for derivative instruments and hedging activities in accordance with SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended. SFAS No. 133, as amended, requires that all derivative instruments, such as interest rate swaps, be recognized in the financial statements and measured at fair value regardless of the purpose or intent of holding them.

On the date we enter into a derivative contract that qualifies for hedge accounting, we designate the derivative as either a fair value or cash flow hedge. A hedge of the fair value of a recognized asset or liability or of an unrecognized firm commitment is a fair value hedge. A hedge of a forecasted transaction or the variability of cash flows to be received or paid related to a recognized asset or liability is a cash flow hedge. We formally document all relationships between hedging instruments and hedged items, as well as our risk-management objective and strategy for undertaking the hedge transaction. This process includes linking all derivatives that are designated as fair-value or cash flow hedges to specific assets and liabilities on the balance sheet or to specific firm commitments or forecasted transactions.

We also formally assess, both at the hedge's inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items. If it is determined that a derivative is not highly effective as a hedge or that it has ceased to be a highly effective hedge, we would discontinue hedge accounting prospectively.

All derivatives are recognized on the balance sheet at their fair value. Changes in the fair value of derivative financial instruments are either recognized in income or stockholders' equity (as a component of other comprehensive income), depending on whether the derivative is being used to hedge changes in fair value or cash flows.

We have interest rate swap arrangements related to a portion of our fixed rate debt. These hedge strategies satisfy the fair value hedging requirements of SFAS No. 133, as amended. As a result, the fair value of the swaps is carried on the balance sheet in other current assets and the related hedged liabilities are also adjusted to fair value by the same amount.

## CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES

### Notes to Consolidated Financial Statements

#### (i) Investments:

##### *Marketable Securities*

We classify our cost method investments at purchase as available-for-sale. We do not maintain a trading portfolio or held-to-maturity securities.

Securities classified as available-for-sale are carried at estimated fair market value. These securities are held for an indefinite period of time, but might be sold in the future as changes in market conditions or economic factors occur. Net aggregate unrealized gains and losses related to such securities, net of taxes, are included as a separate component of shareholders' equity. Interest, dividends and gains and losses realized on sales of securities are reported in Investment income.

We evaluate our investments periodically to determine whether any decline in fair value, below the cost basis, is other than temporary. To determine whether an impairment is other than temporary, we consider whether we have the ability and intent to hold the investment until a market price recovery and whether evidence indicating the cost of the investment is recoverable outweighs evidence to the contrary. Evidence considered in this assessment includes the reasons for the impairment, the severity and duration of the impairment, changes in value subsequent to year-end, and forecasted performance of the investee. If we determine that a decline in fair value is other than temporary, the cost basis of the individual investment is written down to fair value, which becomes the new cost basis. The amount of the write-down is transferred from other comprehensive income (loss) and included in the statement of operations as a loss.

##### *Investments in Other Entities*

Investments in entities that we do not control, but where we have the ability to exercise significant influence over operating and financial policies, are accounted for using the equity method of accounting.

#### (j) Income Taxes and Deferred Income Taxes:

We file a consolidated federal income tax return. We utilize the asset and liability method of accounting for income taxes. Under the asset and liability method, deferred income taxes are recorded for the tax effect of temporary differences between the financial statement basis and the tax basis of assets and liabilities using tax rates expected to be in effect when the temporary differences are expected to reverse.

#### (k) Stock Plans:

We have various stock-based compensation plans. Awards under these plans are granted to eligible officers, management, non-management employees and non-employee directors. Awards may be made in the form of incentive stock options, non-qualified stock options, stock appreciation rights, restricted stock or other stock based awards. As permitted by current accounting rules, we apply Accounting Principles Board Opinions (APB) No. 25 and related interpretations in accounting for the employee stock plans resulting in the use of the intrinsic value to value the stock.

SFAS No. 123, "Accounting for Stock-Based Compensation" and SFAS No. 148, "Accounting for Stock-Based Compensation – Transition and Disclosure, an amendment of SFAS No. 123," established accounting and disclosure requirements using a fair-value-based method of accounting for stock-based employee compensation plans. As permitted by existing accounting standards, we have elected to continue to apply the intrinsic-valued-based method of accounting described above, and have adopted only the disclosure requirements of SFAS No. 123, as amended.

In December 2004, the FASB issued SFAS No. 123 (revised 2004), "Share-Based Payment," ("SFAS No. 123R"). SFAS 123R requires that stock-based employee compensation be recorded as a charge to earnings. In April 2005, the Securities and Exchange Commission required the adoption of SFAS No. 123R for annual periods beginning after June 15, 2005. Accordingly, we will adopt SFAS 123R commencing January 1, 2006 and expect to recognize approximately \$2,800,000 of expense related to the non-vested portion of previously granted stock options for the year ended December 31, 2006.

**CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements**

We provide pro forma net income and pro forma net income per common share disclosures for employee and non-employee director stock option grants based on the fair value of the options at the date of grant (see Note 18). For purposes of presenting pro forma information, the fair value of options granted is computed using the Black Scholes option-pricing model.

Had we determined compensation cost based on the fair value at the grant date for the Management Equity Incentive Plan (MEIP), Equity Incentive Plan (EIP) and Directors' Deferred Fee Equity Plan, our pro forma net income and net income per common share available for common shareholders would have been as follows:

<u>(\$ in thousands)</u>		<u>2005</u>	<u>2004</u>	<u>2003</u>
Net income available for common shareholders . . . . .	As reported	\$ 202,375	\$ 72,150	\$ 187,852
Add: Stock-based employee compensation expense included in reported net income, net of related tax effects . . . . .		5,267	29,381	6,014
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects . . . . .		<u>(8,165)</u>	<u>(38,312)</u>	<u>(16,139)</u>
	Pro forma	<u>\$ 199,477</u>	<u>\$ 63,219</u>	<u>\$ 177,727</u>
Net income per common share available for common shareholders . . . . .	As reported:			
	Basic	\$ 0.60	\$ 0.24	\$ 0.67
	Diluted	0.60	0.23	0.64
	Pro forma:			
	Basic	\$ 0.59	\$ 0.21	\$ 0.63
	Diluted	0.59	0.20	0.61

In connection with the payment of the special, non-recurring dividend of \$2.00 per common share on September 2, 2004, the exercise price and number of all outstanding options was adjusted such that each option had the same value to the holder after the dividend as it had before the dividend. In accordance with FASB Interpretation No. 44 (FIN 44), "Accounting for Certain Transactions Involving Stock Compensation" and EITF 00-23, "Issues Related to the Accounting for Stock Compensation under APB No. 25 and FIN 44," there is no accounting consequence for changes made to the exercise price and the number of shares of a fixed stock option or award as a direct result of the special, non-recurring dividend.

**(1) Net Income Per Common Share Available for Common Shareholders:**

Basic net income per common share is computed using the weighted average number of common shares outstanding during the period being reported on. Except when the effect would be antidilutive, diluted net income per common share reflects the dilutive effect of the assumed exercise of stock options using the treasury stock method at the beginning of the period being reported on as well as common shares that would result from the conversion of convertible debt. In addition, the related interest on debt (net of tax) is added back to income since it would not be paid if the debt was converted to common stock.

**(2) RECENT ACCOUNTING LITERATURE AND CHANGES IN ACCOUNTING PRINCIPLES:**

**Accounting for Asset Retirement Obligations**

In June 2001, the FASB issued SFAS No. 143, "Accounting for Asset Retirement Obligations." We adopted SFAS No. 143 effective January 1, 2003. As a result of our adoption of SFAS No. 143, we recognized an after tax non-cash gain of approximately \$65,769,000. This gain resulted from the elimination of the cumulative cost of removal included in accumulated depreciation and is reflected as a cumulative effect of a change in accounting principle in our statement of operations in 2003, as we have no legal obligation to remove certain of our long-lived assets.

# CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES

## Notes to Consolidated Financial Statements

### Stock-Based Compensation

In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation – Transition and Disclosure, an amendment of FASB Statement No. 123, "Accounting for Stock-Based Compensation." SFAS No. 148 provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based compensation and amends the disclosure requirements of SFAS No. 123 to require prominent disclosures in both annual and interim financial statements. This statement is effective for fiscal years ending after December 15, 2002. We have adopted the expanded disclosure requirements of SFAS No. 148.

In December 2004, the FASB issued SFAS No. 123 (revised 2004), "Share-Based Payment," (SFAS No. 123R). SFAS No. 123R requires that stock-based employee compensation be recorded as a charge to earnings. In April 2005, the Securities and Exchange Commission required adoption of SFAS No. 123R for annual periods beginning after June 15, 2005. Accordingly, we will adopt SFAS 123R commencing January 1, 2006 and expect to recognize approximately \$2,800,000 of expense related to the non-vested portion of previously granted stock options for the year ended December 31, 2006.

### Variable Interest Entities

In December 2003, the FASB issued FASB Interpretation No. 46 (revised December 2003) (FIN 46R), "Consolidation of Variable Interest Entities," which addresses how a business enterprise should evaluate whether it has a controlling financial interest in an entity through means other than voting rights and accordingly should consolidate the entity. FIN 46R replaces FASB Interpretation No. 46, "Consolidation of Variable Interest Entities," which was issued in January 2003. We are required to apply FIN 46R to variable interests in variable interest entities, or VIEs, created after December 31, 2003. For any VIEs that must be consolidated under FIN 46R that were created before January 1, 2004, the assets, liabilities and noncontrolling interests of the VIE initially would be measured at their carrying amounts with any difference between the net amount added to the balance sheet and any previously recognized interest being recognized as the cumulative effect of an accounting change. If determining the carrying amounts is not practicable, fair value at the date FIN 46R first applies may be used to measure the assets, liabilities and noncontrolling interest of the VIE. We reviewed all of our investments and determined that the Trust Convertible Preferred Securities (EPPICS), issued by our consolidated wholly-owned subsidiary, Citizens Utilities Trust and the related Citizens Utilities Capital L.P., were our only VIEs. Except as described in Note 15, the adoption of FIN 46R on January 1, 2004 did not have a material impact on our financial position or results of operations.

### Investments

In March 2004, the FASB issued EITF Issue No. 03-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments" (EITF 03-1), which provides new guidance for assessing impairment losses on debt and equity investments. Additionally, EITF 03-1 includes new disclosure requirements for investments that are deemed to be temporarily impaired. In September 2004, the FASB delayed the accounting provisions of EITF 03-1; however, the disclosure requirements remain effective and were adopted for our year ended December 31, 2004. Although we have no material investments at the present time, we will evaluate the effect, if any, of EITF 03-1 when final guidance is released.

### Exchanges of Productive Assets

In December 2004, the FASB issued SFAS No. 153, "Exchanges of Nonmonetary Assets," an amendment of APB Opinion No. 29. SFAS No. 153 addresses the measurement of exchanges of certain non-monetary assets (except for certain exchanges of products or property held for sale in the ordinary course of business). The Statement requires that non-monetary exchanges be accounted for at the fair value of the assets exchanged, with gains or losses being recognized, if the fair value is determinable within reasonable limits and the transaction has commercial substance. SFAS No. 153 is effective for nonmonetary exchanges occurring in fiscal periods beginning after June 15, 2005. We do not expect the adoption of the new standard to have a material impact on our financial position, results of operations and cash flows.

# CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES

## Notes to Consolidated Financial Statements

### Accounting for Conditional Asset Retirement Obligations

In March 2005, the FASB issued FIN 47, "Accounting for Conditional Asset Retirement Obligations," an interpretation of FASB No. 143. FIN 47 clarifies that the term conditional asset retirement obligation as used in FASB No. 143 refers to a legal obligation to perform an asset retirement activity in which the timing or method of settlement are conditional on a future event that may or may not be within the control of the entity. FIN 47 also clarifies when an entity would have sufficient information to reasonably estimate the fair value of an asset retirement obligation. Although a liability exists for the removal of poles and asbestos, sufficient information is not available currently to estimate our liability, as the range of time over which we may settle these obligations is unknown or cannot be reasonably estimated. The adoption of FIN 47 during the fourth quarter of 2005 had no impact on our financial position or results of operations.

### Accounting Changes and Error Corrections

In May 2005, the FASB issued SFAS No. 154, "Accounting Changes and Error Corrections," a replacement of APB Opinion No. 20 and FASB Statement No. 3. SFAS No. 154 changes the accounting for, and reporting of, a change in accounting principle. SFAS No. 154 requires retrospective application to prior period's financial statements of voluntary changes in accounting principle, and changes required by new accounting standards when the standard does not include specific transition provisions, unless it is impracticable to do so. SFAS No. 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005.

### Partnerships

In June 2005, the FASB issued EITF No. 04-5, "Determining Whether a General Partner, or the General Partners as a Group, Controls a Limited Partnership or Similar Entity When the Limited Partners Have Certain Rights," which provides new guidance on how general partners in a limited partnership should determine whether they control a limited partnership. EITF No. 04-5 is effective for fiscal periods beginning after December 15, 2005. We do not expect the adoption of EITF No. 04-5 to have a material impact on our financial position, results of operations or cash flows.

### (3) ACCOUNTS RECEIVABLE:

The components of accounts receivable at December 31, 2005 and 2004 are as follows:

(\$ in thousands)	2005	2004
End user .....	\$ 226,717	\$ 227,385
Other .....	34,798	42,301
Less: Allowance for doubtful accounts .....	(32,408)	(35,996)
Accounts receivable, net .....	<u>\$ 229,107</u>	<u>\$ 233,690</u>

We maintain an allowance for estimated bad debts based on our estimate of collectibility of our accounts receivable. Bad debt expense, which is recorded as a reduction of revenue, was \$13,510,000, \$17,906,000 and \$21,540,000 for the years ended December 31, 2005, 2004, and 2003, respectively.

**CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements**

**(4) PROPERTY, PLANT AND EQUIPMENT:**

The components of property, plant and equipment at December 31, 2005 and 2004 are as follows:

(\$ in thousands)	Estimated Useful Lives	2005	2004
Land .....	N/A	\$ 20,748	\$ 21,481
Buildings and leasehold improvements .....	30 to 41 years	359,339	357,983
General support .....	3 to 17 years	413,512	414,360
Central office/electronic circuit equipment .....	5 to 11 years	2,611,934	2,536,579
Cable and wire .....	15 to 60 years	3,085,338	2,972,919
Other .....	5 to 30 years	35,458	31,993
Construction work in progress .....		99,746	93,049
		<u>6,626,075</u>	<u>6,428,364</u>
Less: accumulated depreciation .....		<u>(3,439,610)</u>	<u>(3,092,514)</u>
Property, plant and equipment, net. ....		<u>\$ 3,186,465</u>	<u>\$ 3,335,850</u>

Depreciation expense is principally based on the composite group method. Depreciation expense was \$415,581,000, \$444,288,000 and \$466,323,000 for the years ended December 31, 2005, 2004 and 2003, respectively. Effective January 1, 2003, as a result of the adoption of SFAS No. 143, "Accounting for Asset Retirement Obligations," we ceased recognition of the cost of removal provision in depreciation expense and eliminated the cumulative cost of removal included in accumulated depreciation. Effective with the completion of an independent study of the estimated useful lives of our plant assets we adopted new lives beginning October 1, 2005.

**(5) LOSSES ON IMPAIRMENT:**

During 2005 and 2004, we did not recognize any impairment charges.

During 2003, we recognized non-cash pre-tax impairment losses of \$15,300,000 related to our Vermont electric division assets held for sale in accordance with the provisions of SFAS No. 144.

**(6) DISPOSITIONS:**

Pre-tax gains (losses) in connection with the following transactions were recorded in other income (loss), net:

**2005**

On February 1, 2005, we sold shares of Prudential Financial, Inc. for approximately \$1,112,000 in cash, and we recognized a pre-tax gain of approximately \$493,000.

In June 2005, we sold for cash our interests in certain key man life insurance policies on the lives of Leonard Tow, our former Chairman and Chief Executive Officer, and his wife, a former director. The cash surrender value of the policies purchased by Dr. Tow totaled approximately \$24,195,000, and we recognized a pre-tax gain of approximately \$457,000.

During 2005, we sold shares of Global Crossing Limited for approximately \$1,084,000 in cash, and we recognized a pre-tax gain for the same amount.

**2004**

In October 2004, we sold cable assets in California, Arizona, Indiana, and Wisconsin for approximately \$2,263,000 in cash. The pre-tax gain on the sale was \$40,000.

During the third quarter of 2004, we sold our corporate aircraft for approximately \$15,298,000 in cash. The pre-tax loss on the sale was \$1,087,000.

**CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements**

**2003**

On April 1, 2003, we completed the sale of approximately 11,000 telephone access lines in North Dakota for approximately \$25,700,000 in cash. The pre-tax gain on the sale was \$2,274,000.

On April 4, 2003, we completed the sale of our wireless partnership interest in Wisconsin for approximately \$7,500,000 in cash. The pre-tax gain on the sale was \$2,173,000.

**(7) OTHER INTANGIBLES:**

Other intangibles at December 31, 2005 and 2004 are as follows:

(\$ in thousands)	2005	2004
Customer base - amortizable over 96 months .....	\$ 994,605	\$ 994,605
Trade name - non-amortizable .....	122,058	122,058
Other intangibles .....	1,116,663	1,116,663
Accumulated amortization .....	(557,930)	(431,552)
Total other intangibles, net .....	<u>\$ 558,733</u>	<u>\$ 685,111</u>

Amortization expense was \$126,378,000, \$126,520,000 and \$126,838,000 for the years ended December 31, 2005, 2004 and 2003, respectively. Amortization expense, based on our estimate of useful lives, is estimated to be \$126,380,000 per year through 2008 and \$57,533,000 in 2009, at which point these assets will have been fully amortized.

**(8) DISCONTINUED OPERATIONS:**

**Conference Call USA**

In February 2005, we entered into a definitive agreement to sell Conference-Call USA, LLC (CCUSA), our conferencing services business. On March 15, 2005, we completed the sale for \$43,565,000 in cash, subject to adjustments under the terms of the agreement. The pre-tax gain on the sale of CCUSA was \$14,061,000. Our after-tax gain was approximately \$1,167,000. The book income taxes recorded upon sale are primarily attributable to a low tax basis in the assets sold.

In accordance with SFAS No. 144, any component of our business that we dispose of or classify as held for sale that has operations and cash flows clearly distinguishable from operations, and for financial reporting purposes, and that will be eliminated from the ongoing operations, should be classified as discontinued operations. Accordingly, we have classified the results of operations of CCUSA as discontinued operations in our consolidated statements of operations and have restated prior periods.

CCUSA had revenues of approximately \$24,600,000 and operating income of approximately \$8,000,000 for the year ended December 31, 2004. At December 31, 2004, CCUSA's net assets totaled approximately \$23,400,000. The company had no outstanding debt specifically identified with CCUSA and therefore no interest expense was allocated to discontinued operations. In addition, we ceased to record depreciation expense effective February 16, 2005.

**CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements**

Summarized financial information for CCUSA (discontinued operations) is set forth below:

(\$ in thousands)	For the years ended December 31,		
	2005	2004	2003
Revenue .....	\$ 4,607	\$ 24,558	\$ 20,764
Operating income .....	\$ 1,489	\$ 8,188	\$ 6,820
Income taxes .....	\$ 449	\$ 2,957	\$ 2,440
Net income .....	\$ 1,040	\$ 5,231	\$ 4,380
Gain on disposal of CCUSA, net of tax .....	\$ 1,167	\$ —	\$ —

(\$ in thousands)	December 31, 2004
Current assets .....	\$ 2,819
Net property, plant and equipment .....	2,450
Goodwill .....	18,853
Total assets of discontinued operations .....	<u>\$ 24,122</u>
Current liabilities .....	<u>\$ 735</u>
Total liabilities of discontinued operations .....	<u>\$ 735</u>

**Public Utilities**

On April 1, 2004, we completed the sale of our Vermont electric distribution operations for approximately \$13,992,000 in cash, net of selling expenses. With that transaction, we completed the divestiture of our public utilities services business pursuant to plans announced in 1999. Losses on the sales of our Vermont properties were included in the impairment charges recorded in 2003.

**(9) INVESTMENTS:**

The components of investments at December 31, 2005 and 2004 are as follows:

(\$ in thousands)	2005	2004
Marketable equity securities .....	\$ 122	\$ 2,336
Equity method investments .....	19,014	20,726
	<u>\$ 19,136</u>	<u>\$ 23,062</u>

**Marketable Securities**

As of December 31, 2005 and 2004, we owned 3,059,000 shares of Adelphia Communications Corp. (Adelphia) common stock. As a result of write downs recorded in 2002 and 2001, our "book cost basis" was reduced to zero and subsequent increases and decreases, except for those deemed other than temporary, are included in accumulated other comprehensive income (loss).

During 2004, we sold our investments in D & E Communications, Inc. (D & E) and Hungarian Telephone and Cable Corp. (HTCC) for approximately \$13,300,000 and \$13,200,000 in cash, respectively. We recorded net realized gains of \$12,066,000 in our statement of operations for the sale of these marketable securities.

**CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements**

The following summarizes the adjusted cost, gross unrealized holding gains and losses and fair market value for marketable securities:

(\$ in thousands)	Adjusted	Unrealized Holding		Aggregate Fair
Investment Classification	Cost	Gains	(Losses)	Market Value
<u>As of December 31, 2005</u>				
Available-for-Sale .....	\$ —	\$ 122	\$ —	\$ 122
<u>As of December 31, 2004</u>				
Available-for-Sale .....	\$ 1,138	\$ 1,198	\$ —	\$ 2,336

At December 31, 2005 and 2004, we did not have any investments that have been in a continuous unrealized loss position deemed to be temporary for more than 12 months. We determined that market fluctuations during the period are not other than temporary because the severity and duration of the unrealized losses were not significant.

**Investments in Other Entities**

During 2004, we reclassified our investments accounted for under the equity method from other assets to the investment caption in our consolidated balance sheets and conformed prior periods to the current presentation.

Our investments in entities that are accounted for under the equity method of accounting consist of the following: (1) a 33% interest in the Mohave Cellular Limited Partnership which is engaged in cellular mobile telephone service in the Arizona area; (2) a 16.8% interest in the Fairmount Cellular Limited Partnership which is engaged in cellular mobile telephone service in the Rural Service Area (RSA) designated by the FCC as Georgia RSA No. 3; and (3) our investments in CU Capital and CU Trust with relation to our convertible preferred securities. The investments in these entities amounted to \$19,014,000 and \$20,726,000 at December 31, 2005 and 2004, respectively.

**(10) FAIR VALUE OF FINANCIAL INSTRUMENTS:**

The following table summarizes the carrying amounts and estimated fair values for certain of our financial instruments at December 31, 2005 and 2004. For the other financial instruments, representing cash, accounts receivables, long-term debt due within one year, accounts payable and other accrued liabilities, the carrying amounts approximate fair value due to the relatively short maturities of those instruments.

The fair value of our marketable securities and long-term debt is estimated based on quoted market prices at the reporting date for those financial instruments. Other securities and investments for which market values are not readily available are carried at cost.

(\$ in thousands)	2005		2004	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Investments .....	\$ 19,136	\$ 19,136	\$ 23,062	\$ 23,062
Long-term debt <sup>(1)</sup> .....	\$ 3,999,376	\$ 4,026,453	\$ 4,266,998	\$ 4,607,298

(1) 2005 and 2004 includes interest rate swaps of \$(8,727,000) and \$4,466,000, respectively. 2005 and 2004 includes EPPICS of \$33,785,000 and \$63,765,000, respectively.

**CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements**

**(11) LONG-TERM DEBT:**

The activity in our long-term debt from December 31, 2004 to December 31, 2005 is summarized as follows:

(\$ in thousands)	Twelve Months Ended				December 31, 2005	Interest Rate* at December 31, 2005
	December 31, 2004	Payments	Interest Rate Swap	Other		
Rural Utilities Service Loan Contracts . . . . .	\$ 29,108	\$ (6,299)	\$ —	\$ —	\$ 22,809	6.070%
Senior Unsecured Debt . . . . .	4,131,803	—	(13,193)	2,171	4,120,781	8.117%
EPPICS** (reclassified as a result of adopting FIN 46R) . . . . .	63,765	—	—	(29,980)	33,785	5.000%
ELI Capital Leases . . . . .	4,421	(134)	—	—	4,287	10.364%
Industrial Development Revenue Bonds . . . . .	58,140	—	—	—	58,140	5.559%
<b>TOTAL LONG TERM DEBT . . . . .</b>	<b>\$ 4,287,237</b>	<b>\$ (6,433)</b>	<b>\$ (13,193)</b>	<b>\$ (27,809)</b>	<b>\$ 4,239,802</b>	
Less: Debt Discount . . . . .	(13,859)				(12,692)	
Less: Current Portion . . . . .	(6,380)				(227,734)	
	<b>\$ 4,266,998</b>				<b>\$ 3,999,376</b>	

\* Interest rate includes amortization of debt issuance expenses, debt premiums or discounts. The interest rate for Rural Utilities Service Loan Contracts, Senior Unsecured Debt, and Industrial Development Revenue Bonds represent a weighted average of multiple issuances.

\*\* In accordance with FIN 46R, the Trust holding the EPPICS and the related Citizens Utilities Capital L.P. are now deconsolidated (see Note 15).

Additional information regarding our Senior Unsecured Debt at December 31, 2005 is as follows:

(\$ in thousands)	Principal Outstanding	Interest Rate
Senior Notes:		
Due 8/17/2006 . . . . .	\$ 51,770	6.750%
Due 8/15/2008 . . . . .	698,470	7.625%
Due 5/15/2011 . . . . .	1,044,256	9.250%
Due 10/24/2011 . . . . .	200,000	6.270%
Due 1/15/2013 . . . . .	698,537	6.250%
Due 8/15/2031 . . . . .	748,006	9.000%
	3,441,039	
Debentures due 2006 - 2046 . . . . .	643,742	7.263%
Subsidiary Senior Notes due 12/1/2012 . . . . .	36,000	8.050%
Total . . . . .	<b>\$ 4,120,781</b>	

In February 2006, our Board of Directors authorized us to repurchase up to \$150.0 million of our outstanding debt securities over the following twelve-month period. These repurchases may require us to pay premiums, which would result in pre-tax losses to be recorded in other income (loss), net.

## CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES

### Notes to Consolidated Financial Statements

For the year ended December 31, 2005, we retired an aggregate \$36,412,000 of debt (including \$29,980,000 of EPPICS conversions), representing approximately 1% of total debt outstanding at December 31, 2004. During the second quarter of 2005, we entered into two debt-for-debt exchanges of our debt securities. As a result, \$50,000,000 of our 7.625% Notes due 2008 were exchanged for approximately \$52,171,000 of our 9.00% Notes due 2031. The 9.00% Notes are callable on the same general terms and conditions as the 7.625% Notes exchanged. No cash was exchanged in these transactions, however a non-cash pre-tax loss of approximately \$3,175,000 was recognized in accordance with EITF No. 96-19, "Debtor's Accounting for a Modification or Exchange of Debt Instruments" which is included in other income (loss), net.

As of December 31, 2005, EPPICS representing a total principal amount of \$177,971,000 had been converted into 14,237,807 shares of our common stock.

Total future minimum cash payment commitments under ELI's long-term capital leases including interest amounted to \$9,113,000 as of December 31, 2005.

The total outstanding principal amounts of industrial development revenue bonds were \$58,140,000 at December 31, 2005 and 2004. The earliest maturity date for these bonds is in August 2015. Under the terms of our agreements to sell our former gas and electric operations in Arizona, completed in 2003, we are obligated to call for redemption, at their first available call dates, three Arizona industrial development revenue bond series aggregating to approximately \$33,440,000. These bonds' first call dates are in 2007. We expect to retire all called bonds with cash. In addition, holders of \$11,150,000 principal amount of industrial development bonds may tender such bonds to us at par and we have the simultaneous option to call such bonds at par on August 7, 2007. We expect to call the bonds and retire them with cash.

As of December 31, 2005 we had available lines of credit with financial institutions in the aggregate amount of \$250,000,000 with a maturity date of October 29, 2009. Associated facility fees vary depending on our leverage ratio and were 0.375% as of December 31, 2005. During the term of the credit facility we may borrow, repay and re-borrow funds. The credit facility is available for general corporate purposes but may not be used to fund dividend payments. There have never been any borrowings under the facility.

For the year ended December 31, 2004, we retired an aggregate \$1,362,012,000 of debt (including \$147,991,000 of EPPICS conversions), representing approximately 28% of total debt outstanding at December 31, 2003.

On January 15, 2004, we repaid at maturity the remaining outstanding \$80,955,000 of our 7.45% Debentures.

On January 15, 2004, we redeemed at 101% the remaining outstanding \$12,300,000 of our Hawaii Special Purpose Revenue Bonds, Series 1993A and Series 1993B.

On May 17, 2004, we repaid at maturity the remaining outstanding \$5,975,000 of ELI's 6.05% Notes. These Notes had been guaranteed by the Company.

On July 15, 2004, we renegotiated and prepaid with \$4,954,000 of cash the entire remaining \$5,524,000 ELI capital lease obligation to a third party.

On July 30, 2004, we purchased \$300,000,000 of the 6.75% notes that were a component of our equity units at 105.075% of par, plus accrued interest, at a premium of approximately \$15,225,000 recorded in investment and other income (loss), net.

During August and September 2004, we repurchased through a series of transactions an additional \$108,230,000 of the 6.75% notes due 2006 at a weighted average price of 104.486% of par, plus accrued interest, at a premium of approximately \$4,855,000 recorded in investment and other income (loss), net.

On November 8, 2004, we issued an aggregate \$700,000,000 principal amount of 6.25% senior notes due January 15, 2013 through a registered underwritten public offering. Proceeds from the sale were used to redeem our outstanding \$700,000,000 of 8.50% Notes due 2006, which is discussed below.

On November 12, 2004, we called for redemption on December 13, 2004 the entire \$700,000,000 of our 8.50% Notes due 2006 at a price of 107.182% of the principal amount called, plus accrued interest, at a premium of approximately \$50,300,000.

**CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements**

As of December 31, 2004, EPPICS representing a total principal amount of \$147,991,000 had been converted into 11,622,749 shares of our common stock.

During the twelve months ended December 31, 2003, we executed a series of purchases in the open market of our outstanding debt securities. The aggregate principal amount of debt securities purchased was \$94,895,000 and they generated a pre-tax loss on the early extinguishment of debt at a premium of approximately \$3,117,000 recorded in other income (loss), net.

Our principal payments and capital lease payments (principal only) for the next five years are as follows:

<u>(\$ in thousands)</u>	<u>Principal Payments</u>	<u>ELI Capital Lease Payments</u>
2006 . . . . .	227,693	41
2007 . . . . .	37,771	110
2008 . . . . .	700,938	126
2009 . . . . .	1,006	145
2010 . . . . .	4,387	165

**(12) DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES:**

Interest rate swap agreements are used to hedge a portion of our debt that is subject to fixed interest rates. Under our interest rate swap agreements, we agree to pay an amount equal to a specified variable rate of interest times a notional principal amount, and to receive in return an amount equal to a specified fixed rate of interest times the same notional principal amount. The notional amounts of the contracts are not exchanged. No other cash payments are made unless the agreement is terminated prior to maturity, in which case the amount paid or received in settlement is established by agreement at the time of termination and represents the market value, at the then current rate of interest, of the remaining obligations to exchange payments under the terms of the contracts.

The interest rate swap contracts are reflected at fair value in our consolidated balance sheets and the related portion of fixed-rate debt being hedged is reflected at an amount equal to the sum of its book value and an amount representing the change in fair value of the debt obligations attributable to the interest rate risk being hedged. Changes in the fair value of interest rate swap contracts, and the offsetting changes in the adjusted carrying value of the related portion of the fixed-rate debt being hedged, are recognized in the consolidated statements of operations in interest expense. The notional amounts of interest rate swap contracts hedging fixed-rate indebtedness as of December 31, 2005 and December 31, 2004 were \$500,000,000 and \$300,000,000, respectively. Such contracts require us to pay *variable rates of interest (average pay rates of approximately 8.60% and 6.12% as of December 31, 2005 and 2004, respectively)* and receive fixed rates of interest (average receive rates of 8.46% and 8.44% as of December 31, 2005 and 2004, respectively). The fair value of these derivatives is reflected in other assets as of December 31, 2005 and 2004, in the amount of \$(8,727,000) and \$4,466,000, respectively. The related underlying debt has been decreased in 2005 and increased in 2004 by a like amount. The amounts received during the year ended December 31, 2005 and 2004 as a result of these contracts amounted to \$2,522,000 and \$9,363,000, respectively, and are included as a reduction of interest expense.

During September 2005, we entered into a series of separate forward rate agreements with our swap counterparties that fixed the underlying variable rate component of some of our swaps at the market rate as of the date of execution for certain future rate-setting dates. At December 31, 2005, the rates obtained under these forward rate agreements were below market rates. The fair value of these derivatives is reflected in other current assets as of December 31, 2005, in the amount of \$1,129,000. A gain for the changes in the fair value of these forward rate agreements of \$1,851,000 is included in other income (loss), net for the year ended December 31, 2005.

# CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES

## Notes to Consolidated Financial Statements

As the result of our call of all of our 8.50% Notes in November 2004, we terminated five interest rate swaps involving an aggregate \$250,000,000 notional amount of indebtedness. Proceeds from the swap terminations of approximately \$3,026,000 and U.S. Treasury rate lock agreements of approximately \$971,000 were applied against the cost to retire the debt, resulting in a net premium of approximately \$46,277,000 recorded in other income (loss), net.

We do not anticipate any nonperformance by counter-parties to our derivative contracts as all counter-parties have investment grade credit ratings.

### (13) MANAGEMENT SUCCESSION AND STRATEGIC ALTERNATIVES EXPENSES:

On July 11, 2004, our Board of Directors announced that it had completed its review of our financial and strategic alternatives, and on September 2, 2004, we paid a special, non-recurring dividend of \$2.00 per common share and a quarterly dividend of \$0.25 per common share to shareholders of record on August 18, 2004. Concurrently, Leonard Tow decided to step down from his position as chief executive officer, effective immediately, and resigned his position as Chairman of the Board on September 27, 2004. The Board of Directors named Mary Agnes Wilderotter president and chief executive officer in November 2004.

In 2004, we expensed approximately \$90,632,000 of costs related to management succession and our exploration of financial and strategic alternatives. Included are \$36,618,000 of non-cash expenses for the acceleration of stock benefits, cash expenses of \$19,229,000 for advisory fees, \$19,339,000 for severance and retention arrangements and \$15,446,000 primarily for tax reimbursements.

### (14) OTHER INCOME (LOSS), NET:

The components of other income (loss), net for the years ended December 31, 2005, 2004 and 2003 are as follows:

(\$ in thousands)	2005	2004	2003
Legal contingencies	\$ (7,000)	\$ —	\$ —
Gain on capital lease termination/restructuring	—	—	69,512
Gain on expiration/settlement of customer advances	681	25,345	6,165
Loss on exchange of debt	(3,175)	—	—
Premium on debt repurchases	—	(66,480)	(10,851)
Gain on forward rate agreements	1,851	—	—
Gain (loss) on sale of assets	—	(1,945)	(20,492)
Other, net	5,969	(10,279)	(275)
Total other income (loss), net	<u>\$ (1,674)</u>	<u>\$ (53,359)</u>	<u>\$ 44,059</u>

In the fourth quarter of 2005, we recorded \$7,000,000 of expense was recorded in connection with a legal matter. In connection with our exchange of debt during the second quarter of 2005, we recognized a non-cash, pre-tax loss of approximately \$3,175,000. 2005 also includes a gain for the changes in fair value of our forward rate agreements.

During 2005, 2004 and 2003, we recognized income in connection with certain retained liabilities associated with customer advances for construction from our disposed water properties, as a result of some of these liabilities terminating. During 2003, we recognized gains in connection with the termination/restructuring of capital leases at ELI. Gain (loss) on sale of assets in 2004 is primarily attributable to the loss on the sale of our corporate aircraft during the third quarter. In 2003, the amount represents the sales of The Gas Company in Hawaii and our Arizona gas and electric divisions, access lines in North Dakota and our wireless partnership interest in Wisconsin, and our Plano, Texas office building.

## CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES

### Notes to Consolidated Financial Statements

#### **(15) COMPANY OBLIGATED MANDATORILY REDEEMABLE CONVERTIBLE PREFERRED SECURITIES:**

In 1996, our consolidated wholly-owned subsidiary, Citizens Utilities Trust (the Trust), issued, in an underwritten public offering, 4,025,000 shares of 5% Company Obligated Mandatorily Redeemable Convertible Preferred Securities due 2036 (EPPICS), representing preferred undivided interests in the assets of the Trust, with a liquidation preference of \$50 per security (for a total liquidation amount of \$201,250,000). These securities have an adjusted conversion price of \$11.46 per Citizens common share. The conversion price was reduced from \$13.30 to \$11.46 during the third quarter of 2004 as a result of the \$2.00 per share special, non-recurring dividend. The proceeds from the issuance of the Trust Convertible Preferred Securities and a Company capital contribution were used to purchase \$207,475,000 aggregate liquidation amount of 5% Partnership Convertible Preferred Securities due 2036 from another wholly-owned subsidiary, Citizens Utilities Capital L.P. (the Partnership). The proceeds from the issuance of the Partnership Convertible Preferred Securities and a Company capital contribution were used to purchase from us \$211,756,000 aggregate principal amount of 5% Convertible Subordinated Debentures due 2036. The sole assets of the Trust are the Partnership Convertible Preferred Securities, and our Convertible Subordinated Debentures are substantially all the assets of the Partnership. Our obligations under the agreements related to the issuances of such securities, taken together, constitute a full and unconditional guarantee by us of the Trust's obligations relating to the Trust Convertible Preferred Securities and the Partnership's obligations relating to the Partnership Convertible Preferred Securities.

In accordance with the terms of the issuances, we paid the annual 5% interest in quarterly installments on the Convertible Subordinated Debentures in the four quarters of 2005, 2004 and 2003. Only cash was paid (net of investment returns) to the Partnership in payment of the interest on the Convertible Subordinated Debentures. The cash was then distributed by the Partnership to the Trust and then by the Trust to the holders of the EPPICS.

As of December 31, 2005, EPPICS representing a total principal amount of \$177,971,000 had been converted into 14,237,807 shares of our common stock.

We adopted the provisions of FIN 46R (revised December 2003) (FIN 46R), "Consolidation of Variable Interest Entities," effective January 1, 2004. Accordingly, the Trust holding the EPPICS and the related Citizens Utilities Capital L.P. are deconsolidated.

#### **(16) CAPITAL STOCK:**

*We are authorized to issue up to 600,000,000 shares of common stock. The amount and timing of dividends payable on common stock are within the sole discretion of our Board of Directors.*

#### **(17) STOCK PLANS:**

At December 31, 2005, we have four stock based compensation plans, which are described below. We apply APB Opinion No. 25 and related interpretations in accounting for the employee stock plans resulting in the use of the intrinsic value to value the stock option. Compensation cost has not generally been recognized in the financial statements for options issued pursuant to the Management Equity Incentive Plan (MEIP), the 1996 Equity Incentive Plan (1996 EIP) or the Amended and Restated 2000 Equity Incentive Plan (2000 EIP), as the exercise price for such options was equal to the market price of the stock at the time of grant.

In connection with our Directors' Deferred Fee Equity Plan, compensation costs associated with the issuance of stock units was \$1,069,000, \$2,222,000 and \$607,000 in 2005, 2004 and 2003, respectively. Cash compensation associated with this plan was \$434,000, \$642,000 and \$374,000 in 2005, 2004 and 2003, respectively. These costs are recognized in other operating expenses.

We have granted restricted stock awards to key employees in the form of our common stock. The number of shares issued as restricted stock awards during 2005, 2004 and 2003 were 352,000, 2,172,000 and 312,000, respectively. None of the restricted stock awards may be sold, assigned, pledged or otherwise transferred, voluntarily or involuntarily, by the employees until the restrictions lapse. The restrictions are time based. At December 31, 2005,

## CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES

### Notes to Consolidated Financial Statements

1,456,000 shares of restricted stock were outstanding. Compensation expense, recognized in operating expense, of \$7,358,000, \$45,313,000 and \$8,552,000, for the years ended December 31, 2005, 2004 and 2003, respectively, has been recorded in connection with these grants.

#### Management Equity Incentive Plan

Under the MEIP, awards of our common stock may be granted to eligible officers, management employees and non-management employees in the form of incentive stock options, non-qualified stock options, stock appreciation rights (SARs), restricted stock or other stock-based awards. The Compensation Committee of the Board of Directors administers the MEIP.

Since the expiration date of the MEIP plan on June 21, 2000, no awards can be granted under the MEIP. The exercise price of stock options issued was equal to or greater than the fair market value of the underlying common stock on the date of grant. Stock options are generally not exercisable on the date of grant but vest over a period of time. Under the terms of the MEIP, subsequent stock dividends and stock splits have the effect of increasing the option shares outstanding, which correspondingly decreases the average exercise price of outstanding options.

#### Equity Incentive Plans

In May 1996, our shareholders approved the 1996 EIP and in May 2001, our shareholders approved the 2000 EIP. Under the EIP plans, awards of our common stock may be granted to eligible officers, management employees and non-management employees in the form of incentive stock options, non-qualified stock options, SARs, restricted stock or other stock-based awards. Directors may receive awards under the 2000 EIP (other than options for annual retainer fees). SARs may be granted under the 1996 EIP. The Compensation Committee of the Board of Directors administers the EIP plans.

The maximum number of shares of common stock, which may be issued pursuant to awards at any time for both plans, is 25,358,000 shares, which has been adjusted for subsequent stock dividends. No awards will be granted more than 10 years after the effective dates (May 23, 1996 and May 18, 2000) of the EIP plans. The exercise price of stock options and SARs generally shall be equal to or greater than the fair market value of the underlying common stock on the date of grant. Stock options are generally not exercisable on the date of grant but vest over a period of time.

Under the terms of the EIP plans, subsequent stock dividends and stock splits have the effect of increasing the option shares outstanding, which correspondingly decrease the average exercise price of outstanding options.

In connection with the payment of the special, non-recurring dividend of \$2.00 per common share on September 2, 2004, the exercise price and number of all outstanding options was adjusted such that each option had the same value to the holder after the dividend as it had before the dividend. In accordance with FASB Interpretation No. 44 (FIN 44), "Accounting for Certain Transactions Involving Stock Compensation" and EITF 00-23, "Issues Related to the Accounting for Stock Compensation under APB No. 25 and FIN 44," there is no accounting consequence for changes made to the exercise price and the number of shares of a fixed stock option or award as a direct result of the special, non-recurring dividend.

**CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements**

The following is a summary of share activity subject to option under the MEIP and EIP plans.

	Shares Subject to Option	Weighted Average Option Price Per Share
Balance at January 1, 2003 .....	19,132,000	\$ 11.66
Options granted .....	2,017,000	12.14
Options exercised .....	(1,612,000)	7.97
Options canceled, forfeited or lapsed .....	<u>(1,572,000)</u>	12.92
Balance at December 31, 2003 .....	17,965,000	11.94
Options granted .....	—	—
Options exercised .....	(7,411,000)	9.69
Options canceled, forfeited or lapsed .....	(355,000)	12.14
Effect of special, non-recurring dividend .....	<u>2,212,000</u>	—
Balance at December 31, 2004 .....	12,411,000	11.15
Options granted .....	183,000	11.58
Options exercised .....	(4,317,000)	10.52
Options canceled, forfeited or lapsed .....	<u>(292,000)</u>	10.48
Balance at December 31, 2005 .....	<u>7,985,000</u>	\$ 11.52

The following table summarizes information about shares subject to options under the MEIP and EIP plans at December 31, 2005.

<u>Options Outstanding</u>				<u>Options Exercisable</u>	
<u>Number Outstanding</u>	<u>Range of Exercise Prices</u>	<u>Weighted Average Exercise Price</u>	<u>Weighted Average Remaining Life in Years</u>	<u>Number Exercisable</u>	<u>Weighted Average Exercise Price</u>
517,000	\$ 6.45 – 6.67	\$ 6.54	2.64	517,000	\$ 6.54
300,000	7.33 – 7.98	7.37	1.92	289,000	7.35
1,228,000	8.19 – 8.19	8.19	6.38	737,000	8.19
173,000	8.80 – 9.68	9.02	1.55	173,000	9.02
1,399,000	10.44 – 10.44	10.44	7.41	519,000	10.44
815,000	10.64 – 11.15	11.13	4.78	815,000	11.13
1,430,000	11.79 – 11.79	11.79	5.38	1,430,000	11.79
<u>2,123,000</u>	<u>11.90 – 18.46</u>	<u>16.14</u>	<u>4.95</u>	<u>2,068,000</u>	<u>16.24</u>
<u>7,985,000</u>	<u>\$ 6.45 – 18.46</u>	<u>\$ 11.52</u>	<u>5.32</u>	<u>6,548,000</u>	<u>\$ 11.92</u>

The number of options exercisable at December 31, 2004 and 2003 were 9,235,000 and 11,690,000, respectively.

The weighted average fair value of options granted during 2005 was \$2.98. There were no option grants made during 2004. The weighted average fair value of options granted during 2003 was \$6.04. For purposes of the pro forma calculation, the fair value of each option grant is estimated on the date of grant using the Black Scholes option-pricing model with the following weighted average assumptions used for grants in 2005 and 2003:

	<u>2005</u>	<u>2003</u>
Dividend yield .....	7.72%	—
Expected volatility .....	46%	44%
Risk-free interest rate .....	4.16%	2.94%
Expected life .....	6 years	7 years

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### Notes to Consolidated Financial Statements

#### Non-Employee Directors' Compensation Plan

Upon commencement of his or her service on the Board of Directors, each non-employee director receives a grant of 10,000 stock options, which is awarded under our 2000 EIP. The price of these options, which are immediately exercisable, is set at the average of the high and low market prices of our common stock on the effective date of the director's initial election to the board.

Annually, each non-employee director also receives a grant of 3,500 stock units under our Formula Plan, which commenced in 1997 and continues through May 22, 2007. Prior to April 20, 2004, each non-employee director received an award of 5,000 stock options. The exercise price of the options granted under the Formula Plan was set at 100% of the average of the high and low market prices of our common stock on the third, fourth, fifth, and sixth trading days of the year in which the options were granted. The options are exercisable six months after the grant date and remain exercisable for ten years after the grant date. In addition, on September 1, 1996, each non-employee director received a grant, under the Formula Plan, of options to purchase 2,500 shares of common stock. These options granted under the Formula Plan became exercisable six months after the grant date and remain exercisable for ten years after the grant date.

Effective April 2004, the Formula Plan was amended to replace the annual grant of stock options with an annual grant of 3,500 stock units. The stock units are awarded on the first business day of each calendar year. Each non-employee director must elect, by December 31 of the preceding year, whether the stock units awarded under the Formula Plan will be redeemed in cash or stock upon the director's retirement or death, whichever occurs first.

In addition, each non-employee director is also entitled to annually receive a retainer, meeting fees, and, when applicable, fees for serving as a committee chair or as Lead Director, which are awarded under the Non-Employee Directors' Deferred Fee Equity Plan. For 2005, each non-employee director had to elect, by December 31 of the preceding year, to receive \$30,000 cash or 5,000 stock units as an annual retainer. Directors making a stock unit election must also elect to convert the units to either common stock (convertible on a one-to-one basis) or cash upon retirement or death. Prior to June 30, 2003, a director could elect to receive 20,000 stock options as an annual retainer in lieu of cash or stock units. The exercise price of the stock options was set at the average of the high and low market prices of our common stock on the date of grant. The options were exercisable six months after the date of grant and had a 10-year term.

As of any date, the maximum number of shares of common stock which the Non-Employee Directors' Deferred Fee Equity Plan is obligated to deliver shall not be more than one percent (1%) of the total outstanding shares of our common stock as of June 30, 2003, subject to adjustment in the event of changes in our corporate structure affecting capital stock. There were 14 directors participating in the Directors' Plan during all or part of 2005. In 2005, the total options, plan units, and stock earned were 0, 64,000 and 0, respectively. In 2004, the total options, plan units, and stock earned were 50,000, 57,226 and 0, respectively. In 2003, the total options, plan units, and stock earned were 83,125, 46,034 and 0, respectively. At December 31, 2005, 473,252 options were exercisable at a weighted average exercise price of \$9.80.

For 2005, each non-employee director received fees of \$2,000 for each Board of Directors and committee meeting attended. The chairs of the Audit, Compensation, Nominating and Corporate Governance and Retirement Plan Committees were paid an additional annual fee of \$25,000, \$15,000, \$7,500 and \$5,000, respectively. In addition, the Lead Director, who heads the ad hoc committee of non-employee directors, received an additional annual fee of \$17,000 (based on an annual fee that was changed from \$20,000 to \$15,000 mid-year). A director must elect, by December 31 of the preceding year, to receive meeting and other fees in cash, stock units, or a combination of both. All fees paid to the non-employee directors in 2005 were paid quarterly (except for the retainer which was paid at the beginning of the year. If the director elects stock units, the number of units credited to the director's account is determined as follows: the total cash value of the fees payable to the director are divided by 85% of the average of the high and low market prices of our common stock on the first trading day of the year the election is in effect. Units are credited to the director's account quarterly.

# CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES

## Notes to Consolidated Financial Statements

We account for the Directors' Deferred Fee Equity Plan in accordance with APB Opinion No. 25, "Accounting for Stock Issued to Employees" and related interpretations. Compensation expense is recorded if cash or stock units are elected. If stock units are elected, the compensation expense is based on the market value of our common stock at the date of grant. If the stock option election is chosen, compensation expense is not recorded because the options are granted at the fair market value of our common stock on the grant date.

We had also maintained a Non-Employee Directors' Retirement Plan providing for the payment of specified sums annually to our non-employee directors, or their designated beneficiaries, starting at the director's retirement, death or termination of directorship. In 1999, we terminated this Plan. The vested benefit of each non-employee director, as of May 31, 1999, was credited to the director's account in the form of stock units. Such benefit will be payable to each director upon retirement, death or termination of directorship. Each participant had until July 15, 1999 to elect whether the value of the stock units awarded would be payable in our common stock (convertible on a one-for-one basis) or in cash. As of December 31, 2005, the liability for such payments was \$634,000 all of which will be payable in stock (based on the July 15, 1999 stock price).

### (18) RESTRUCTURING AND OTHER EXPENSES:

#### 2005 and 2004

During 2005 and 2004, we did not recognize any restructuring and other expenses. We continue to review our operations, personnel and facilities to achieve greater efficiency.

#### 2003

Restructuring and other expenses primarily consist of expenses related to reductions in personnel at our telecommunications operations and the write-off of software no longer useful.

### (19) INCOME TAXES:

The following is a reconciliation of the provision for income taxes for continuing operations computed at federal statutory rates to the effective rates for the years ended December 31, 2005, 2004 and 2003:

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Consolidated tax provision at federal statutory rate .....	35.0 %	35.0 %	35.0 %
State income tax provisions, net of federal income tax benefit .....	2.0 %	1.8 %	6.6 %
Tax reserve adjustment .....	(7.9)%	(19.3)%	(8.4)%
All other, net .....	0.5 %	(4.0)%	1.1 %
	<u>29.6 %</u>	<u>13.5 %</u>	<u>34.3 %</u>

**CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements**

The components of the net deferred income tax liability (asset) at December 31 are as follows:

Deferred income tax liabilities:

Property, plant and equipment basis differences .....	\$ 567,411	\$ 578,501
Intangibles .....	168,703	161,955
Other, net .....	<u>7,752</u>	<u>9,004</u>
	<u>743,866</u>	<u>749,460</u>

Deferred income tax assets:

Minimum pension liability .....	76,368	62,435
Tax operating loss carryforward .....	260,053	394,797
Alternate minimum tax credit carryforward .....	43,678	37,796
Employee benefits .....	66,853	55,566
Other, net .....	<u>21,279</u>	<u>23,095</u>
	468,231	573,689
Less: Valuation allowance .....	<u>(38,131)</u>	<u>(43,503)</u>
Net deferred income tax asset .....	<u>430,100</u>	<u>530,186</u>
Net deferred income tax liability .....	<u>\$ 313,766</u>	<u>\$ 219,274</u>

Deferred tax assets and liabilities are reflected in the following captions on the balance sheet:

Deferred income taxes .....	\$ 325,084	\$ 232,766
Other current assets .....	<u>(11,318)</u>	<u>(13,492)</u>
Net deferred income tax liability	<u>\$ 313,766</u>	<u>\$ 219,274</u>

Our federal and state tax operating loss carryforwards as of December 31, 2005 are estimated at \$584,476,000 and \$1,409,983,000, respectively. Our federal loss carryforward will begin to expire in the year 2021. A portion of our state loss carryforward will begin to expire in 2006. Our alternative minimum tax credit as of December 31, 2005 can be carried forward indefinitely to reduce future regular tax liability.

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**Notes to Consolidated Financial Statements**

The provision (benefit) for federal and state income taxes, as well as the taxes charged or credited to shareholders' equity, includes amounts both payable currently and deferred for payment in future periods as indicated below:

(\$ in thousands)	2005	2004	2003
Income taxes charged (credited) to the income statement for continuing operations:			
Current:			
Federal .....	\$ 16,708	\$ (9,951)	\$ (12,632)
State .....	(33,004)	(3,643)	2,900
Total current .....	(16,296)	(13,594)	(9,732)
Deferred:			
Federal .....	96,163	26,586	77,794
Federal tax credits .....	(18)	(40)	(3,128)
State .....	4,491	(2,530)	(158)
Total deferred .....	100,636	24,016	74,508
Subtotal income taxes for continuing operations .....	84,340	10,422	64,776
Income taxes charged to the income statement for discontinued operations:			
Current:			
State .....	—	3	—
Total current .....	—	3	—
Deferred:			
Federal .....	12,156	2,816	2,358
State .....	1,187	138	82
Total deferred .....	13,343	2,954	2,440
Subtotal income taxes for discontinued operations .....	13,343	2,957	2,440
Income tax benefit on dividends on convertible preferred securities:			
Current:			
Federal .....	—	—	(3,344)
State .....	—	—	(508)
Subtotal income taxes on dividends on convertible preferred securities .....	—	—	(3,852)
Income taxes charged to the income statement for cumulative effect of change in accounting principle:			
Deferred:			
Federal .....	—	—	35,414
State .....	—	—	6,177
Subtotal income taxes for cumulative effect of change in accounting principle .....	—	—	41,591
<b>Total income taxes charged to the income statement (a) .....</b>	<b>97,683</b>	<b>13,379</b>	<b>104,955</b>
Income taxes charged (credited) to shareholders' equity:			
Deferred income taxes (benefits) on unrealized/realized gains or losses on securities classified as available-for-sale .....	(411)	(10,982)	5,539
Current benefit arising from stock options exercised and restricted stock .....	(5,976)	(13,765)	(2,535)
Deferred income taxes (benefits) arising from recognition of a minimum pension liability .....	(13,933)	(6,645)	13,373
Income taxes charged (credited) to shareholders' equity (b) .....	(20,320)	(31,392)	16,377
<b>Total income taxes: (a) plus (b) .....</b>	<b>\$ 77,363</b>	<b>\$ (18,013)</b>	<b>\$ 121,332</b>

**CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements**

**(20) NET INCOME PER COMMON SHARE:**

The reconciliation of the net income per common share calculation for the years ended December 31, 2005, 2004 and 2003 is as follows:

<u>(\$ in thousands, except per-share amounts)</u>	<u>2005</u>	<u>2004</u>	<u>2003</u>
Net income used for basic and diluted earnings per common share:			
Income from continuing operations before cumulative effect of change in accounting principle . . . . .	\$ 200,168	\$ 66,919	\$ 117,703
Income from discontinued operations . . . . .	2,207	5,231	4,380
Income before cumulative effect of change in accounting principle . . . . .	<u>202,375</u>	<u>72,150</u>	<u>122,083</u>
Income from cumulative effect of change in accounting principle . . . . .	—	—	65,769
Total basic net income available for common shareholders . . . . .	<u>\$ 202,375</u>	<u>\$ 72,150</u>	<u>\$ 187,852</u>
Effect of conversion of preferred securities . . . . .	1,255	—	6,210
Total diluted net income available for common shareholders . . . . .	<u>\$ 203,630</u>	<u>\$ 72,150</u>	<u>\$ 194,062</u>
Basic earnings per common share:			
Weighted-average shares outstanding - basic . . . . .	<u>337,065</u>	<u>303,989</u>	<u>282,434</u>
Income from continuing operations before cumulative effect of change in accounting principle . . . . .	\$ 0.59	\$ 0.22	\$ 0.42
Income from discontinued operations . . . . .	0.01	0.02	0.02
Income before cumulative effect of change in accounting principle . . . . .	<u>0.60</u>	<u>0.24</u>	<u>0.44</u>
Income from cumulative effect of change in accounting principle . . . . .	—	—	0.23
Net income per share available for common shareholders . . . . .	<u>\$ 0.60</u>	<u>\$ 0.24</u>	<u>\$ 0.67</u>
Diluted earnings per common share:			
Weighted-average shares outstanding . . . . .	337,065	303,989	282,434
Effect of dilutive shares . . . . .	1,417	5,194	4,868
Effect of conversion of preferred securities . . . . .	3,193	—	15,134
Weighted-average shares outstanding - diluted . . . . .	<u>341,675</u>	<u>309,183</u>	<u>302,436</u>
Income from continuing operations before cumulative effect of change in accounting principle . . . . .	\$ 0.59	\$ 0.22	\$ 0.41
Income from discontinued operations . . . . .	0.01	0.01	0.01
Income before cumulative effect of change in accounting principle . . . . .	<u>0.60</u>	<u>0.23</u>	<u>0.42</u>
Income from cumulative effect of change in accounting principle . . . . .	—	—	0.22
Net income per share available for common shareholders . . . . .	<u>\$ 0.60</u>	<u>\$ 0.23</u>	<u>\$ 0.64</u>

**Stock Options**

For the years ended December 31, 2005, 2004 and 2003 options of 1,930,000 and 2,495,000 (at exercise prices ranging from \$13.09 to \$18.46), and 10,190,000 (at exercise prices ranging from \$9.18 to \$21.47), respectively, issuable under employee compensation plans were excluded from the computation of diluted earnings per share (EPS) for those periods because the exercise prices were greater than the average market price of common shares and, therefore, the effect would be antidilutive.

In connection with the payment of the special, non-recurring dividend of \$2.00 per common share on September 2, 2004, the exercise price and number of all outstanding options was adjusted such that each option had the same value to the holder after the dividend as it had before the dividend. In accordance with FASB Interpretation No. 44 (FIN 44), "Accounting for Certain Transactions Involving Stock Compensation" and EITF 00-23, "Issues Related to the Accounting for Stock Compensation under APB No. 25 and FIN 44," there is no accounting consequence for changes made to the exercise price and the number of shares of a fixed stock option or award as a direct result of the special, non-recurring dividend.

## CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES

### Notes to Consolidated Financial Statements

In addition, for the years ended December 31, 2005, 2004 and 2003, restricted stock awards of 1,456,000, 1,686,000 and 1,249,000 shares, respectively, are excluded from our basic weighted average shares outstanding and included in our dilutive shares until the shares are no longer contingent upon the satisfaction of all specified conditions.

#### Equity Units and EPPICS

On August 17, 2004 we issued 32,073,633 shares of common stock, including 3,591,000 treasury shares, to our equity unit holders in settlement of the equity purchase contract component of the equity units. With respect to the \$460,000,000 Senior Note component of the equity units, we repurchased \$300,000,000 principal amount of these Notes in July 2004. The remaining \$160,000,000 of the Senior Notes were repriced and a portion was remarketed on August 12, 2004 as the 6.75% Notes due August 17, 2006. During 2004, we repurchased an additional \$108,230,000 of the 6.75% Notes which, in addition to the \$300,000,000 purchased in July, resulted in a pre-tax charge of approximately \$20,080,000 during the third quarter of 2004.

As a result of our July dividend announcement with respect to our common shares, our 5% Company Obligated Mandatorily Redeemable Convertible Preferred Securities due 2036 (EPPICS) began to convert into shares of our common stock. As of December 31, 2005, approximately 88% of the EPPICS outstanding, or about \$177,971,000 aggregate principal amount of units, have converted to 14,237,807 shares of common stock, including 1,116,000 issued from treasury.

At December 31, 2005 and 2004, we had 465,588 and 1,065,171 shares, respectively, of potentially dilutive EPPICS, which were convertible into common stock at a 4.36 to 1 ratio at an exercise price of \$11.46 per share. As a result of the September 2004 special, non-recurring dividend, the EPPICS exercise price for conversion into common stock was reduced from \$13.30 to \$11.46. These securities have been included in the diluted income per common share calculation for the period ended December 31, 2005, however, they have not been included in the diluted income per share calculation for the period ended December 31, 2004 because their inclusion would have had an antilutive effect.

At December 31, 2003 we had 4,025,000 shares of potentially dilutive EPPICS that have been included in the diluted income per common share calculation for the period ended December 31, 2003.

#### Stock Units

At December 31, 2005, 2004 and 2003, we had 206,630, 464,879 and 427,475 stock units, respectively, issuable under our Directors' Deferred Fee Equity Plan and Non-Employee Directors' Retirement Plan. These securities have not been included in the diluted income per share calculation because their inclusion would have had an antilutive effect.

#### (21) COMPREHENSIVE INCOME (LOSS):

Comprehensive income consists of net income (loss) and other gains and losses affecting shareholder's investment and minimum pension liability that, under GAAP, are excluded from net income (loss).

**CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements**

Our other comprehensive income (loss) for the years ended December 31, 2005, 2004 and 2003 is as follows:

(\$ in thousands)	2005		
	Before-Tax Amount	Tax Expense/ (Benefit)	Net-of-Tax Amount
Net unrealized holding losses on securities arising during period . . . . .	\$ (1,055)	\$ (395)	\$ (660)
Minimum pension liability . . . . .	(36,416)	(13,933)	(22,483)
Less: Reclassification adjustments for net gains on securities realized in net income . . . . .	(537)	(7)	(530)
Other comprehensive loss . . . . .	<u>\$ (38,008)</u>	<u>\$ (14,335)</u>	<u>\$ (23,673)</u>
	2004		
(\$ in thousands)	Before-Tax Amount	Tax Expense/ (Benefit)	Net-of-Tax Amount
Net unrealized holding losses on securities arising during period . . . . .	\$ (1,901)	\$ (742)	\$ (1,159)
Minimum pension liability . . . . .	(17,372)	(6,645)	(10,727)
Less: Reclassification adjustments for net gains on securities realized in net income . . . . .	(26,247)	(10,240)	(16,007)
Other comprehensive loss . . . . .	<u>\$ (45,520)</u>	<u>\$ (17,627)</u>	<u>\$ (27,893)</u>
	2003		
(\$ in thousands)	Before-Tax Amount	Tax Expense/ (Benefit)	Net-of-Tax Amount
Net unrealized holding gains on securities arising during period . . . . .	\$ 14,470	\$ 5,539	\$ 8,931
Minimum pension liability . . . . .	34,935	13,373	21,562
Other comprehensive income . . . . .	<u>\$ 49,405</u>	<u>\$ 18,912</u>	<u>\$ 30,493</u>

**(22) SEGMENT INFORMATION:**

We operate in two segments, Frontier and ELI (a CLEC). The Frontier segment provides both regulated and unregulated communications services to residential, business and wholesale customers and is typically the incumbent provider in its service areas. ELI provides telecommunications services, principally to businesses. ELI frequently obtains the "last mile" access to customers through arrangements with the applicable ILEC.

As permitted by SFAS No. 131, we have utilized the aggregation criteria in combining our markets because all of our Frontier properties share similar economic characteristics, in that they provide the same products and services to similar customers using comparable technologies in all of the states that we operate in. The regulatory structure is generally similar. Differences in the regulatory regime of a particular state do not impact the economic characteristics or operating results of a particular property.

(\$ in thousands)	For the year ended December 31, 2005		
	Frontier	ELI	Total Segments
Revenue . . . . .	\$ 2,003,318	\$ 159,161	\$ 2,162,479
Depreciation and Amortization . . . . .	516,982	24,977	541,959
Operating Income . . . . .	588,543	18,306	606,849
Capital Expenditures . . . . .	252,213	16,099	268,312
Assets . . . . .	5,805,423	168,342	5,973,765

**CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements**

(\$ in thousands)	For the year ended December 31, 2004			
	Frontier	ELI	Electric	Total Segments
Revenue.....	\$ 2,002,657	\$ 156,030	\$ 9,735	\$ 2,168,422
Depreciation and Amortization .....	546,747	24,061	—	570,808
Management Succession and Strategic Alternatives Expenses.....	87,279	3,353	—	90,632
Operating Income (Loss) .....	468,889	10,350	(3,134)	476,105
Capital Expenditures .....	263,193	11,644	—	274,837
Assets .....	6,077,424	173,369	—	6,250,793

(\$ in thousands)	For the year ended December 31, 2003				
	Frontier	ELI	Gas	Electric	Total Segments
Revenue.....	\$ 2,020,171	\$ 165,389	\$ 137,686	\$ 100,928	\$ 2,424,174
Depreciation and Amortization ..	569,651	23,510	—	—	593,161
Reserve for Telecommunications Bankruptcies.....	(5,524)	1,147	—	—	(4,377)
Restructuring and Other Expenses	9,373	314	—	—	9,687
Loss on Impairment .....	—	—	—	15,300	15,300
Operating Income (Loss) .....	530,368	9,710	14,013	(3,359)	550,732
Capital Expenditures .....	243,445	9,496	9,877	13,984	276,802
Assets .....	6,399,953	184,559	—	23,130	6,607,642

The following table presents supplemental financial data for ELI.

**Summary Income Statement for ELI**

(\$ in thousands)	For the years ended December 31,	
	2005	2004
Revenue.....	\$ 159,161	\$ 156,030
Operating expenses .....	115,878	121,619
Depreciation expense .....	24,977	24,061
Non-operating expense, net .....	185	629
Income before income taxes.....	<u>\$ 18,121</u>	<u>\$ 9,721</u>

The following tables are reconciliations of certain sector items to the total consolidated amount.

Capital Expenditures	2005	2004	2003
Total segment capital expenditures .....	\$ 268,312	\$ 274,837	\$ 276,802
General capital expenditures .....	147	367	569
Consolidated reported capital expenditures.....	<u>\$ 268,459</u>	<u>\$ 275,204</u>	<u>\$ 277,371</u>

Assets	2005	2004
Total segment assets .....	\$ 5,973,765	\$ 6,250,793
General assets .....	438,344	393,504
Discontinued operations assets .....	—	24,122
Consolidated reported assets .....	<u>\$ 6,412,109</u>	<u>\$ 6,668,419</u>

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**(23) QUARTERLY FINANCIAL DATA (UNAUDITED):**

(\$ in thousands, except per share amounts)	First quarter	Second quarter	Third quarter	Fourth quarter
<b>2005</b>				
Revenue.....	\$ 537,223	\$ 531,798	\$ 537,346	\$ 556,112
Operating income.....	145,112	146,897	141,617	173,223
Net income.....	42,634	44,584	38,376	76,781
Net income available for common shareholders per basic share.....	\$ 0.13	\$ 0.13	\$ 0.11	\$ 0.23
Net income available for common shareholders per diluted share.....	\$ 0.12	\$ 0.13	\$ 0.11	\$ 0.23
<b>2004</b>				
Revenue.....	\$ 552,311	\$ 537,796	\$ 539,188	\$ 539,127
Operating income.....	137,598	126,014	70,087	142,406
Net income (loss).....	42,868	23,792	(11,290)	16,780
Net income (loss) available for common shareholders per basic share.....	\$ 0.15	\$ 0.08	\$ (0.04)	\$ 0.05
Net income (loss) available for common shareholders per diluted share.....	\$ 0.15	\$ 0.08	\$ (0.04)	\$ 0.05

The quarterly net income (loss) per common share amounts are rounded to the nearest cent. Annual net income (loss) per common share may vary depending on the effect of such rounding.

**2005 Transactions**

On February 1, 2005, we sold shares of Prudential Financial, Inc. for approximately \$1,112,000 in cash, and we recognized a pre-tax gain of approximately \$493,000 that is included in other income (loss), net.

On March 15, 2005, we completed the sale of our conferencing business for approximately \$43,565,000 million in cash. The pre-tax gain on the sale of CCUSA was \$14,061,000. The after-tax gain was approximately \$1,167,000.

In June 2005, the Company sold for cash its interests in certain key man life insurance policies on the lives of Leonard Tow, our former Chairman and Chief Executive Officer, and his wife, a former director. The cash surrender value of the policies purchased by Dr. Tow totaled approximately \$24,195,000, and we recognized a pre-tax gain of approximately \$457,000 that is included in other income (loss), net.

During 2005, we sold shares of Global Crossing Limited for approximately \$1,084,000 in cash, and we recognized a pre-tax gain for the same amount that is included in other income (loss), net.

**2004 Transactions**

On April 1, 2004, we completed the sale of our Vermont electric distribution operations for approximately \$13,992,000 in cash, net of selling expenses.

During the third quarter of 2004, we sold our corporate aircraft for approximately \$15,298,000 in cash. The pre-tax loss on the sale was \$1,087,000.

In October 2004, we sold cable assets in California, Arizona, Indiana, and Wisconsin for approximately \$2,263,000 in cash. The pre-tax gain on these sales was \$40,000.

## CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES

### Notes to Consolidated Financial Statements

#### (24) RETIREMENT PLANS:

We sponsor a noncontributory defined benefit pension plan covering a significant number of our employees and other postretirement benefit plans that provide medical, dental, life insurance benefits and other benefits for covered retired employees and their beneficiaries and covered dependents. The benefits are based on years of service and final average pay or career average pay. Contributions are made in amounts sufficient to meet ERISA funding requirements while considering tax deductibility. Plan assets are invested in a diversified portfolio of equity and fixed-income securities and alternative investments.

The accounting results for pension and postretirement benefit costs and obligations are dependent upon various actuarial assumptions applied in the determination of such amounts. These actuarial assumptions include the following: discount rates, expected long-term rate of return on plan assets, future compensation increases, employee turnover, healthcare cost trend rates, expected retirement age, optional form of benefit and mortality. We review these assumptions for changes annually with its outside actuaries. We consider our discount rate and expected long-term rate of return on plan assets to be our most critical assumptions.

The discount rate is used to value, on a present value basis, our pension and postretirement benefit obligation as of the balance sheet date. The same rate is also used in the interest cost component of the pension and postretirement benefit cost determination for the following year. The measurement date used in the selection of our discount rate is the balance sheet date. Our discount rate assumption is determined annually with assistance from our actuaries based on the duration of our pension and postretirement benefit liabilities, the pattern of expected future benefit payments and the prevailing rates available on long-term, high quality corporate bonds that approximate the benefit obligation. In making this determination we consider, among other things, the yields on the Citigroup Pension Discount Curve and Bloomberg Finance. This rate can change from year-to-year based on market conditions that impact corporate bond yields.

The expected long-term rate of return on plan assets is applied in the determination of periodic pension and postretirement benefit cost as a reduction in the computation of the expense. In developing the expected long-term rate of return assumption, we considered published surveys of expected market returns, 10 and 20 year actual returns of various major indices, and our own historical 5-year and 10-year investment returns.

The expected long-term rate of return on plan assets is based on an asset allocation assumption of 30% to 45% in fixed income securities, 45% to 55% in equity securities and 5% to 15% in alternative investments. We review our asset allocation at least annually and make changes when considered appropriate. In 2005, we did not change our expected long-term rate of return from the 8.25% used in 2004. Our pension plan assets are valued at actual market value as of the measurement date. The measurement date used to determine pension and other postretirement benefit measures for the pension plan and the postretirement benefit plan is December 31.

Accounting standards require that we record an additional minimum pension liability when the plan's "accumulated benefit obligation" exceeds the fair market value of plan assets at the pension plan measurement (balance sheet) date. In the fourth quarter of 2005, mainly due to a decrease in the year-end discount rate, we recorded an additional minimum pension liability in the amount of \$36,416,000 with a corresponding charge to shareholders' equity of \$22,483,000, net of taxes of \$13,933,000. In the fourth quarter of 2004, mainly due to a decrease in the year-end discount rate, we recorded an additional minimum pension liability in the amount of \$17,372,000 with a corresponding charge to shareholders' equity of \$10,727,000, net of taxes of \$6,645,000. These adjustments did not impact our net income or cash flows for either year. If discount rates and the equity markets performance decline, we would be required to increase our minimum pension liabilities and record additional charges to shareholder's equity in the future.

Actual results that differ from our assumptions are added or subtracted to our balance of unrecognized actuarial gains and losses. For example, if the year-end discount rate used to value the plan's projected benefit obligation decreases from the prior year-end, then the plan's actuarial loss will increase. If the discount rate increases from the prior year-end then the plan's actuarial loss will decrease. Similarly, the difference generated from the plan's actual asset performance as compared to expected performance would be included in the balance of unrecognized gains and losses.

**CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES**

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The impact of the balance of accumulated actuarial gains and losses are recognized in the computation of pension cost only to the extent this balance exceeds 10% of the greater of the plan's projected benefit obligation or market value of plan assets. If this occurs, that portion of gain or loss that is in excess of 10% is amortized over the estimated future service period of plan participants as a component of pension cost. The level of amortization is affected each year by the change in actuarial gains and losses and could potentially be eliminated if the gain/loss activity reduces the net accumulated gain/loss balance to a level below the 10% threshold.

**Pension Plan**

The following tables set forth the plan's benefit obligations and fair values of plan assets as of December 31, 2005 and 2004 and net periodic benefit cost for the years ended December 31, 2005, 2004 and 2003.

(\$ in thousands)	2005	2004
<u>Change in benefit obligation</u>		
Benefit obligation at beginning of year . . . . .	\$ 799,458	\$ 761,683
Service cost . . . . .	6,117	5,748
Interest cost . . . . .	46,416	46,468
Actuarial loss . . . . .	48,750	44,350
Benefits paid . . . . .	(58,139)	(58,791)
Benefit obligation at end of year . . . . .	<u>\$ 842,602</u>	<u>\$ 799,458</u>
<u>Change in plan assets</u>		
Fair value of plan assets at beginning of year . . . . .	\$ 761,168	\$ 719,622
Actual return on plan assets . . . . .	59,196	80,337
Employer contribution . . . . .	—	20,000
Benefits paid . . . . .	(58,139)	(58,791)
Fair value of plan assets at end of year . . . . .	<u>\$ 762,225</u>	<u>\$ 761,168</u>
<u>(Accrued)/Prepaid benefit cost</u>		
Funded status . . . . .	\$ (80,377)	\$ (38,290)
Unrecognized prior service cost . . . . .	(1,745)	(1,988)
Unrecognized net actuarial loss . . . . .	223,525	183,481
Prepaid benefit cost . . . . .	<u>\$ 141,403</u>	<u>\$ 143,203</u>
<u>Amounts recognized in the statement of financial position</u>		
Accrued benefit liability . . . . .	\$ (58,250)	\$ (20,034)
Other comprehensive income . . . . .	199,653	163,237
Net amount recognized . . . . .	<u>\$ 141,403</u>	<u>\$ 143,203</u>

(\$ in thousands)	2005	2004	2003
<u>Components of net periodic benefit cost</u>			
Service cost . . . . .	\$ 6,117	\$ 5,748	\$ 6,479
Interest cost on projected benefit obligation . . . . .	46,416	46,468	49,103
Return on plan assets . . . . .	(60,371)	(57,203)	(53,999)
Amortization of prior service cost and unrecognized net obligation . . . . .	(244)	(244)	(172)
Amortization of unrecognized loss . . . . .	9,882	8,806	11,026
Net periodic benefit cost . . . . .	1,800	3,575	12,437
Curtailment/settlement charge . . . . .	—	—	6,585
Total periodic benefit cost . . . . .	<u>\$ 1,800</u>	<u>\$ 3,575</u>	<u>\$ 19,022</u>

**CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES**

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The plan's weighted average asset allocations at December 31, 2005 and 2004 by asset category are as follows:

	<u>2005</u>	<u>2004</u>
Asset category:		
Equity securities .....	50%	57%
Debt securities.....	34%	32%
Alternative investments .....	13%	8%
Cash and other.....	3%	3%
Total.....	<u>100%</u>	<u>100%</u>

The plan's expected benefit payments by year are as follows:

<u>Year</u>	<u>Amount</u>
(\$ in thousands)	
2006 .....	\$ 55,350
2007 .....	57,171
2008 .....	58,523
2009 .....	61,394
2010.....	62,006
2011 - 2015 .....	319,075
Total .....	<u>\$ 613,519</u>

Our required contribution to the plan in 2006 is \$0.

The accumulated benefit obligation for the plan was \$820,475,000 and \$781,202,000 at December 31, 2005 and 2004, respectively.

Assumptions used in the computation of pension and postretirement benefits other than pension costs/year-end benefit obligations were as follows:

	<u>2005</u>	<u>2004</u>
Discount rate.....	6.00%/5.625%	6.25%/6.00%
Expected long-term rate of return on plan assets. . . .	8.25%/8.25%	8.25%/8.25%
Rate of increase in compensation levels. . . . .	4.0%/4.0%	4.0%/4.0%

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**Postretirement Benefits Other Than Pensions**

The following table sets forth the plan's benefit obligations, fair values of plan assets and the postretirement benefit liability recognized on our balance sheets at December 31, 2005 and 2004 and net periodic postretirement benefit costs for the years ended December 31, 2005, 2004 and 2003:

In 2005, we approved changes to certain retiree medical plans. The plan changes (reflected as amendments in the table below) and the related impact are included in the accumulated postretirement benefit obligation (APBO) as of December 31, 2005. The plan changes resulted in a reduction in the APBO of \$59,798,000 which will be amortized as a reduction of retiree medical expense over the average remaining service life.

(\$ in thousands)	2005	2004	
<u>Change in benefit obligation</u>			
Benefit obligation at beginning of year . . . . .	\$ 217,380	\$ 223,337	
Service cost . . . . .	1,046	1,128	
Interest cost . . . . .	12,055	12,698	
Plan participants' contributions . . . . .	3,461	4,118	
Actuarial (gain) loss . . . . .	3,770	(1,706)	
Amendments . . . . .	(59,798)	(3,045)	
Benefits paid . . . . .	(16,992)	(19,150)	
Benefit obligation at end of year . . . . .	<u>\$ 160,922</u>	<u>\$ 217,380</u>	
<u>Change in plan assets</u>			
Fair value of plan assets at beginning of year . . . . .	\$ 15,126	\$ 27,493	
Actual return on plan assets . . . . .	397	987	
Benefits paid . . . . .	(13,530)	(15,032)	
Employer contribution . . . . .	9,431	1,678	
Fair value of plan assets at end of year . . . . .	<u>\$ 11,424</u>	<u>\$ 15,126</u>	
<u>Accrued benefit cost</u>			
Funded status . . . . .	\$ (149,498)	\$ (202,254)	
Unrecognized prior service cost . . . . .	(61,161)	(2,617)	
Unrecognized loss . . . . .	42,325	44,319	
Accrued benefit cost . . . . .	<u>\$ (168,334)</u>	<u>\$ (160,552)</u>	

(\$ in thousands)	2005	2004	2003
<u>Components of net periodic postretirement benefit cost</u>			
Service cost . . . . .	\$ 1,046	\$ 1,128	\$ 1,387
Interest cost on projected benefit obligation . . . . .	12,055	12,698	13,606
Return on plan assets . . . . .	(1,248)	(2,268)	(2,133)
Amortization of prior service cost and transition obligation . . . . .	(1,255)	(204)	26
Amortization of unrecognized (gain)/loss . . . . .	6,615	5,238	3,985
Net periodic postretirement benefit cost . . . . .	<u>\$ 17,213</u>	<u>\$ 16,592</u>	<u>\$ 16,871</u>

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The plan's weighted average asset allocations at December 31, 2005 and 2004 by asset category are as follows:

	<u>2005</u>	<u>2004</u>
Asset category:		
Equity securities .....	0%	0%
Debt securities .....	100%	100%
Cash and other .....	<u>0%</u>	<u>0%</u>
Total .....	<u>100%</u>	<u>100%</u>

The plan's expected benefit payments by year are as follows:

<u>Year</u>	<u>Gross</u>	<u>Medicare</u>	
(\$ in thousands)	<u>Benefits</u>	<u>D Subsidy</u>	<u>Total</u>
2006 .....	\$ 9,847	\$ 676	\$ 9,171
2007 .....	10,375	712	9,663
2008 .....	10,843	742	10,101
2009 .....	11,282	770	10,512
2010 .....	11,656	793	10,863
2011 - 2015 .....	60,619	4,049	56,570
Total .....	<u>\$ 114,622</u>	<u>\$ 7,742</u>	<u>\$ 106,880</u>

Our expected contribution to the plan in 2006 is \$9,847,000.

For purposes of measuring year-end benefit obligations, we used, depending on medical plan coverage for different retiree groups, a 9.5% annual rate of increase in the per-capita cost of covered medical benefits, gradually decreasing to 5% in the year 2015 and remaining at that level thereafter. The effect of a 1% increase in the assumed medical cost trend rates for each future year on the aggregate of the service and interest cost components of the total postretirement benefit cost would be \$1,306,000 and the effect on the accumulated postretirement benefit obligation for health benefits would be \$13,397,000. The effect of a 1% decrease in the assumed medical cost trend rates for each future year on the aggregate of the service and interest cost components of the total postretirement benefit cost would be \$(1,068,000) and the effect on the accumulated postretirement benefit obligation for health benefits would be \$(11,480,000).

In December 2003, the Medicare Prescription Drug Improvement and Modernization Act of 2003 (the Act) became law. The Act introduces a prescription drug benefit under Medicare. It includes a federal subsidy to sponsors of retiree health care benefit plans that provide a benefit that is at least actuarially equivalent to the Medicare Part D benefit. The amount of the federal subsidy will be based on 28% of an individual beneficiary's annual eligible prescription drug costs ranging between \$250 and \$5,000. We have determined that the Company-sponsored postretirement healthcare plans that provide prescription drug benefits are actuarially equivalent to the Medicare Prescription Drug benefit. The impact of the federal subsidy has been incorporated in the December 31, 2005 measurement date.

**401(k) Savings Plans**

We sponsor an employee retirement savings plan under section 401(k) of the Internal Revenue Code. The Plan covers substantially all full-time employees. Under the Plan, we provide matching and certain profit-sharing contributions. Employer contributions were \$7,181,000, \$8,403,000 and \$9,724,000 for 2005, 2004 and 2003, respectively.

# CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES

## Notes to Consolidated Financial Statements

### (25) COMMITMENTS AND CONTINGENCIES:

The City of Bangor, Maine, filed suit against us on November 22, 2002, in the U.S. District Court for the District of Maine (City of Bangor v. Citizens Communications Company, Civ. Action No. 02-183-B-S). The City alleged, among other things, that we are responsible for the costs of cleaning up environmental contamination alleged to have resulted from the operation of a manufactured gas plant owned by Bangor Gas Company from 1852-1948 and by us from 1948-1963. In acquiring the operation in 1948 we acquired the stock of Bangor Gas Company and merged it into the Company. The City alleged the existence of extensive contamination of the Penobscot River and asserted that money damages and other relief at issue in the lawsuit could exceed \$50,000,000. The City also requested that punitive damages be assessed against us. We filed an answer denying liability to the City, and asserted a number of counterclaims against the City. In addition, we identified a number of other potentially responsible parties that may be liable for the damages alleged by the City and joined them as parties to the lawsuit. These additional parties include Honeywell Corporation, Guilford Transportation (operating as Maine Central Railroad), UGI Utilities, Inc. and Centerpoint Energy Resources Corporation. The Court dismissed all but two of the City's claims, including its claims for joint and several liability under the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) and the claim against us for punitive damages. Trial was conducted in September and October 2005 for the first (liability) phase of the case, and a decision from the court is anticipated by the end of the first quarter of 2006. We intend to continue to defend ourselves vigorously against the City's lawsuit. We have demanded that various of our insurance carriers defend and indemnify us with respect to the City's lawsuit, and on December 26, 2002, we filed a declaratory judgment action against those insurance carriers in the Superior Court of Penobscot County, Maine, for the purpose of establishing their obligations to us with respect to the City's lawsuit. We intend to vigorously pursue this lawsuit to obtain from our insurance carriers indemnification for any damages that may be assessed against us in the City's lawsuit as well as to recover the costs of our defense of that lawsuit.

On June 7, 2004, representatives of Robert A. Katz Technology Licensing, LP, contacted us regarding possible infringement of several patents held by that firm. The patents cover a wide range of operations in which telephony is supported by computers, including obtaining information from databases via telephone, interactive telephone transactions, and customer and technical support applications. We were cooperating with the patent holder to determine if we are currently using any of the processes that are protected by its patents but have not had any communication with them on this issue since mid-2004. If we determine that we are utilizing the patent holder's intellectual property, we expect to commence negotiations on a license agreement.

On June 24, 2004, one of our subsidiaries, Frontier Subsidiary Telco Inc., received a "Notice of Indemnity Claim" from Citibank, N.A., that is related to a complaint pending against Citibank and others in the U.S. Bankruptcy Court for the Southern District of New York as part of the Global Crossing bankruptcy proceeding. Citibank bases its claim for indemnity on the provisions of a credit agreement that was entered into in October 2000 between Citibank and our subsidiary. We purchased Frontier Subsidiary Telco, Inc., in June 2001 as part of our acquisition of the Frontier telephone companies. The complaint against Citibank, for which it seeks indemnification, alleges that the seller improperly used a portion of the proceeds from the Frontier transaction to pay off the Citibank credit agreement, thereby defrauding certain debt holders of Global Crossing North America Inc. Although the credit agreement was paid off at the closing of the Frontier transaction, Citibank claims the indemnification obligation survives. Damages sought against Citibank and its co-defendants could exceed \$1,000,000,000. In August 2004, we notified Citibank by letter that we believe its claims for indemnification are invalid and are not supported by applicable law. We have received no further communications from Citibank since our August 2004 letter.

We are party to other legal proceedings arising in the normal course of our business. The outcome of individual matters is not predictable. However, we believe that the ultimate resolution of all such matters, after considering insurance coverage, will not have a material adverse effect on our financial position, results of operations, or our cash flows.

For 2006, we expect our capital expenditures to increase in order to build wireless data networks and expand the capabilities of our data networks. Although we from time to time make short-term purchasing commitments to vendors with respect to these expenditures, we generally do not enter into firm, written contracts for such activities.

**CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements**

We conduct certain of our operations in leased premises and also lease certain equipment and other assets pursuant to operating leases. The lease arrangements have terms ranging from 1 to 99 years and several contain rent escalation clauses providing for increases in monthly rent at specific intervals. When rent escalation clauses exist, we record total expected rent payments on a straight-line basis over the lease term. Certain leases also have renewal options. Renewal options that are reasonably assured are included in determining the lease term. Future minimum rental commitments for all long-term noncancelable operating leases and future minimum capital lease payments for continuing operations as of December 31, 2005 are as follows:

(\$ in thousands)	<u>ELI Capital Leases</u>	<u>Operating Leases</u>
Year ending December 31:		
2006.....	\$ 179	\$ 19,062
2007.....	549	12,605
2008.....	555	11,840
2009.....	561	10,416
2010.....	566	8,891
Thereafter.....	<u>6,703</u>	<u>29,274</u>
Total minimum lease payments.....	9,113	<u>\$ 92,088</u>
Less amount representing interest (rates range from 9.75% to 10.65%) ...	<u>(4,826)</u>	
Present value of net minimum capital lease payments.....	4,287	
Less current installments of obligations under capital leases.....	<u>(41)</u>	
Obligations under capital leases, excluding current installments.....	<u>\$ 4,246</u>	

Total rental expense included in our results of operations for the years ended December 31, 2005, 2004 and 2003 was \$24,146,000, \$26,349,000 and \$33,801,000, respectively. Until March 1, 2005, we sublet certain office space in our corporate office to a charitable foundation formed by our former Chairman.

We are a party to contracts with several unrelated long distance carriers. The contracts provide fees based on traffic they carry for us subject to minimum monthly fees.

At December 31, 2005, the estimated future payments for obligations under our noncancelable long distance contracts and service agreements are as follows:

Year	<u>ILEC / ELI</u>
(\$ in thousands)	
2006.....	\$ 30,619
2007.....	18,337
2008.....	11,017
2009.....	10,244
2010.....	1,052
thereafter.....	<u>5,115</u>
Total.....	<u>\$ 76,384</u>

We sold all of our utility businesses as of April 1, 2004. However, we have retained a potential payment obligation associated with our previous electric utility activities in the state of Vermont. The Vermont Joint Owners (VJO), a consortium of 14 Vermont utilities, including us, entered into a purchase power agreement with Hydro-Quebec in 1987. The agreement contains "step-up" provisions that state that if any VJO member defaults on its purchase obligation under the contract to purchase power from Hydro-Quebec the other VJO participants will assume responsibility for the defaulting party's share on a pro-rata basis. Our pro-rata share of the purchase power obligation

**CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements**

is 10%. If any member of the VJO defaults on its obligations under the Hydro-Quebec agreement, then the remaining members of the VJO, including us, may be required to pay for a substantially larger share of the VJO's total power purchase obligation for the remainder of the agreement (which runs through 2015). Paragraph 13 of FIN 45 requires that we disclose "the maximum potential amount of future payments (undiscounted) the guarantor could be required to make under the guarantee." Paragraph 13 also states that we must make such disclosure "... even if the likelihood of the guarantor's having to make any payments under the guarantee is remote..." As noted above, our obligation only arises as a result of default by another VJO member, such as upon bankruptcy. Therefore, to satisfy the "maximum potential amount" disclosure requirement we must assume that all members of the VJO simultaneously default, a highly unlikely scenario given that the two members of the VJO that have the largest potential payment obligations are publicly traded with credit ratings equal to or superior to ours, and that all VJO members are regulated utility providers with regulated cost recovery. Regardless, despite the remote chance that such an event could occur, or that the State of Vermont could or would allow such an event, assuming that all the members of the VJO defaulted on January 1, 2007 and remained in default for the duration of the contract (another 9 years), we estimate that our undiscounted purchase obligation for 2007 through 2015 would be approximately \$1,264,000,000. In such a scenario the Company would then own the power and could seek to recover its costs. We would do this by seeking to recover our costs from the defaulting members and/or reselling the power to other utility providers or the northeast power grid. There is an active market for the sale of power. We could potentially lose money if we were unable to sell the power at cost. We caution that we cannot predict with any degree of certainty any potential outcome.

At December 31, 2005, we have outstanding performance letters of credit as follows:

(\$ in thousands)	
CNA .....	\$ 19,404
State of New York .....	2,993
ELI projects .....	50
Total .....	<u>\$ 22,447</u>

CNA serves as our agent with respect to general liability claims (auto, workers compensation and other insured perils of the Company). As our agent, they administer all claims and make payments for claims on our behalf. We reimburse CNA for such services upon presentation of their invoice. To serve as our agent and make payments on our behalf, CNA requires that we establish a letter of credit in their favor. CNA could potentially draw against this letter of credit if we failed to reimburse CNA in accordance with the terms of our agreement. The value of the letter of credit is reviewed annually and adjusted based on claims history.

None of the above letters of credit restrict our cash balances.

**(26) SUBSEQUENT EVENT:**

In February 2006, we entered into a definitive agreement to sell all of the outstanding membership interests in ELI, our CLEC business, to Integra Telecom Holdings, Inc. (Integra), for \$247,000,000, including \$243,000,000 in cash plus the assumption of approximately \$4,000,000 in capital lease obligations, subject to customary adjustments under the terms of the agreement. This transaction is expected to close during the third quarter of 2006 and is subject to regulatory and other customary approvals and conditions, as well as the funding of Integra's fully committed financing. We expect that for periods subsequent to December 31, 2005, ELI will be accounted for as a discontinued operation.

Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders  
Citizens Communications Company:

Under date of March 1, 2006, we reported separately on the consolidated balance sheets of Citizens Communications Company and subsidiaries as of December 31, 2005 and 2004, and the related consolidated statements of operations, shareholders' equity, comprehensive income (loss) and cash flows for each of the years in the three-year period ended December 31, 2005. In connection with our audits of the aforementioned consolidated financial statements, we have also audited the related financial statement schedule. The financial statement schedule is the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statement schedule based on our audits. In our opinion, such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

Our report refers to the adoption of Statement of Financial Accounting Standards No. 143, "Accounting for Asset Retirement Obligations" as of January 1, 2003.

KPMG LLP

Stamford, Connecticut  
March 1, 2006

## CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES

Valuation and Qualifying Accounts  
(\$ In thousands)

Accounts	Balance at beginning of period	Additions		Deductions	Balance at End of Period
		Charged to costs and expenses	Charged to other accounts- Revenue		
Allowance for doubtful accounts					
2003 .....	38,871	21,540	32,240	(45,342)	47,309
2004 .....	47,309	17,906	13,446	(42,665)	35,996
2005 .....	35,996	13,510	10,791	(27,889)	32,408

## **CORPORATE HEADQUARTERS**

Three High Ridge Park  
Stamford, CT 06905-1390  
Tel: 203-614-5600

## **STOCKHOLDER INQUIRIES**

Investor material is available on Citizen's website at [www.czn.net](http://www.czn.net). Copies of the company's 2005 Form 10-K report filed with the U.S. Securities and Exchange Commission and other information about the company may be obtained by telephoning 402-572-4972, faxing to 203-614-4602, or e-mailing [Citizens@czn.com](mailto:Citizens@czn.com).

## **STOCK TRANSFER AGENT**

Illinois Stock Transfer Company  
209 West Jackson Boulevard, Suite 903  
Chicago, IL 60606-6905  
Tel: 800-757-5755 or 312-427-2953  
Fax: 312-427-2879

## **AUDITORS**

KPMG LLP  
3001 Summer Street  
Stamford, CT 06905

The common stock is listed on the New York Stock Exchange and trades under the symbol "CZN."

The 5% Company Obligated Mandatorily Redeemable Convertible Preferred Securities due 2036 are listed on the New York Stock Exchange and trade under the symbol "CZNPR."

## **OUR MISSION**

**To be the leader in providing  
communications services to residential  
and business customers in our markets**

## **OUR VALUES**

**Put the customer first  
Treat one another with respect  
Keep our commitments; be accountable  
Be ethical in all of our dealings  
Take the initiative  
Be team players  
Be innovative; practice continuous improvement  
Be active in our communities  
Do it right the first time  
Use resources wisely  
Have a positive attitude**

**Citizens Communications Company  
Three High Ridge Park  
Stamford, CT 06905-1390  
203-614-5600**

**AGREEMENT AND PLAN OF MERGER**

dated as of

September 17, 2006

among

**COMMONWEALTH TELEPHONE ENTERPRISES, INC.,**

**CITIZENS COMMUNICATIONS COMPANY,**

and

**CF MERGER CORP.**

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## AGREEMENT AND PLAN OF MERGER

AGREEMENT AND PLAN OF MERGER dated as of September 17, 2006 among COMMONWEALTH TELEPHONE ENTERPRISES, INC., a Pennsylvania corporation (the "**Company**"), CITIZENS COMMUNICATIONS COMPANY, a Delaware corporation ("**Parent**"), and CF MERGER CORP., a Delaware corporation ("**Merger Subsidiary**").

WHEREAS, the respective Boards of Directors of Parent, Merger Subsidiary and the Company have approved this Agreement, and deem it advisable and in the best interests of their respective stockholders to consummate the merger of the Company and Merger Subsidiary on the terms and conditions set forth herein.

NOW, THEREFORE, in consideration for the various representations, warranties, covenants and agreements contained herein, the parties hereto agree as follows:

### ARTICLE I THE MERGER

Section 1.01. *The Merger.* (a) At the Effective Time, Merger Subsidiary shall be merged (the "**Merger**") with and into the Company in accordance with the Pennsylvania Business Corporation Law ("**Pennsylvania Law**") and the Delaware General Corporation Law ("**Delaware Law**"), whereupon the separate existence of Merger Subsidiary shall cease, and the Company shall be the surviving corporation (the "**Surviving Corporation**"). For purposes hereof, the closing of the Merger is referred to herein as the "**Closing**", and the date of the Closing is referred to herein as the "**Closing Date**".

(b) The Closing will take place on the first Business Day after satisfaction or, to the extent permitted hereunder, waiver of all conditions to the Merger (other than those conditions that by their nature are to be satisfied at the Closing and will in fact be satisfied at the Closing). As soon as practicable on the Closing Date, the Company and Merger Subsidiary will file articles of merger with the Department of State of the Commonwealth of Pennsylvania and a certificate of merger with the Secretary of State of the State of Delaware, and make all other filings or recordings required by Pennsylvania Law or Delaware Law in connection with the Merger. The Merger shall become effective on the Closing Date at such time as the articles of merger and the certificate of merger are duly filed as described in this paragraph or at such later time as is specified therein by agreement of Parent and the Company (the "**Effective Time**"). For purposes of this Agreement, "**Business Day**" means a day, other than Saturday, Sunday or other day on which commercial banks in New York, New York, are authorized or required by Applicable Law to close. For purposes of this Agreement, "**Applicable Law**" means, with respect to any Person, any federal, state or local law (statutory, common or otherwise), constitution, treaty, convention, ordinance, code, rule, regulation, order, injunction, judgment, decree, ruling or other similar requirement enacted, adopted, promulgated or applied by a Governmental Authority that is binding upon or applicable to

such Person, its properties or assets or its business or operations, as amended unless expressly specified otherwise.

(c) From and after the Effective Time, the Surviving Corporation shall possess all the rights, privileges, powers and franchises, and be subject to all of the obligations, liabilities, restrictions, disabilities and duties, of the Company and Merger Subsidiary, all as provided under Pennsylvania Law and Delaware Law.

Section 1.02. *Conversion of Shares.* At the Effective Time:

(a) each Common Share held by the Company as treasury stock (the “**Treasury Shares**”), including each Grantor Trust Share, if any, distributed to the Company pursuant to Section 1.04(a)(v), or owned by Parent or Merger Subsidiary immediately prior to the Effective Time shall be canceled, and no payment shall be made with respect thereto;

(b) each Common Share outstanding immediately prior to the Effective Time (which, for the avoidance of doubt, will not include any Common Shares canceled pursuant to Section 1.04(a)(iii)) shall, except as otherwise provided in Section 1.02(a), be converted into the following:

(i) the right to receive 0.768 shares of common stock, par value \$0.25 per share (“**Parent Stock**”), of Parent (the “**Stock Merger Consideration**”); and

(ii) the right to receive \$31.31 in cash, without interest (the “**Cash Merger Consideration**”, and together with the Stock Merger Consideration, the “**Merger Consideration**”); and

(c) each share of common stock of Merger Subsidiary outstanding immediately prior to the Effective Time shall be converted into and become one share of common stock of the Surviving Corporation with the same rights, powers and privileges as the shares so converted and shall constitute the only outstanding shares of capital stock of the Surviving Corporation.

Section 1.03. *Surrender and Payment.* (a) Prior to the Effective Time, Parent shall appoint an agent reasonably acceptable to the Company (the “**Exchange Agent**”) for the purpose of exchanging certificates representing Common Shares for the Merger Consideration and shall deposit with the Exchange Agent, for the benefit of the holders of Common Shares, for exchange in accordance with this Article 1, the aggregate Merger Consideration, consisting of (i) certificates representing Parent Stock to be issued as Stock Merger Consideration and (ii) cash sufficient to pay the aggregate Cash Merger Consideration. In addition, Parent shall deposit with the Exchange Agent, as necessary from time to time after the Effective Time, cash sufficient to pay any dividends or other distributions and cash in lieu of any fractional shares of Parent Stock payable pursuant to Section 1.03(b). Promptly (and in any event, within two Business Days) after the Effective Time, the Surviving Corporation will send, or will cause the Exchange Agent to send, to each holder of record of Common Shares at the Effective Time (and make customary arrangements for the prompt delivery to each such holder) a letter of

transmittal ("**Letter of Transmittal**") for use in such exchange, which shall specify that the delivery shall be effected, and risk of loss and title shall pass, only upon proper delivery of the certificates representing Common Shares to the Exchange Agent.

(b) Each holder of Common Shares that have been converted into a right to receive the Merger Consideration, upon surrender to the Exchange Agent of a certificate or certificates representing such Common Shares, together with a properly completed Letter of Transmittal covering such Common Shares, will be entitled to receive therefor (i) the Cash Merger Consideration payable in respect of such Common Shares, (ii) a certificate or certificates representing that number of whole shares of Parent Stock to which such holder is entitled pursuant to Section 1.02(b) and (iii) any dividends or distributions, and any cash in lieu of any fractional shares of Parent Stock, payable at the time of such surrender pursuant to Section 1.03(f), and the certificate or certificates representing such Common Shares shall forthwith be canceled. Until so surrendered, each such certificate shall, after the Effective Time, represent for all purposes, only the right to receive the Merger Consideration payable in respect of the Common Shares represented thereby and any such dividends or distributions and cash in lieu of fractional shares of Parent Stock, *subject, however*, to the Surviving Corporation's obligation to pay all dividends that may have been declared by the Company in accordance with Section 5.01 and that remain unpaid at the Effective Time. No interest will be paid or will accrue on any cash payable as Merger Consideration, in lieu of any fractional shares of Parent Stock or otherwise pursuant to this Article.

(c) If any portion of the Merger Consideration is to be paid to a Person other than the registered holder of the Common Shares represented by the certificate or certificates surrendered in exchange therefor, it shall be a condition to such payment that the certificate or certificates so surrendered shall be properly endorsed or otherwise be in proper form for transfer and that the Person requesting such payment shall pay to the Exchange Agent any transfer or other taxes required as a result of such payment (and the payment of any other amounts referred to in Section 1.03(b)) to a Person other than the registered holder of such Common Shares or establish to the satisfaction of the Exchange Agent that such tax has been paid or is not payable. For purposes of this Agreement, "**Person**" means an individual, a corporation, a limited liability company, a partnership, an association, a trust or any other entity or organization, including a government or political subdivision or any agency or instrumentality thereof.

(d) After the Effective Time, there shall be no further registration of transfers of Common Shares. If, after the Effective Time, certificates representing Common Shares are presented to the Surviving Corporation, they shall be canceled and exchanged for the consideration provided for, and in accordance with the procedures set forth, in this Article 1.

(e) Any portion of the Merger Consideration or other funds made available to the Exchange Agent pursuant to Section 1.03(a) that remains unclaimed by the holders of Common Shares six months after the Effective Time shall be returned to Parent, upon demand, and any such holder who has not exchanged his Common Shares for the Merger Consideration in accordance with this Section prior to that time shall thereafter look only

to Parent for payment of the Merger Consideration in respect of his Common Shares, and any dividends and distributions with respect thereto, without any interest thereon. Notwithstanding the foregoing, none of the Surviving Corporation, the Company, Merger Subsidiary, Parent or the Exchange Agent shall be liable to any holder of Common Shares for any amount paid or any shares of Parent Stock delivered to a public official pursuant to applicable abandoned property laws. Any amounts or shares remaining unclaimed by holders of Common Shares two years after the Effective Time (or such earlier date immediately prior to such time as such amounts or shares would otherwise escheat to or become property of any Governmental Authority) shall, to the extent permitted by Applicable Law, become the property of Parent free and clear of any claims or interest of any Person previously entitled thereto.

(f) No dividends or other distributions with respect to Parent Stock with a record date after the Effective Time shall be paid to the holder of any unsurrendered certificate for Common Shares with respect to the shares of Parent Stock represented thereby and no cash payment in lieu of fractional shares shall be paid to any such holder pursuant to Section 1.06, in each case, until the surrender of such certificate in accordance with this Section. Subject to the effect of Applicable Laws, following surrender of any such certificate, there shall be paid to the holder of the certificate representing whole shares of Parent Stock issued in exchange therefor, without interest, (i) at the time of such surrender, the amount of any cash payable in lieu of a fractional share of Parent Stock to which such holder is entitled pursuant to Section 1.06 and the amount of all dividends or other distributions with a record date after the Effective Time theretofore paid with respect to such whole shares of Parent Stock, and (ii) at the appropriate payment date, the amount of dividends or other distributions with a record date after the Effective Time but prior to such surrender, and with a payment date subsequent to such surrender, payable with respect to such whole shares of Parent Stock.

(g) With respect to any certificate representing Common Shares properly surrendered to the Exchange Agent, the Exchange Agent shall, subject to the provisions of this Agreement, including Section 1.03(e), mail or otherwise transmit the Merger Consideration in respect thereof to the applicable holder or transferee thereof within five Business Days (or as promptly thereafter as practicable) of the date such certificate representing Common Shares is properly surrendered.

Section 1.04. *Treatment of Equity Compensation Awards.* (a) Prior to the Effective Time, the Company or the Board of Directors of the Company (or, if appropriate, any committee thereof) shall take all action necessary so that (or, in the case of clause (v) below, shall use reasonable best efforts so that) immediately prior to the Effective Time:

(i) each outstanding compensatory stock option to purchase Common Shares granted under the Amended and Restated Equity Incentive Plan or the Non-Management Directors' Stock Compensation Plan of the Company (together, the "**Company Stock Plans**"), any other compensatory agreement, plan, arrangement or policy of the Company or otherwise (an "**Option**") shall be canceled, and Parent shall pay, or cause the Surviving Corporation to pay,

immediately after the Effective Time, each holder of such Option, whether or not then vested or exercisable, for each such Option an amount determined by multiplying (A) the excess, if any, of the Merger Consideration Value over the applicable per share exercise price of such Option by (B) the number of Common Shares such holder could have purchased (assuming full vesting of all Options) had such holder exercised such Option in full immediately prior to the Effective Time;

(ii) each outstanding share unit granted or otherwise issued under the Executive Stock Purchase Plan of the Company or the Deferred Compensation Plan of the Company (an "**ESPP Share Unit**") shall be canceled, and Parent shall pay, or cause the Surviving Corporation to pay, immediately after the Effective Time, each holder of such ESPP Share Unit, whether or not then vested, for each such ESPP Share Unit an amount equal to the Merger Consideration Value;

(iii) each outstanding Common Share that is subject to vesting, restrictions on transferability and risks of forfeiture and is granted or otherwise issued under any Company Stock Plan or any other compensatory agreement, plan, arrangement or policy of the Company (a "**Restricted Share**") shall be canceled, and Parent shall pay, or cause the Surviving Corporation to pay, immediately after the Effective Time, each holder of such Restricted Share for each such Restricted Share an amount equal to the Merger Consideration Value;

(iv) each outstanding share unit (other than ESPP Share Units) granted or otherwise issued under any Company Stock Plan, any other compensatory agreement, plan, arrangement or policy of the Company or otherwise (a "**Restricted Share Unit**" and, collectively, together with Options, ESPP Share Units and Restricted Shares, "**Compensatory Awards**") shall be canceled, and Parent shall pay, or cause the Surviving Corporation to pay, immediately after the Effective Time, each holder of such Restricted Share Unit, whether or not then vested, for each such Restricted Share Unit an amount equal to the Merger Consideration Value; and

(v) the trust established under the Agreement of Trust Under C-TEC Corporation Executive One-for-One Stock Purchase Plan shall be terminated, and all Common Shares held in such trust ("**Grantor Trust Shares**") shall be distributed to the Company immediately prior to the Effective Time, and shall be canceled at the Effective Time in accordance with Section 1.02(a).

Prior to the Closing, Parent shall put in place arrangements reasonably satisfactory to the Company to ensure payment of such amounts in accordance with the provisions set forth in this Section 1.04(a).

(b) For purposes of this Agreement, the term "**Merger Consideration Value**" means the sum of (i) the per share Cash Merger Consideration and (ii) the product obtained by multiplying the per share Stock Merger Consideration by the five-day average

closing price of Parent Stock ending on the second trading day immediately preceding the Closing Date (as reported in The Wall Street Journal).

Section 1.05. *Adjustments.* If, during the period between the date of this Agreement and the Effective Time, any change in the outstanding shares of capital stock of the Company or Parent shall occur by reason of any reclassification, recapitalization, stock split or combination, exchange or readjustment of shares, or any stock dividend thereon with a record date during such period, or any other similar event, the Merger Consideration and any other amounts payable pursuant to this Article shall be appropriately adjusted.

Section 1.06. *Fractional Shares.* Notwithstanding any other provision of this Agreement, no fractional shares of Parent Stock will be issued, and any holder of Common Shares entitled to receive a fractional share of Parent Stock but for this Section shall be entitled to receive a cash payment in lieu thereof in an amount equal to the product obtained by multiplying (a) the fractional share interest in Parent Stock that such holder otherwise would be entitled to receive by (b) the per share closing price of Parent Stock on the Closing Date (as reported in The Wall Street Journal). Such fractional share interests shall not entitle the owner thereof to any dividends or other distributions made in respect of Parent Stock or to the right to vote or any other rights of a stockholder of Parent.

Section 1.07. *Withholding Rights.* Each of the Exchange Agent, the Surviving Corporation and Parent (without duplication) shall be entitled to deduct and withhold from the consideration otherwise payable to any Person pursuant to this Article such amounts as it is required to deduct and withhold with respect to the making of such payment under any provision of federal, state, local or foreign tax law. If the Exchange Agent, the Surviving Corporation or Parent, as the case may be, so withholds amounts, such amounts shall be treated for all purposes of this Agreement as having been paid to the holder of the Common Shares in respect of which the Exchange Agent, the Surviving Corporation or Parent, as the case may be, made such deduction and withholding. No such deduction or withholding shall be made if the relevant Person shall provide documentation reasonably satisfactory to the Exchange Agent, the Surviving Corporation and Parent establishing an exemption from withholding, and the Exchange Agent, the Surviving Corporation and Parent, as applicable, shall take customary actions to obtain such documentation prior to such deduction or withholding.

Section 1.08. *Lost Certificates.* If any certificate representing Common Shares shall have been lost, stolen or destroyed, upon the making of an affidavit of that fact by the Person claiming such certificate to be lost, stolen or destroyed and, if required by the Surviving Corporation, the posting by such Person of a bond, in such reasonable amount as the Surviving Corporation may direct, as indemnity against any claim that may be made against it with respect to such certificate, the Exchange Agent will issue, in exchange for such lost, stolen or destroyed certificate, the Merger Consideration and the other amounts referred to in Section 1.03(b) to be paid in respect of the Common Shares represented by such certificate, as contemplated by this Article.

ARTICLE 2  
THE SURVIVING CORPORATION

Section 2.01. *Articles of Incorporation.* At the Effective Time, the articles of incorporation of the Surviving Corporation shall be amended and restated as set forth in Exhibit A to this Agreement, subject to further amendment thereof in accordance with Applicable Law.

Section 2.02. *Bylaws.* The bylaws of Merger Subsidiary in effect immediately prior to the Effective Time shall be the bylaws of the Surviving Corporation, until amended in accordance with Applicable Law.

Section 2.03. *Directors and Officers.* From and after the Effective Time, until the earlier of their resignation or removal or until their respective successors are duly elected or appointed and qualified in accordance with Applicable Law, (a) the directors of Merger Subsidiary immediately prior to the Effective Time shall be the directors of the Surviving Corporation and (b) the officers of Merger Subsidiary immediately prior to the Effective Time shall be the officers of the Surviving Corporation.

ARTICLE 3  
REPRESENTATIONS AND WARRANTIES OF THE COMPANY

Except as disclosed in the Company SEC Documents filed prior to the date hereof (excluding any disclosures in the Company SEC Documents under the heading "Risk Factors" and any other disclosures of risks that are predictive or forward-looking in nature) or in a separate disclosure schedule (the "**Company Disclosure Schedule**") which has been delivered by the Company to Parent prior to the execution of this Agreement (each section of which qualifies the correspondingly numbered representation and warranty to the extent specified therein and such other representations and warranties to the extent a matter in such section is disclosed in such a way as to make its relevance to the information called for by such other representation and warranty readily apparent), the Company represents and warrants to Parent that:

Section 3.01. *Organization and Authority.* The Company is a corporation duly organized, validly existing and in good standing under the laws of the Commonwealth of Pennsylvania, and has all requisite corporate power to carry on its business as now being conducted. The Company is duly qualified to do business as a foreign corporation and is in good standing in each jurisdiction where the character of the property owned or leased by it or the nature of its activities makes such qualification necessary, with such exceptions as would not reasonably be expected to have, individually or in the aggregate, a Material Adverse Effect on the Company (a "**Company Material Adverse Effect**"). The execution, delivery and performance by the Company of this Agreement and the consummation by the Company of the transactions contemplated hereby are within the Company's corporate powers and, except for any required approval by the Company's stockholders in connection with the consummation of the Merger, have been duly authorized by all necessary corporate action. This Agreement has been duly executed

and delivered by the Company and constitutes a valid and binding agreement of the Company, enforceable against the Company in accordance with its terms, except (x) as the same may be limited by applicable bankruptcy, insolvency, moratorium or similar laws of general application relating to or affecting creditors' rights, and (y) for the limitations imposed by general principles of equity. The foregoing exceptions (x) and (y) are hereinafter referred to as the "**Enforceability Exceptions.**" The Company has delivered to Parent true and complete copies of the Articles of Incorporation and Bylaws of the Company as in effect on the date hereof. For purposes of this Agreement, "**Material Adverse Effect**" means, with respect to any Person, any effect, event, occurrence, state of facts or development that has a materially adverse effect on the business, assets, liabilities, operations or financial condition of such Person and its Subsidiaries, taken as a whole, excluding any such effect, event, occurrence, state of facts or development resulting from or arising in connection with (i) this Agreement, the transactions contemplated hereby or the announcement or consummation thereof or the taking of any actions required by this Agreement, (ii) changes or conditions generally affecting the industries in which such Person and its Subsidiaries operate, to the extent such changes or conditions do not disproportionately impact such Person and its Subsidiaries, taken as a whole, (iii) general economic or financial markets conditions, (iv) any change in generally accepted accounting principles in the United States ("**GAAP**"), (v) changes in Applicable Law to the extent such changes do not disproportionately impact such Person and its Subsidiaries, taken as a whole, (vi) any failure by such Person to meet analysts' revenue or earning projections and (vii) any decline in the price of any publicly traded securities of such Person (it being understood, in the case of clauses (vi) and (vii), that the facts or occurrences giving rise or contributing to any such failure or decline may be deemed to constitute, or be taken into account in determining whether there has been, or would reasonably be expected to be, a Material Adverse Effect). For purposes of this Agreement, a "**Subsidiary,**" as to any Person, means any corporation or other entity of which securities or other ownership interests having ordinary voting power to elect a majority of the board of directors or other persons performing similar functions are directly or indirectly owned by such Person.

Section 3.02. *No Breach.* The execution and delivery of this Agreement by the Company do not, and the consummation of the transactions contemplated hereby by the Company will not, (i) violate or conflict with the Articles of Incorporation or Bylaws of the Company, (ii) except as set forth on Section 3.02 of the Company Disclosure Schedule, constitute a breach or default of (with or without notice or lapse of time, or both), or give rise to any third-party right of termination, cancellation, modification or acceleration under, or to a loss of a benefit of the Company or any of its Subsidiaries under, any agreement, understanding, undertaking or License to which the Company or any of its Subsidiaries is a party or by which any of them is bound, or give rise to any Lien on any of their properties, or (iii) subject to obtaining the approvals and making the filings described in Section 3.03 hereof, constitute a violation or breach of any provision of any Applicable Law, with such exceptions in the cases of subsections (ii) and (iii) as would not, individually or in the aggregate, reasonably be expected to have a Company Material Adverse Effect or materially interfere with or delay the consummation of the transactions contemplated hereby. For purposes of this Agreement, "**Lien**" means, with

respect to any asset, any lien, claim, charge, restriction, pledge, mortgage, security interest or other encumbrance in respect of such asset.

Section 3.03. *Consents and Approvals.* Neither the execution and delivery of this Agreement by the Company nor the consummation of the transactions contemplated hereby will require any consent, approval, authorization or permit of, or filing with or notification to, any transnational, domestic, foreign, federal, state or local authority, department, court, agency or official, including any political subdivision thereof (each, a “**Governmental Authority**”), except (i) compliance with any applicable requirements of the Securities Act, the Exchange Act and any other applicable securities laws, whether federal, state or foreign, (ii) for notification pursuant to, and expiration or termination of the waiting period under, the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended, and the rules and regulations thereunder (the “**HSR Act**”), (iii) for the filing of the articles of merger under Pennsylvania Law, the certificate of merger under Delaware Law and related filings as set forth in Section 1.01 hereof, (iv) for approvals of and filings with the Federal Communications Commission (the “**FCC**”) and the Pennsylvania Public Utility Commission (the “**PPUC**”), (v) where the failure to obtain such consents, approvals, authorizations or permits, or to make such filings or notifications, would not, individually or in the aggregate, reasonably be expected to have a Company Material Adverse Effect or materially interfere with or delay the consummation of the transactions contemplated hereby and (vi) as may be necessary as a result of any fact or circumstance relating to Parent, Merger Subsidiary or any of their Affiliates. As used herein, the term “**Securities Act**” means the Securities Act of 1933, as amended, together with the rules and regulations promulgated thereunder, and the term “**Exchange Act**” means the Securities Exchange Act of 1934, as amended, together with the rules and regulations promulgated thereunder.

Section 3.04. *Approval of the Board; Fairness Opinion; Vote Required.* The Board of Directors of the Company has, by resolutions duly adopted at meetings duly called and held, (i) approved and adopted this Agreement, the Merger and the other transactions contemplated hereby, (ii) directed that the adoption of this Agreement be submitted to a vote at the Company Stockholders’ Meeting, (iii) determined that this Agreement and the Merger are advisable and in the best interests of the stockholders of the Company and (iv) recommended that the stockholders of the Company adopt this Agreement, which resolutions have not been rescinded, modified or withdrawn in any way except as permitted under Section 5.02(b). The Company has received the opinion, dated the date of this Agreement, of Evercore Group L.L.C. (“**Evercore**”), as financial advisor to the Company, that the Merger Consideration to be received by the Company’s stockholders (other than Parent and its Affiliates) in the Merger is fair to such stockholders from a financial point of view, a signed copy of which opinion has been or will promptly be delivered to Parent. The affirmative vote of a majority of the votes cast by the holders of Common Shares is the only vote of the holders of any class or series of capital stock or other securities of the Company necessary for the Company to adopt this Agreement and to approve the Merger.

Section 3.05. *Capitalization.* The authorized capital stock of the Company consists of 85,000,000 shares of common stock, par value \$1.00 per share (the “**Common**”).

Shares”), and 25,000,000 shares of preferred stock, no par value (the “**Preferred Stock**”). At the close of business on August 31, 2006, there were outstanding (i) 21,085,433 Common Shares (including 4,294 Restricted Shares granted or otherwise issued under the Company Stock Plans and 270,744 Grantor Trust Shares), (ii) Options granted under the Company Stock Plans to purchase an aggregate of 384,282 Common Shares, with exercise prices as set forth in Section 3.05 of the Company Disclosure Schedule, (iii) 250,767 ESPP Share Units, (iv) 444,671 Restricted Share Units granted or otherwise issued under the Company Stock Plans, (v) awards (subject to the satisfaction of certain performance criteria) (“**Performance Awards**”) that could result in the issuance of up to 82,850 additional Restricted Share Units under the Company Stock Plans and (vi) no shares of Preferred Stock. At the close of business on August 31, 2006, 3,141,049 Common Shares were held by the Company as treasury stock and, if all of the Company Convertible Notes had been converted into Common Shares on such date, a total of 7,513,380 Common Shares would be issued as a result. All outstanding shares of capital stock of the Company have been duly authorized and validly issued and are fully paid and nonassessable. Except as set forth in this Section 3.05 and for changes since August 31, 2006 resulting from (1) the exercise of Options granted under the Company Stock Plans outstanding on such date, (2) the settlement of ESPP Share Units and Restricted Share Units granted or otherwise issued under the Company Stock Plans, in each case, outstanding on such date, (3) issuances of additional ESPP Share Units in respect of compensation deferred after such date (including any matching grant with respect thereto) and the settlement of any ESPP Share Units so issued, (4) issuances of Restricted Share Units under the Company Stock Plans awardable under Performance Awards outstanding on such date and the settlement of any such Restricted Share Units so awarded, (5) issuances of Common Shares on the conversion, if any, of Company Convertible Notes, (6) adjustments to the ESPP Share Units and the Restricted Share Units granted or otherwise issued under the Company Stock Plans, in each case, as a result of the payment of regular quarterly dividends (“**Permitted Share Unit Adjustments**”) and (7) the release of Treasury Shares consistent with past practice in connection with the operation of the Company’s qualified defined contribution plan (the issuances referred to in clauses (1) – (7) collectively, the “**Permitted Additional Company Issuances**”), there are outstanding no (a) shares of capital stock or other voting securities of the Company, (b) securities of the Company convertible into or exchangeable for shares of capital stock or voting securities of the Company, (c) options or other rights to acquire from the Company any capital stock, voting securities or securities convertible into or exchangeable for capital stock or voting securities of the Company, or any rights against or obligating the Company that give the holder thereof any economic interest of a nature occurring to the holders of Common Shares (the items in clauses (a), (b) and (c) of this sentence being referred to collectively as the “**Company Securities**”) or (d) obligations of the Company to issue, deliver or sell any Company Security, other than the Company’s 2005 Series A 3 1/4% Convertible Notes due 2023 and the 2003 3 1/4% Convertible Notes due 2023 (collectively, the “**Company Convertible Notes**”) and the obligations of the Company thereunder to issue Common Shares upon the conversion thereof. Except as required by the terms of the Company Convertible Notes, there are no outstanding obligations of the Company or any Subsidiary of the Company to repurchase, redeem or otherwise acquire any Company Securities. Except as

would not reasonably be expected to have, individually or in the aggregate, a Company Material Adverse Effect, with respect to the Options, (I) each grant of an Option was duly authorized no later than the date on which the grant of such Option was by its terms to be effective (the "Grant Date") by all necessary corporate action, including, as applicable, approval by the Board of Directors of the Company (or a duly constituted and authorized committee thereof) and any required stockholder approval by the necessary number of votes or written consents, and the award agreement governing such grant (if any) was duly executed and delivered by each party thereto, (II) each such grant was made in accordance with the terms of the applicable compensation plan or arrangement of the Company, the Exchange Act and all other Applicable Laws and regulatory rules or requirements, including the rules of NASDAQ, (III) the per share exercise price of each Option was equal to the fair market value of a Common Share on the applicable Grant Date and (IV) each such grant was properly accounted for in accordance with GAAP in the financial statements (including the related notes) of the Company and disclosed in the Company SEC Documents in accordance with the Exchange Act and all other Applicable Laws.

Section 3.06. *Subsidiaries.* (a) Section 3.06 of the Company Disclosure Schedule sets forth, as of the date of this Agreement, the name and the jurisdiction and form of organization of each Subsidiary of the Company. Each of the material Subsidiaries of the Company is a corporation or limited liability company duly organized, validly existing and in good standing under the laws of its state of incorporation or formation. Each of the Subsidiaries of the Company has all requisite corporate or limited liability company power to carry on its business as now being conducted, except where the failure to have such power or authority would not reasonably be expected to have, individually or in the aggregate, a Company Material Adverse Effect. Each Subsidiary of the Company is duly qualified to do business as a foreign corporation or limited liability company and is in good standing in each jurisdiction where the character of the property owned or leased by it or the nature of its activities makes such qualification necessary, with such exceptions as would not reasonably be expected to have, individually or in the aggregate, a Company Material Adverse Effect. All Subsidiaries of the Company that are "significant subsidiaries" within the meaning of Rule 1-02 of Regulation S-X of the SEC ("**Company Significant Subsidiaries**"), together with their respective jurisdictions of incorporation, are listed in the Company's most recent Annual Report on Form 10-K. As used herein, the term "SEC" means the United States Securities and Exchange Commission.

(b) All of the outstanding capital stock of, or other voting securities or ownership interests in, each Subsidiary of the Company have been duly authorized and validly issued and are fully paid and nonassessable, and are owned by the Company, directly or indirectly, free and clear of any Lien (other than Company Permitted Liens). There are no outstanding (i) securities of the Company or any Subsidiary of the Company convertible into or exchangeable for shares of capital stock or other voting securities or ownership interests in any Subsidiary of the Company, (ii) options or other rights to acquire from the Company or any Subsidiary of the Company any capital stock, voting securities or other ownership interests in, or any securities convertible into or exchangeable for any capital stock, voting securities or ownership interests in, or any

rights against or obligating the Company or any Subsidiary of the Company that give the holders thereof any economic interest of a nature occurring to the holders of capital stock, voting securities or ownership interests in any Subsidiary of the Company (the items in clauses (i) and (ii) of this sentence, together with capital stock, voting securities or ownership interests in any Subsidiary of the Company, being referred to collectively as the “**Company Subsidiary Securities**”) or (iii) obligations of the Company or any Subsidiary of the Company to issue, deliver or sell any Company Subsidiary Security. There are no outstanding obligations of the Company or any Subsidiary of the Company to repurchase, redeem or otherwise acquire any outstanding Company Subsidiary Securities.

(c) Except for its interest in its Subsidiaries and any de minimis interests which do not impose any obligations on the Company, the Company does not own, directly or indirectly, any capital stock or other ownership interests in any corporation, partnership, joint venture, association or other entity.

Section 3.07. *SEC Filings and the Sarbanes-Oxley Act.* (a) The Company has filed or furnished all reports, schedules, forms, statements and other documents (including exhibits and other information incorporated therein) with the SEC required to be filed or furnished by the Company since January 1, 2004 (collectively, but excluding the Proxy Statement, the “**Company SEC Documents**”).

(b) As of its filing date, each Company SEC Document complied as to form in all material respects with the requirements of the Exchange Act or the Securities Act, as the case may be.

(c) As of its filing date, none of the Company SEC Documents filed pursuant to the Exchange Act contained any untrue statement of a material fact or omitted to state any material fact necessary in order to make the statements made therein, in the light of the circumstances under which they were made, not misleading. Except to the extent that information contained in any such Company SEC Document has been revised, amended, supplemented or superseded by a subsequent Company SEC Document, none of the Company SEC Documents filed pursuant to the Exchange Act contains any untrue statement of a material fact or omits to state any material fact in circumstances where an amendment, supplement or corrective filing to any such Company SEC Document is required under the Exchange Act.

(d) None of the Company SEC Documents that is a registration statement, as amended or supplemented, if applicable, filed pursuant to the Securities Act, as of the date such statement or amendment became effective, contained any untrue statement of a material fact or omitted to state any material fact required to be stated therein or necessary to make the statements therein not misleading.

(e) The Company has established and maintains disclosure controls and procedures (as defined in Rule 13a-15 under the Exchange Act). Such disclosure controls and procedures are designed to ensure that material information relating to the Company, including its consolidated Subsidiaries, is made known to the Company’s principal

executive officer and its principal financial officer by others within those entities, particularly during the periods in which the periodic reports required under the Exchange Act are being prepared. Such disclosure controls and procedures are designed to be effective in timely alerting the Company's principal executive officer and principal financial officer to material information required to be included in the Company's periodic reports required under the Exchange Act.

(f) Since March 31, 2005, the Company and its Subsidiaries have established and maintained a system of internal control over financial reporting (as defined in Rule 13a-15 under the Exchange Act) ("**internal controls**"). Such internal controls are sufficient in all material respects to provide reasonable assurance regarding the reliability of the Company's financial reporting and the preparation of Company financial statements for external purposes in accordance with GAAP. The Company has disclosed, based on its most recent evaluation of internal controls prior to the date hereof, to the Company's auditors and audit committee (x) any significant deficiencies and material weaknesses in the design or operation of internal controls which are reasonably likely to adversely affect the Company's ability to record, process, summarize and report financial information and (y) any fraud, whether or not material, that involves management or other employees who have a significant role in internal controls. The Company has made available to Parent a summary of any such disclosure made by management to the Company's auditors and audit committee since January 1, 2004.

(g) The Company has made available to Parent true and complete copies of all comment letters received by the Company from the SEC since January 1, 2004 and relating to the Company SEC Documents, together with all written responses of the Company thereto. As of the date of this Agreement, there are no outstanding or unresolved comments in such comment letters received by the Company from the SEC, and, to the knowledge of the Company, none of the Company SEC Documents is the subject of any ongoing review by the SEC.

Section 3.08. *Financial Statements.* The audited consolidated financial statements and unaudited consolidated interim financial statements of the Company included in the Company SEC Documents when filed complied as to form in all material respects with the published rules and regulations of the SEC with respect thereto and fairly present in all material respects, and in conformity with GAAP applied on a consistent basis (except as may be indicated in the notes thereto), the consolidated financial position of the Company and its consolidated Subsidiaries as of the dates thereof and their consolidated results of operations and cash flows for the periods then ended (subject to normal year-end adjustments in the case of any unaudited interim financial statements). For purposes of this Agreement, "**Company Balance Sheet**" means the consolidated balance sheet as of June 30, 2006 of the Company and its consolidated Subsidiaries set forth in the Company's Form 10-Q for the quarter ended June 30, 2006, and "**Company Balance Sheet Date**" means June 30, 2006.

Section 3.09. *Disclosure Documents.* None of the information supplied by the Company for inclusion in (i) the joint proxy statement/prospectus (as amended or supplemented, the "**Proxy Statement**") to be sent to the stockholders of the Company in

connection with their meeting to consider this Agreement and the Merger (the "Company Stockholders' Meeting") will, at the time the Proxy Statement or any amendment or supplement thereto is first mailed to the stockholders of the Company or at the time of the Company Stockholders' Meeting, contain any untrue statement of a material fact or omit to state any material fact necessary in order to make the statements made therein, in the light of the circumstances under which they were made, not misleading or (ii) the registration statement on Form S-4 pursuant to which shares of Parent Stock issuable in the Merger will be registered with the SEC to be filed by Parent with the SEC in connection with the Merger (as amended or supplemented, the "Registration Statement") will, at the time the Registration Statement or any amendment or supplement thereto is declared effective by the SEC, contain any untrue statement of a material fact or omit to state any material fact necessary in order to make the statements made therein, in the light of the circumstances under which they were made, not misleading.

Section 3.10. *Absence of Certain Changes or Events.* (a) Since the Company Balance Sheet Date, there has not been any change, effect, event, occurrence, state of facts or development that has had or would reasonably be expected to have, individually or in the aggregate, a Company Material Adverse Effect.

(b) Since the Company Balance Sheet Date and through the date of this Agreement, the Company and its Subsidiaries have conducted their respective businesses in all material respects in the ordinary course consistent with their past practices, and there has not been:

(i) any declaration, setting aside or payment of any dividend or other distribution with respect to any shares of capital stock of the Company or any of its Subsidiaries, other than (A) in the case of the Company, regular quarterly cash dividends and (B) in the case of any direct or indirect wholly owned Subsidiary of the Company, dividends or distributions to its parent;

(ii) except as required by the terms of the Company Convertible Notes, any repurchase, redemption or other acquisition by the Company or any of its Subsidiaries of any Company Securities or Company Subsidiary Securities;

(iii) any split, combination, subdivision or reclassification of any Company Securities or Company Subsidiary Securities;

(iv) except as required to comply with any Applicable Law or any Employee Plans as in effect on the Company Balance Sheet Date, (A) any grant of any severance, change in control or termination pay to any director or executive officer of the Company, (B) any entry into any employment, consulting, change in control, deferred compensation or other similar agreement, plan, arrangement or policy (or any material amendment to any such agreement, plan, arrangement or policy) with any director or executive officer of the Company, (C) any increase in the compensation or benefits payable under any severance, change in control or termination pay policies or Employee Plans (except as provided

under the terms thereof as a result of increases in compensation permitted under clause (D)), (D) any increase in the compensation, bonus or other benefits payable to any director, officer or employee of the Company or any of its Subsidiaries, other than normal increases in base salary (and, any corresponding increases in the dollar amount of target bonuses that result from such base salary increases) and wages in the ordinary course of business consistent with past practice, (E) any establishment, adoption, entry into, amendment, modification or termination of any collective bargaining agreement, (F) any establishment, adoption, entry into, termination, or amendment or modification in any material respect, of any material Employee Plan or (G) the taking of any action to accelerate any material compensation or benefits, including vesting and payment, or the making of any material determinations, under any collective bargaining agreement or Employee Plan;

(v) any material change in the Company's method of accounting or accounting principles or practices, except for any such change required by reason of a change in GAAP or by Regulation S-X under the Exchange Act, as approved by its independent public accountants;

(vi) any amendment of any material Tax Return or the making of any material Tax election; and

(vii) any material modification of any Communications License.

Section 3.11. *No Undisclosed Material Liabilities.* None of the Company or any of its Subsidiaries has any liabilities or obligations of any nature, whether accrued, contingent, absolute or otherwise, other than:

(a) liabilities or obligations disclosed and provided for in the Company Balance Sheet or in the notes thereto;

(b) liabilities or obligations of a nature disclosed and provided for in the Company Balance Sheet or in the notes thereto and incurred in the ordinary course of business since the Company Balance Sheet Date in amounts consistent with past practice; or

(c) liabilities or obligations that would not reasonably be expected to have, individually or in the aggregate, a Company Material Adverse Effect.

Section 3.12. *Litigation.* There is no suit, claim, action, proceeding or investigation pending against or, to the knowledge of the Company, threatened against the Company or any of its Subsidiaries that would reasonably be expected to have, individually or in the aggregate, a Company Material Adverse Effect, nor is there any judgment, settlement agreement, decree, inquiry, rule or order outstanding against the Company or any of its Subsidiaries that would reasonably be expected to have, individually or in the aggregate, a Company Material Adverse Effect. This Section 3.12 does not relate to environmental matters, which are the subject of Section 3.19.

Section 3.13. *Taxes.* (a) All material federal, state, local and foreign Tax Returns required to have been filed by or on behalf of the Company and each of its Subsidiaries have been timely filed, and all such filed Tax Returns were complete and accurate at the time of filing, except to the extent any failure to file or any inaccuracies in filed Tax Returns would not reasonably be expected to have, individually or in the aggregate, a Company Material Adverse Effect. All Taxes shown to be due on such Tax Returns have been paid, or adequately reserved for in accordance with GAAP, except to the extent any failure to pay or reserve would not reasonably be expected to have, individually or in the aggregate, a Company Material Adverse Effect. There is no audit, examination, deficiency, refund litigation, proposed adjustment or matter in controversy with respect to any Taxes due or owing by the Company or any of its Subsidiaries which would reasonably be expected to have, individually or in the aggregate, a Company Material Adverse Effect.

(b) The relevant statute of limitations is closed with respect the U.S. federal income Tax Returns of the Company and its Subsidiaries for all years through 2002.

(c) Neither the Company nor any of its Subsidiaries has constituted either a "distributing corporation" or a "controlled corporation" (i) in a distribution of stock qualifying for Tax-free treatment under Section 355 of the Code in the two years prior to the date of this Agreement or (ii) in a distribution that could otherwise constitute part of a "plan" or "series of related transactions" (within the meaning of Section 355(e) of the Code) in conjunction with the Merger or any of the other transactions contemplated by this Agreement.

(d) The Company and its Subsidiaries have adequately disclosed on the appropriate Tax Returns information about any "listed transaction" (within the meaning of Section 1.6001-4(b) of the Treasury regulations) or any similar transaction under any other Tax law, including state or local Tax laws, in which the Company or any of its Subsidiaries has ever participated, in accordance with Section 1.6011-4 of the Treasury regulations or any similar provision of any other Tax law, including state or local Tax laws.

(e) For purposes of this Agreement, (i) "Taxes" means any and all federal, state, local, foreign or other taxes of any kind (together with any and all interest, penalties, additions to tax and additional amounts imposed with respect thereto) imposed by any taxing authority, including, without limitation, taxes or other charges on or with respect to income, franchises, windfall or other profits, gross receipts, property, sales, use, capital stock, payroll, employment, social security workers' compensation, unemployment compensation, or net worth, and taxes or other charges in the nature or excise, withholding, ad valorem or value added, and (ii) "Tax Return" means any return, report or similar statement (including the attached schedules) required to be filed with a taxing authority with respect to any Tax, including, without limitation, any information return, claim for refund, amended return or declaration of estimated Tax.

Section 3.14. *Employee Benefit Matters.* (a) Set forth in Section 3.14(a) of the Company Disclosure Schedule is a true and complete list, as of the date of this

Agreement, of all Title IV Plans, all Employee Plans that provide for stock-based, severance, change in control, termination or similar compensation or benefits or that are maintained primarily for directors or officers of the Company or any of its Subsidiaries and all other material Employee Plans. The Company has made available to Parent true and complete copies of each such Employee Plan, and all amendments thereto, together with the most recent annual report, actuarial report, financial statements and summary plan description, in each case if applicable, prepared in connection therewith.

(b) As of December 31, 2005, the difference between (i) the fair market value of the assets of each Employee Plan subject to Title IV of ERISA (a "Title IV Plan") (excluding for these purposes any accrued but unpaid contributions) and (ii) the present value of all benefits accrued under such Title IV Plan determined on an accumulated benefit obligation basis was as set forth in Section 3.14(b) of the Company Disclosure Schedules. No "accumulated funding deficiency," as defined in Section 412 of the Code, has been incurred with respect to any Employee Plan subject to such Section 412, whether or not waived. No "reportable event," within the meaning of Section 4043 of ERISA, other than a "reportable event" that would not reasonably be expected to have, individually or in the aggregate, a Company Material Adverse Effect, and no event described in Sections 4062 or 4063 of ERISA, has occurred in connection with any Employee Plan. Neither the Company nor any ERISA Affiliate thereof has (A) engaged in a "prohibited transaction" (as such term is defined in Section 406 of ERISA or Section 4975 of the Code) or any other breach of fiduciary responsibility that could subject the Company or any of its Subsidiaries to any material Tax or penalty on prohibited transactions imposed by Section 4975 of the Code or to any material liability under Section 502 of ERISA, (B) engaged in, or is a successor or parent corporation to an entity that has engaged in, a transaction described in Sections 4069 or 4212(c) of ERISA or (C) incurred, or reasonably expects to incur prior to the Effective Time (1) any liability under Title IV of ERISA arising in connection with the termination of, or a complete or partial withdrawal from, any plan covered or previously covered by Title IV of ERISA or (2) any liability under Section 4971 of the Code that, in each case, could become a liability of Parent or any of its ERISA Affiliates after the Effective Time. None of the Company nor any of its ERISA Affiliates makes contributions to, or has any liability under, any multiemployer plan (as defined in Section 3(37) of ERISA).

(c) Each Employee Plan which is intended to be qualified under Section 401(a) of the Code has received a favorable determination letter, or has pending or has time remaining in which to file an application for such determination letter from the Internal Revenue Service, and the Company is not aware of any reason why any such determination letter should be revoked or not be reissued. The Company has made available to Parent true and complete copies of the most recent Internal Revenue Service determination letters with respect to each such Employee Plan. Each Employee Plan has been maintained in compliance with its terms and with the requirements prescribed by any and all statutes, orders, rules and regulations which are applicable to such Employee Plan, except where such non-compliance would not reasonably be expected to have, individually or in the aggregate, a Company Material Adverse Effect.

(d) With respect to any Employee Plan that is an "employee welfare benefit plan," as defined in Section 3(3) of ERISA, whether or not subject to ERISA, (i) no such Plan is unfunded, funded through a "welfare benefits fund" (as defined in Section 419(e) of the Code) or similar arrangement or self-insured and (ii) no such Employee Plan provides health or welfare benefits (whether or not insured) with respect to employees or former employees of the Company or any of its Subsidiaries (or any of their beneficiaries) after retirement or other termination of service (other than coverage or benefits (A) required to be provided under Part 6 of Title I of ERISA or any other similar Applicable Law or (B) the full cost of which is borne by employees or former employees of the Company or any of its Subsidiaries (or any of their beneficiaries)).

(e) Except as provided in Section 1.04, no current or former director, officer or employee of the Company or any of its Subsidiaries will be entitled to (i)(A) any severance, separation, change of control, termination, bonus or other additional compensation or benefits or (B) any acceleration of the time of payment or vesting of any compensation or benefits or the forgiveness of indebtedness owed by such employee, in each case as a result of any of the transactions contemplated hereby (alone or in combination with any other event) or in connection with the termination of such Person's employment on or after the Closing or (ii) any compensation or benefits related to or contingent upon, or the value of which will be calculated on the basis of, any of the transactions contemplated hereby (alone or in combination with any other event). The execution and delivery of this Agreement and the consummation of the transactions contemplated hereby (alone or in combination with any other event) and compliance by the Company with the provisions hereof do not and will not require the funding (whether through a grantor trust or otherwise) of, or increase the cost of, or give rise to any other obligation under, any Employee Plan and will not result in any breach or violation of, or default under, or limit the ability of the Company or any of its Subsidiaries to amend, modify or terminate, any Employee Plan.

(f) (i) No amount, economic benefit or other entitlement that could be received (whether in cash or property or the vesting of property) as a result of the transactions contemplated hereby (alone or in combination with any other event) by any person who is a "disqualified individual" (as defined in Treasury Regulation Section 1.280G-1) with respect to the Company would be characterized as an "excess parachute payment" (as defined in Section 280G(b)(1) of the Code). (ii) No director, officer or employee of the Company or any of its Subsidiaries is entitled to receive any additional payment from the Company, any of its Subsidiaries or any other Person in the event that the excise Tax required by Section 4999(a) of the Code, any Tax imposed under Section 409A of the Code or any other Tax is imposed on such individual.

(g) For purposes of this Agreement, the following terms shall have the meanings set forth below:

"Code" means the Internal Revenue Code of 1986, as amended, and the rules and regulations promulgated thereunder.

**“Employee Plan”** means any (x) “employee benefit plan”, as defined in Section 3(3) of ERISA; (y) any employment, consultancy, severance, change of control or similar agreement, plan, arrangement or policy; or (z) any other agreement, plan, arrangement or policy providing for compensation, bonuses, profit-sharing, equity or equity-based compensation or other forms of incentive or deferred compensation, vacation benefits, insurance (including any self-insured arrangements), welfare, disability or sick leave benefits, employee assistance program, supplemental unemployment benefits or post-employment or retirement benefits (including compensation, welfare, pension or insurance benefits) or perquisites or fringe benefits; that, in any such case referred to in clause (x), (y) or (z), is sponsored, maintained, administered, or contributed to by the Company or any Subsidiary of the Company, or that is required to be maintained or contributed to by the Company or any Subsidiary of the Company, and covers any current or former director, officer or employee of the Company or any of its Subsidiaries or with respect to which the Company or any of its Subsidiaries has any liability.

**“ERISA”** means the Employee Retirement Income Security Act of 1974, as amended, and the rules and regulations promulgated thereunder.

**“ERISA Affiliate”** of any entity means any other entity which, together with such entity, would be treated as a single employer under Section 414(b) or (c) of the Code.

Section 3.15. *Labor Matters.* Except as would not reasonably be expected to have, individually or in the aggregate, a Company Material Adverse Effect, (a) neither the Company nor any of its Subsidiaries is party to any labor union or collective bargaining agreement, and as of the date of this Agreement no such agreement is being negotiated by the Company or any of its Subsidiaries, (b) no employees of the Company or any of its Subsidiaries are represented by any labor organization, (c) as of the date hereof, no labor organization or group of employees of the Company or any of its Subsidiaries has made a pending demand for recognition or certification, and there are no representation or certification proceedings or petitions seeking a representation proceeding presently pending or, to the knowledge of the Company, threatened to be brought or filed with the National Labor Relations Board or any other labor relations tribunal or authority, (d) to the knowledge of the Company, as of the date hereof, there are no formal organizing activities involving a material number of employees of the Company or any of its Subsidiaries pending with, or threatened by, any labor organization, (e) within the past three years, there have been no strikes, work stoppages, slowdowns, lockouts, arbitrations or other labor disputes (other than with respect to grievances) pending or, to the knowledge of the Company, threatened against the Company or any of its Subsidiaries, (f) there are no grievances pending or, to the knowledge of the Company, threatened against the Company or any of its Subsidiaries, (g) there is no unfair labor practice charge, claim or proceeding pending before the National Labor Relations Board or any comparable administrative body with respect to the Company or any of its Subsidiaries, (h) neither the Company nor any of its Subsidiaries is in breach of any collective bargaining agreement and (i) neither the Company nor any of its Subsidiaries is a party to, or otherwise bound by, any consent

decree with, or citation by, any Governmental Authority relating to employees or employment practices.

Section 3.16. *Compliance with Laws.* The Company and its Subsidiaries hold all Licenses necessary for them to own, lease and operate their properties and to conduct their businesses, except where the failure to hold any of the foregoing would not reasonably be expected to have, individually or in the aggregate, a Company Material Adverse Effect. The Company and its Subsidiaries are not in violation of any such Licenses or any Applicable Law, except where such violations would not reasonably be expected to have, individually or in the aggregate, a Company Material Adverse Effect. Each License issued to the Company or any of its Subsidiaries by the FCC or the PPUC (collectively, the “**Communications Licenses**”) is set forth, as of the date of this Agreement, in Section 3.16 of the Company Disclosure Schedule. This Section does not relate to environmental matters, which are the subject of Section 3.19.

Section 3.17. *Finders' Fees.* Except for Evercore, a true and complete copy of whose engagement agreement has been provided to Parent, there is no investment banker, broker, finder or other intermediary which has been retained by or is authorized to act on behalf of the Company or any Subsidiary of the Company who might be entitled to any fee or commission from the Company, Parent or Merger Subsidiary or any of their Affiliates in connection with the transactions contemplated by this Agreement. For purposes of this Agreement, “**Affiliate**” means, with respect to any Person, any other Person directly or indirectly controlling, controlled by, or under common control with such Person.

Section 3.18. *Title to Properties; Encumbrances; Intellectual Property.* (a) Except as would not reasonably be expected to have, individually or in the aggregate, a Company Material Adverse Effect, the Company and each of its Subsidiaries has good and valid title to (or in the case of leased assets, valid leasehold interests in) the assets set forth on the Company Balance Sheet (other than those disposed of in the ordinary course of business since the Company Balance Sheet Date), free and clear of all Liens other than Company Permitted Liens. Except as would not reasonably be expected to have, individually or in the aggregate, a Company Material Adverse Effect, the Company and each of its Subsidiaries owns or has the lawful right to use all assets, properties, Intellectual Property Rights, operating rights, rights-of-way, easements, contracts, leases, and other instruments necessary to operate its business as presently conducted. For purposes of this Agreement, “**Company Permitted Liens**” means (i) materialmen’s, mechanics’, carriers’, workmen’s, warehousemen’s, repairmen’s, and other like Liens arising in the ordinary course of business, and deposits to obtain the release of such Liens, (ii) Liens imposed by Applicable Laws for (A) Taxes not yet due and payable or (B) Taxes that the Company or any of its Subsidiaries is contesting in good faith through appropriate proceedings and for which adequate reserves, in accordance with GAAP, have been established, (iii) Liens disclosed on the Company Balance Sheet or the notes thereto, (iv) zoning, building and other similar codes and regulations and (v) other immaterial Liens (other than Liens securing Indebtedness).

(b) Each real property owned by the Company or any of its Subsidiaries that is material to the Company and its Subsidiaries, taken as a whole (a “**Material Owned Real Property**”), is set forth, as of the date of this Agreement, in Section 3.18(b) of the Company Disclosure Schedule. The Company or a Subsidiary of the Company has good and marketable title to the Material Owned Real Property, free and clear of all Liens other than Company Permitted Liens, and there are no outstanding options, rights of first offer or rights of first refusal to purchase any Material Owned Real Property or any material portion thereof or interest therein.

(c) Each real property leased by the Company or any of its Subsidiaries that is material to the Company and its Subsidiaries, taken as a whole (a “**Material Leased Real Property**”), is set forth, as of the date of this Agreement, in Section 3.18(c) of the Company Disclosure Schedule. The Company or a Subsidiary of the Company has a good and valid title to a leasehold interest in each Material Leased Real Property.

(d) (i) Each patent, patent application, trademark registration, trademark application, registered service mark, registered copyright and internet domain name, in each case, that is owned by the Company or any of its Subsidiaries and is material to the Company and its Subsidiaries, taken as a whole (“**Material Intellectual Property**”), is set forth, as of the date of this Agreement, in Section 3.18(d) of the Company Disclosure Schedule.

(ii) Except as would not reasonably be expected to have, individually or in the aggregate, a Company Material Adverse Effect:

(w) all Material Intellectual Property is valid, subsisting and enforceable;

(x) there are no claims or proceedings made or, to the knowledge of the Company, threatened against the Company or any of its Subsidiaries with respect to (A) the ownership, validity, use or enforceability of any Material Intellectual Property or (B) the operation of the business of the Company or any of its Subsidiaries infringing or misappropriating any Intellectual Property Rights of any Person (including any demand or request that the Company or any of its Subsidiaries license any rights from any Person);

(y) none of the Material Intellectual Property is subject to any outstanding order, ruling, judgment, decree or stipulation by or with any Governmental Authority, or any agreement, understanding or undertaking with any Person, restricting the scope of use of any Material Intellectual Property; and

(z) no Person has infringed upon or misappropriated, or is currently infringing upon or misappropriating, any Material Intellectual Property.

(iii) For purposes of this Agreement, “**Intellectual Property Rights**” means, collectively, whether arising under the laws of the United States or any other state, country or jurisdiction: (A) trade secrets and confidential information, patents, patent applications, patent disclosures and inventions, including all reissues, continuations, divisions, continuations in part and renewals and extensions thereof; (B) trademarks, service marks, trade dress, trade names, slogans, logos and corporate names and registrations and applications for registration thereof; (C) copyrights (registered or unregistered) and registrations and applications for registration thereof; (D) computer software (including both source and object code), proprietary data and data bases; and (E) internet domain name registrations.

Section 3.19. *Environmental Matters.* (a) Except as would not reasonably be expected to have, individually or in the aggregate, a Company Material Adverse Effect:

(i) no written notice, demand, order, complaint, information request or other communication alleging actual or potential liability has been received by the Company or any of its Subsidiaries arising out of, relating to or based upon any Environmental Laws, and there are no judicial, administrative or other actions, suits, claims, investigations or proceedings pending or, to the Company’s knowledge, threatened which allege a violation by the Company or any of its Subsidiaries of any Environmental Laws;

(ii) the Company and each of its Subsidiaries has all Licenses necessary for their operations to comply with all applicable Environmental Laws (“**Company Environmental Licenses**”), all such Company Environmental Licenses are in full force and effect, and the Company and each of its Subsidiaries are in compliance with the terms of such Company Environmental Licenses;

(iii) the Company and each of its Subsidiaries are and have been in compliance with the terms of applicable Environmental Laws;

(iv) there has been no release of Hazardous Materials, and there are no Hazardous Materials present, in each case, at, on, under or from any property currently or formerly owned, leased or operated by the Company or any of its Subsidiaries that have resulted or would reasonably be expected to result in costs or liability to the Company or any of its Subsidiaries under any Environmental Law;

(v) none of the Company or any of its Subsidiaries has entered into or agreed to, or, to the knowledge of the Company, is otherwise subject to the terms of, any judgment, decree or order arising under, based upon or relating to Environmental Law or to the investigation or remediation of Hazardous Materials; and

(vi) none of the Company or any of its Subsidiaries has generated, stored, used, emitted, discharged, released, disposed of or arranged for the

disposal of any Hazardous Materials except in material compliance with, and in a manner that has not resulted and would not reasonably be expected to result in liability to the Company or any of its Subsidiaries under, applicable Environmental Laws.

(b) For purposes of this Agreement, the term “**Environmental Laws**” means all Applicable Laws relating to pollution, natural resources or protection of endangered or threatened species, human health (as relating to Hazardous Materials) or the environment (including ambient air, surface water, groundwater, land surface or subsurface strata). For purposes of this Agreement, the term “**Hazardous Materials**” means any petroleum or petroleum byproducts, radioactive materials or wastes, asbestos in any form, polychlorinated biphenyls, creosote, electromagnetic or radio frequency emissions, and any other chemical, material, substance or waste that in relevant form or concentration is prohibited, limited or regulated under any Environmental Law.

Section 3.20. *Contracts.* Section 3.20 of the Company Disclosure Schedule sets forth, as of the date of this Agreement, a true and complete list, and the Company has made available to Parent true and complete copies, of:

(i) each agreement, understanding or undertaking that would be required to be filed by the Company as a “material contract” pursuant to Item 601(b)(10) of Regulation S-K under the Securities Act or that, if terminated or subject to a default by any party thereto, would reasonably be expected to result in a Company Material Adverse Effect;

(ii) each agreement, understanding or undertaking to which the Company or any of its Subsidiaries is a party that restricts in any material respect the ability of the Company or any of its Subsidiaries to compete in any business or with any Person in any geographical area;

(iii) each loan and credit agreement, note, debenture, bond, indenture or other similar agreement pursuant to which any Indebtedness of the Company or any of its Subsidiaries, in each case in excess of \$100,000, is outstanding or may be incurred, other than any such agreement between or among the Company and its wholly owned Subsidiaries;

(iv) each agreement, understanding or undertaking to which the Company or any of its Subsidiaries is a party for the acquisition or disposition by the Company or any of its Subsidiaries of properties or assets that, in each case, have a fair market value or purchase price of more than \$500,000; and

(v) each partnership, joint venture or other similar agreement or understanding to which the Company or any of its Subsidiaries is a party relating to the formation, creation, operation, management or control of any partnership or joint venture material to the Company and its Subsidiaries.

Each agreement, understanding or undertaking of the type described in clauses (i) through (v) above, and each lease agreement for any Material Leased Real Property, is

referred to herein as a “**Company Material Agreement**”. Each Company Material Agreement is a valid, binding and legally enforceable obligation of the Company or one of its Subsidiaries, as the case may be, and, to the knowledge of the Company, of the other parties thereto, subject to the Enforceability Exceptions, and is in full force and effect, except for such failures to be valid, binding and legally enforceable or to be in full force and effect as would not reasonably be expected to have, individually or in the aggregate, a Company Material Adverse Effect. Subject to such exceptions as would not reasonably be expected to have, individually or in the aggregate, a Company Material Adverse Effect, there is no default under any Company Material Agreement by the Company or any of its Subsidiaries or, to the knowledge of the Company, by any other party thereto, and no event has occurred that with the lapse of time or the giving of notice or both would constitute a default thereunder by the Company or any of its Subsidiaries or, to the knowledge of the Company, by any other party thereto.

Section 3.21. *Antitakeover Statutes.* The Company has taken all action necessary to exempt this Agreement, the Merger and the other transactions contemplated hereby from Subchapters E, F, G, H, I and J of Chapter 25 of the Pennsylvania Law, and, accordingly, neither such Subchapters nor any other antitakeover or similar statute or regulation applies to any such transactions.

Section 3.22. *No Other Representations.* Except as expressly set forth in this Agreement or in any certificate delivered by or on behalf of the Company pursuant to Section 8.03(a), the Company makes no representations or warranties to Parent or Merger Subsidiary. Further, the Company acknowledges that neither Parent nor Merger Subsidiary makes or has made any representation or warranty to the Company, except as expressly set forth in this Agreement or in any certificate delivered by or on behalf of Parent pursuant to Section 8.04(a).

#### ARTICLE 4 REPRESENTATIONS AND WARRANTIES OF PARENT

Except as disclosed in the Parent SEC Documents filed prior to the date hereof (excluding any disclosures in the Parent SEC Documents under the heading “Risk Factors” and any other disclosures of risks that are predictive or forward-looking in nature) or in a separate disclosure schedule (the “**Parent Disclosure Schedule**”) which has been delivered by Parent to the Company prior to the execution of this Agreement (each section of which qualifies the correspondingly numbered representation and warranty to the extent specified therein and such other representations and warranties to the extent a matter in such section is disclosed in such a way as to make its relevance to the information called for by such other representation and warranty readily apparent), Parent represents and warrants to the Company that:

Section 4.01. *Organization and Authority.* Each of Parent and Merger Subsidiary is a corporation duly organized, validly existing and in good standing under the laws of its jurisdiction of incorporation. Each of Parent and Merger Subsidiary has all requisite corporate power to carry on its business as now being conducted. Each of Parent and

Merger Subsidiary is duly qualified to do business as a foreign corporation and is in good standing in each jurisdiction where the character of the property owned or leased by it or the nature of its activities makes such qualification necessary, with such exceptions as would not reasonably be expected to have, individually or in the aggregate, a Material Adverse Effect on Parent ("**Parent Material Adverse Effect**"). The execution, delivery and performance by Parent and Merger Subsidiary of this Agreement and the consummation by Parent and Merger Subsidiary of the transactions contemplated hereby are within the corporate powers of Parent and Merger Subsidiary and have been duly authorized by all necessary corporate action. This Agreement has been duly executed and delivered by each of Parent and Merger Subsidiary and constitutes a valid and binding agreement of each of Parent and Merger Subsidiary, enforceable against each of Parent and Merger Subsidiary in accordance with its terms, subject to the Enforceability Exceptions. Parent has delivered to the Company true and complete copies of the Certificate of Incorporation and Bylaws of Parent, each in effect as of the date hereof, and the Articles of Incorporation and Bylaws of Merger Subsidiary, each in effect as of the date hereof. Since the date of its incorporation, Merger Subsidiary has not engaged in any activities other than in connection with or as contemplated by this Agreement.

Section 4.02. *No Breach.* The execution and delivery by Parent and Merger Subsidiary of this Agreement do not, and the consummation of the transactions contemplated hereby by Parent and Merger Subsidiary will not, (i) violate or conflict with the Certificate of Incorporation or Bylaws of Parent, or the Articles of Incorporation or Bylaws of Merger Subsidiary, (ii) constitute a breach or default of (with or without notice or lapse of time, or both), or give rise to any third-party right of termination, cancellation, modification or acceleration under, or to a loss of a benefit of Parent or any of its Subsidiaries under, any agreement, understanding or undertaking to which Parent or Merger Subsidiary or any of their Subsidiaries is a party or by which any of them is bound, or give rise to any Lien on any of their properties, or (iii) subject to obtaining the approvals and making the filings described in Section 4.03 hereof, constitute a violation or breach of any provision of any Applicable Law, with such exceptions in the cases of subsections (ii) and (iii) as would not, individually or in the aggregate, reasonably be expected to have a Parent Material Adverse Effect or materially interfere with or delay the consummation of the transactions contemplated hereby.

Section 4.03. *Consents and Approvals.* The execution and delivery of this Agreement by Parent and Merger Subsidiary and the consummation of the transactions contemplated hereby by Parent and Merger Subsidiary require no consent, approval, authorization or permit of, or filing with or notification to, any Governmental Authority, except (i) compliance with any applicable requirements of the Securities Act, the Exchange Act and any other applicable securities laws, whether federal, state or foreign, (ii) for notification pursuant to the HSR Act and expiration or termination of the waiting period thereunder, (iii) for the filing of the articles of merger under Pennsylvania Law, the certificate of merger under Delaware Law and related filings as set forth in Section 1.01 hereof, (iv) for approvals of and filings with the FCC and the PPUC, and (v) where the failure to obtain such consents, approvals, authorizations or permits, or to make such filings or notifications, would not, individually or in the aggregate, reasonably

be expected to have a Parent Material Adverse Effect or materially interfere with or delay the consummation of the transactions contemplated hereby.

Section 4.04. *Approval of the Board; No Vote Required.* The Board of Directors of Parent has, by resolutions duly adopted at meetings duly called and held, approved this Agreement, the Merger and the other transactions contemplated hereby. No vote of holders of any class or series of capital stock of Parent is necessary to approve this Agreement or the Merger.

Section 4.05. *Capitalization.* (a) The authorized capital stock of Parent consists of 600,000,000 shares of Parent Stock and 50,000,000 shares of preferred stock, par value \$0.01 per share ("**Parent Preferred Stock**"). At the close of business on August 31, 2006, there were outstanding (i) 321,311,189 shares of Parent Stock, (ii) 6,196,144 stock options to purchase shares of Parent Stock under any compensatory plan or arrangement of Parent, (iii) 1,498,271 share units granted or otherwise issued under any compensatory plan or arrangement of Parent and (iv) no shares of Parent Preferred Stock. At the close of business on August 31, 2006, 778,091 shares of Parent Stock were reserved for issuance upon conversion of the Citizens Utilities Trusts' 5% Company Obligated Mandatorily Redeemable Convertible Preferred Securities due 2036. Except as set forth in this Section 4.05, at the close of business on August 31, 2006, there were no outstanding (A) shares of capital stock or other voting securities of Parent, (B) securities of Parent convertible into or exchangeable for shares of capital stock or other voting securities of Parent, (C) options or other rights to acquire from Parent any capital stock, voting securities or securities convertible into or exchangeable for capital stock or voting securities of Parent, or any rights against or obligating Parent that give the holder thereof any economic interest of a nature occurring to the holders of shares of Parent Stock (the items in clauses (A), (B) and (C) of this sentence being referred to collectively as the "**Parent Securities**") or (D) obligations of Parent to issue, deliver or sell any Parent Security, other than the Parent Series A Participating Preferred Stock purchase rights issued pursuant to the Rights Agreement dated as of March 6, 2002, between Parent and Mellon Investor Services LLC. The authorized capital stock of the Merger Subsidiary consists of 1,000 shares of common stock, par value \$0.01 per share, of which 1,000 shares are issued and outstanding, all of which shares are beneficially owned by Parent. Except as would not reasonably be expected to have, individually or in the aggregate, a Parent Material Adverse Effect, with respect to the compensatory stock options to purchase shares of Parent Stock ("**Parent Options**"), (I) each grant of a Parent Option was duly authorized no later than the Grant Date by all necessary corporate action, including, as applicable, approval by the Board of Directors of Parent (or a duly constituted and authorized committee thereof) and any required stockholder approval by the necessary number of votes or written consents, and the award agreement governing such grant (if any) was duly executed and delivered by each party thereto, (II) each such grant was made in accordance with the terms of the applicable compensation plan or arrangement of Parent, the Exchange Act and all other Applicable Laws and regulatory rules or requirements, including the rules of the New York Stock Exchange (the "**NYSE**"), (III) the per share exercise price of each Parent Option was equal to the fair market value of a share of Parent Stock on the applicable Grant Date and (IV) each such grant was properly accounted for in accordance with GAAP in the financial statements

(including the related notes) of Parent and disclosed in the Parent SEC Documents in accordance with the Exchange Act and all other Applicable Laws.

(b) The shares of Parent Stock to be issued as part of the Merger Consideration have been duly authorized and, when issued and delivered in accordance with the terms of this Agreement, will have been validly issued and will be fully paid and nonassessable and the issuance thereof is not subject to any preemptive or other similar right.

Section 4.06. *SEC Filings and the Sarbanes-Oxley Act.* (a) Parent has filed or furnished all reports, schedules, forms, statements and other documents (including exhibits and other information incorporated therein) with the SEC required to be filed or furnished by Parent since January 1, 2004 (the “**Parent SEC Documents**”).

(b) As of its filing date, each Parent SEC Document complied as to form in all material respects with the requirements of the Exchange Act or the Securities Act, as the case may be.

(c) As of its filing date, none of the Parent SEC Documents filed pursuant to the Exchange Act contained any untrue statement of a material fact or omitted to state any material fact necessary in order to make the statements made therein, in the light of the circumstances under which they were made, not misleading. Except to the extent that information contained in any such Parent SEC Document has been revised, amended, supplemented or superseded by a subsequent Parent SEC Document, none of the Parent SEC Documents filed pursuant to the Exchange Act contains any untrue statement of a material fact or omits to state any material fact in circumstances where an amendment, supplement or corrective filing to any such Parent SEC Document is required under the Exchange Act.

(d) None of the Parent SEC Documents that is a registration statement, as amended or supplemented, if applicable, filed pursuant to the Securities Act, as of the date such statement or amendment became effective, contained any untrue statement of a material fact or omitted to state any material fact required to be stated therein or necessary to make the statements therein not misleading.

(e) Parent has established and maintains disclosure controls and procedures (as defined in Rule 13a-15 under the Exchange Act). Such disclosure controls and procedures are designed to ensure that material information relating to Parent, including its consolidated Subsidiaries, is made known to Parent’s principal executive officer and its principal financial officer by others within those entities, particularly during the periods in which the periodic reports required under the Exchange Act are being prepared. Such disclosure controls and procedures are designed to be effective in timely alerting Parent’s principal executive officer and principal financial officer to material information required to be included in Parent’s periodic reports required under the Exchange Act.

(f) Since March 31, 2005, Parent and its Subsidiaries have established and maintained a system of internal controls. Such internal controls are sufficient in all

material respects to provide reasonable assurance regarding the reliability of Parent's financial reporting and the preparation of Parent financial statements for external purposes in accordance with GAAP. Parent has disclosed, based on its most recent evaluation of internal controls prior to the date hereof, to Parent's auditors and audit committee (x) any significant deficiencies and material weaknesses in the design or operation of internal controls which are reasonably likely to adversely affect Parent's ability to record, process, summarize and report financial information and (y) any fraud, whether or not material, that involves management or other employees who have a significant role in internal controls. Parent has made available to the Company a summary of any such disclosure made by management to Parent's auditors and audit committee since January 1, 2005.

(g) Parent has made available to the Company true and complete copies of all comment letters received by Parent from the SEC since January 1, 2005 and relating to the Parent SEC Documents, together with all written responses of Parent thereto. As of the date of this Agreement, there are no outstanding or unresolved comments in such comment letters received by Parent from the SEC, and, to the knowledge of Parent, none of the Parent SEC Documents is the subject of any ongoing review by the SEC.

Section 4.07. *Financial Statements.* The audited consolidated financial statements and unaudited consolidated interim financial statements of Parent included in the Parent SEC Documents when filed complied as to form in all material respects with the published rules and regulations of the SEC with respect thereto and fairly present in all material respects, and in conformity with GAAP applied on a consistent basis (except as may be indicated in the notes thereto), the consolidated financial position of Parent and its consolidated Subsidiaries as of the dates thereof and their consolidated results of operations and cash flows for the periods then ended (subject to normal year-end adjustments in the case of any unaudited interim financial statements). For purposes of this Agreement, "**Parent Balance Sheet**" means the consolidated balance sheet as of June 30, 2006 of Parent and its consolidated Subsidiaries set forth in Parent's Form 10-Q for the quarter ended as of June 30, 2006 and "**Parent Balance Sheet Date**" means June 30, 2006.

Section 4.08. *Disclosure Documents.* None of the information supplied by Parent or Merger Subsidiary for inclusion in (i) the Proxy Statement will, at the time the Proxy Statement or any amendment or supplement thereto is first mailed to the stockholders of the Company or at the time of the Company Stockholders' Meeting, contain any untrue statement of a material fact or omit to state any material fact necessary in order to make the statements made therein, in the light of the circumstances under which they were made, not misleading or (ii) the Registration Statement will, at the time the Registration Statement or any amendment or supplement thereto is declared effective by the SEC, contain any untrue statement of a material fact or omit to state any material fact necessary in order to make the statements made therein, in the light of the circumstances under which they were made, not misleading.

Section 4.09. *Absence of Certain Changes or Events.* (a) Since the Parent Balance Sheet Date, there has not been any change, effect, event, occurrence, state of

facts or development that has had or would reasonably be expected to have, individually or in the aggregate, a Parent Material Adverse Effect.

(b) Since the Parent Balance Sheet Date and through the date of this Agreement, Parent and its Subsidiaries have conducted their respective businesses in all material respects in the ordinary course consistent with their past practices, and there has not been (i) any declaration, setting aside or payment of any dividend or other distribution with respect to any shares of capital stock of Parent, other than regular quarterly cash dividends, (ii) any repurchase, redemption or other acquisition by Parent or any of its Subsidiaries of any Parent Securities or (iii) any split, combination, subdivision or reclassification of any Parent Securities.

(c) As of the date hereof, Parent is not engaged in active negotiations or discussions with any Person other than the Company regarding any acquisition, disposition or partnership that would reasonably be expected to be material to Parent and its Subsidiaries, taken as a whole.

Section 4.10. *No Undisclosed Material Liabilities.* None of Parent or any of its Subsidiaries has any liabilities or obligations of any nature, whether accrued, contingent, absolute or otherwise, other than:

(a) liabilities or obligations disclosed and provided for in the Parent Balance Sheet or in the notes thereto;

(b) liabilities or obligations of a nature disclosed and provided for in the Parent Balance Sheet or in the notes thereto and incurred in the ordinary course of business since the Parent Balance Sheet Date in amounts consistent with past practice; or

(c) liabilities or obligations that would not reasonably be expected to have, individually or in the aggregate, a Parent Material Adverse Effect.

Section 4.11. *Litigation.* There is no suit, claim, action, proceeding or investigation pending against or, to the knowledge of Parent, threatened against Parent or any of its Subsidiaries that would reasonably be expected to have, individually or in the aggregate, a Parent Material Adverse Effect, nor is there any judgment, settlement agreement, decree, inquiry, rule or order outstanding against Parent or any of its Subsidiaries that would reasonably be expected to have, individually or in the aggregate, a Parent Material Adverse Effect. This Section 4.11 does not relate to environmental matters, which are the subject of Section 4.15.

Section 4.12. *Taxes.* All material federal, state, local and foreign Tax Returns required to have been filed by or on behalf of Parent and each of its Subsidiaries have been timely filed, and all such filed Tax Returns were complete and accurate at the time of filing, except to the extent any failure to file or any inaccuracies in filed Tax Returns would not reasonably be expected to have, individually or in the aggregate, a Parent Material Adverse Effect. All Taxes shown to be due on such Tax Returns have been paid, or adequately reserved for in accordance with GAAP, except to the extent any failure to pay or reserve would not reasonably be expected to have, individually or in the

aggregate, a Parent Material Adverse Effect. There is no audit, examination, deficiency, refund litigation, proposed adjustment or matter in controversy with respect to any Taxes due or owing by Parent or any of its Subsidiaries which would reasonably be expected to have, individually or in the aggregate, a Parent Material Adverse Effect.

Section 4.13. *Compliance with Laws.* Parent and its Subsidiaries hold all Licenses necessary for them to own, lease and operate their properties and to conduct their businesses, except where the failure to hold any of the foregoing would not reasonably be expected to have, individually or in the aggregate, a Parent Material Adverse Effect. Parent and its Subsidiaries are not in violation of any such Licenses or any Applicable Law, except where such violations would not reasonably be expected to have, individually or in the aggregate, a Parent Material Adverse Effect. This Section 4.13 does not relate to environmental matters, which are the subject of Section 4.15.

Section 4.14. *Finders' Fees.* Except for Citigroup Global Markets Inc., whose fee and expenses shall be paid by Parent, there is no investment banker, broker, finder or other intermediary which has been retained by or is authorized to act on behalf of Parent or Merger Subsidiary who might be entitled to any fee or commission from Parent, Merger Subsidiary or the Company or any of their Affiliates in connection with the transactions contemplated by this Agreement.

Section 4.15. *Environmental Matters.* Except as would not reasonably be expected to have, individually or in the aggregate, a Parent Material Adverse Effect:

(a) no written notice, demand, order, complaint, information request or other communication alleging actual or potential liability has been received by Parent or any of its Subsidiaries arising out of, relating to or based upon any Environmental Laws, and there are no judicial, administrative or other actions, suits, claims, investigations or proceedings pending or, to Parent's knowledge, threatened which allege a violation by Parent or any of its Subsidiaries of any Environmental Laws;

(b) Parent and each of its Subsidiaries has all Licenses necessary for their operations to comply with all applicable Environmental Laws ("**Parent Environmental Licenses**"), all such Parent Environmental Licenses are in full force and effect, and Parent and each of its Subsidiaries are in compliance with the terms of such Parent Environmental Licenses;

(c) Parent and each of its Subsidiaries are and have been in compliance with the terms of applicable Environmental Laws;

(d) there has been no release of Hazardous Materials, and there are no Hazardous Materials present, in each case, at, on, under or from any property currently or formerly owned, leased or operated by Parent or any of its Subsidiaries that have resulted or would reasonably be expected to result in costs or liability to Parent or any of its Subsidiaries under any Environmental Law;

(e) none of Parent or any of its Subsidiaries has entered into or agreed to, or, to the knowledge of Parent, is otherwise subject to the terms of, any judgment, decree or order arising under, based upon or relating to Environmental Law or to the investigation or remediation of Hazardous Materials; and

(f) none of Parent or any of its Subsidiaries has generated, stored, used, emitted, discharged, released, disposed of or arranged for the disposal of any Hazardous Materials except in material compliance with, and in a manner that has not resulted and would not reasonably be expected to result in liability to Parent or any of its Subsidiaries under, applicable Environmental Laws.

Section 4.16. *Financing.* Parent has, or will have prior to the Closing Date, sufficient cash, available lines of credit or other sources of immediately available funds to enable it to make payment of the aggregate amount of Cash Merger Consideration and any other amounts to be paid by it hereunder in cash. Parent has delivered to the Company a true and complete copy of the commitment letter, dated as of September 17, 2006, between Parent and Citigroup Global Markets Inc.

Section 4.17. *Ownership of Shares.* Except as a result of entering into this Agreement or the transactions contemplated hereby, neither Parent, Merger Subsidiary nor any of Parent's other direct or indirect Subsidiaries is an "interested shareholder" (as defined in Section 2553 of Pennsylvania Law) of the Company. As of the date of this Agreement, none of Parent, Merger Subsidiary or any other direct or indirect Subsidiary of Parent beneficially owns any Common Shares.

Section 4.18. *No Other Representations.* Except as expressly set forth in this Agreement or in any certificate delivered by or on behalf of Parent pursuant to Section 8.04(a), Parent makes no representations or warranties to the Company. Further, Parent acknowledges that the Company does not make and has not made any representation or warranty to Parent or Merger Subsidiary, except as expressly set forth in this Agreement or in any certificate delivered by or on behalf of the Company pursuant to Section 8.03(a).

## ARTICLE 5 COVENANTS OF THE COMPANY

The Company agrees that:

Section 5.01. *Conduct of the Company.* Except as otherwise contemplated herein, as set forth in Section 5.01 of the Company Disclosure Schedule or as may be required by Applicable Law, from the date hereof until the Effective Time, the Company and its Subsidiaries shall operate substantially in the same lines of business as they now operate in, and shall conduct their business in the ordinary course consistent with past practice in all material respects and shall use their reasonable best efforts to preserve intact their business organizations and relationships with third parties, including Governmental Authorities, and to keep available the services of their present officers and

employees in all material respects. Without limiting the generality of the foregoing, and except as contemplated herein, as set forth in Section 5.01 of the Company Disclosure Schedule or as may be required by Applicable Law, from the date hereof until the Effective Time, without the prior written consent of Parent (which, in the case of clauses (b)(ii)(y), (f), (i), (j)(ii) and (o) below, shall not be unreasonably withheld or delayed):

(a) the Company will not, and will not permit any Subsidiary of the Company to, (i) adopt or propose any change in the Articles of Incorporation or Bylaws of the Company or a comparable organizational document of any Company Significant Subsidiary or (ii) except for Permitted Share Unit Adjustments, amend any term of any Company Security or any Company Subsidiary Security (in each case, whether by merger, consolidation or otherwise);

(b) the Company will not, and will not permit any Subsidiary of the Company to, (i) merge or consolidate with, or be sold to, any other Person or (ii) acquire (x) any Person or division or line of business of any Person or (y) any asset or assets that have a purchase price in excess of \$500,000, individually, or \$2,000,000, in the aggregate, except for new capital expenditures, which shall be subject to clause (i) below (in each case, whether by merger, consolidation, purchase of stock or otherwise);

(c) the Company will not, and will not permit any Subsidiary of the Company to, issue, deliver or sell, or authorize the issuance, delivery or sale of, any Company Securities or Company Subsidiary Securities, other than (i) the Permitted Additional Company Issuances and (ii) the issuance of any Company Subsidiary Securities to the Company or a wholly owned Subsidiary of the Company;

(d) the Company will not, and will not permit any Subsidiary of the Company to, incur or assume any indebtedness for borrowed money, issue or sell any debt securities or warrants or other rights to acquire any debt securities of the Company or any of its Subsidiaries, guarantee any such indebtedness or any debt securities of another Person, enter into any "keep well" or other agreement to maintain any financial condition of another Person or enter into any arrangement having the economic effect of any of the foregoing (collectively, "Indebtedness"), other than (i) Indebtedness owed to the Company or any wholly owned Subsidiary of the Company, (ii) refinancings of Indebtedness of the Company or any of its Subsidiaries outstanding on the date hereof, *provided* that the aggregate amount of such refinancing Indebtedness does not exceed the aggregate amount of the Indebtedness being refinanced, (iii) Indebtedness for borrowed money incurred solely to settle in cash obligations of the Company under the Company Convertible Notes arising upon the conversion thereof and (iv) any other Indebtedness in an amount not in excess of \$2,000,000 in the aggregate; *provided, however*, that, in the case of clauses (ii) and (iii) above, the term of Indebtedness permitted to be incurred thereunder does not exceed 366 days, unless such Indebtedness is prepayable at the option of the Company or a Subsidiary of the Company, as the case may be, without any premium or penalty;

(e) the Company will not, and will not permit any Subsidiary of the Company to, (i) split, combine, subdivide or reclassify any shares of its capital stock, other equity interests, securities convertible into or exercisable or exchangeable for capital stock or other equity interests, (ii) declare, set aside or pay any dividend or other distribution (whether in cash, stock or property or any combination thereof) in respect of its capital stock, other than (x) in the case of the Company, regular quarterly cash dividends, not to exceed, in the case of any such quarterly dividend, \$0.50 per share, and (y) in the case of any direct or indirect wholly owned Subsidiary of the Company, dividends or distributions to its parent, or (iii) except as required by the terms of the Company Convertible Notes, redeem, repurchase or otherwise acquire, or offer to redeem, repurchase or otherwise acquire, any Company Security or Company Subsidiary Security;

(f) the Company will not, and will not permit any Subsidiary of the Company to, sell, lease, license or otherwise dispose of any assets or property, other than (i) sale or other disposition of inventory or obsolete equipment and (ii) sale, lease, license or other disposition of any asset or assets with a fair market value not in excess of \$250,000, individually, or \$1,000,000 in the aggregate;

(g) the Company will not, and will not permit any Subsidiary of the Company to, create or incur any Lien on any material asset, other than Company Permitted Liens;

(h) the Company will not, and will not permit any Subsidiary of the Company to, make any loan, advance or investment to or in any Person, whether by purchase of stock or securities, contributions to capital or property transfers, other than (i) investments in its wholly owned Subsidiaries made in the ordinary course of business or (ii) advances to employees in the ordinary course of business consistent with past practice;

(i) the Company will not, and will not permit any Subsidiary of the Company to, make any capital expenditures, other than (i) in connection with the repair or replacement of facilities destroyed or damaged due to casualty or accident (whether or not covered by insurance) and (ii) otherwise substantially in accordance with the Company's capital expenditures plan made available to Parent in writing prior to the date of this Agreement;

(j) the Company will not, and will not permit any Subsidiary of the Company to, (i) amend the indentures governing the Company Convertible Notes, (ii) except in the ordinary course of business consistent with past practice and except in connection with any action permitted under clause (d) or (i) above, enter into, terminate, renew, extend, amend or modify in any material respect any Company Material Agreement (it being further agreed that the Company will, and will cause its Subsidiaries to, consult with Parent to the extent permitted by Applicable Law prior to entering into, renewing, extending, amending or modifying in any material respect any agreement, undertaking or understanding to which the Company or any of its Subsidiaries is or will be a party and that, in each case, provides for the acquisition by the Company or any of its Subsidiaries of material information technology (including software and maintenance services) or long-distance telephony services) or (iii) knowingly fail to enforce any material provision of any Company Material Agreement;

(k) the Company will not, and will not permit any Subsidiary of the Company to, except as required to comply with Employee Plans as in effect on the date hereof, (i) grant any severance, change in control or termination pay to any director, officer or employee of the Company or any of its Subsidiaries, (ii) hire or terminate the employment of any executive officer of the Company or any of its material operating Subsidiaries without reasonably consulting with Parent to the extent permitted by Applicable Law, (iii) enter into any employment, consulting, change in control, deferred compensation or other similar agreement, plan, arrangement or policy (or any material amendment to any such existing agreement, plan, arrangement or policy) with (A) any director or executive officer of the Company or any of its material operating Subsidiaries or (B), except in the ordinary course of business consistent with past practice, any other employee of the Company or any of its Subsidiaries, *provided* that no such agreement, plan, arrangement or policy may be entered into to the extent it would provide for a grant or increase of severance, change in control or termination pay prohibited under clauses (i) and (iv) of this Section 5.01(k), (iv) increase the compensation or benefits payable under any existing severance, change in control or termination pay policies or Employee Plans (except as provided under the terms thereof as a result of increases in compensation permitted under clause (v)), (v) increase the compensation, bonus or other benefits payable to any director, officer or employee of the Company or any of its Subsidiaries, except for (A) normal increases in base salary (and any corresponding increases in the dollar amount of target bonuses that result from such base salary increases) and wages in the ordinary course of business consistent with past practice and (B) increases in any other form of compensation or benefits in the ordinary course of business consistent with past practice and that do not materially increase the costs, obligations or liabilities of the Company or any of its Subsidiaries, (vi) establish, adopt, enter into, amend, modify or terminate any collective bargaining agreement, except in connection with renegotiation of expired collective bargaining agreements in the ordinary course of business consistent with past practice in a manner that does not materially increase the costs, obligations or liabilities of the Company or any of its Subsidiaries, (vii) establish, adopt, enter into, terminate, or amend or modify in any material respect any material Employee Plan, except for Employee Plans permitted to be entered into under clause (iii) above, or (viii) take any action to accelerate any material compensation or benefits, including vesting and payment, or make any material determinations, under any collective bargaining agreement or Employee Plan;

(l) the Company will not, and will not permit any Subsidiary of the Company to, effect or permit a "plant closing" or "mass layoff", as such terms are defined under the Worker Adjustment and Retraining Act of 1988, as amended;

(m) the Company will not, and will not permit any Subsidiary of the Company to, change the Company's method of accounting or accounting principles or practices, except for any such change required by reason of a change in GAAP or by Regulation S-X under the Exchange Act, as approved by its independent public accountants;

(n) the Company will not, and will not permit any Subsidiary of the Company to, amend any material Tax Return or make any material Tax election;

(o) the Company will not, and will not permit any Subsidiary of the Company to, (i) pay, discharge, settle or satisfy any material claims, liabilities, obligations or litigation (whether accrued, contingent, absolute, asserted or unasserted or otherwise), other than the payment, discharge, settlement or satisfaction, in the ordinary course of business consistent with past practice or in accordance with their terms, of liabilities disclosed, reflected or reserved against in the most recent financial statements (or, if applicable, the notes thereto) of the Company included in the Company SEC Documents filed and publicly available prior to the date hereof (for amounts not in excess of such reserves) or incurred since the date of such financial statements in the ordinary course of business consistent with past practice, *provided, however*, that in no event shall the Company or any of its Subsidiaries settle any claim or litigation (A) for an amount in excess of \$250,000 for any such settlement individually or (B) if such settlement would reasonably be expected to prohibit or materially restrict the Company and its Subsidiaries from conducting their business in substantially the same manner as conducted on the date of this Agreement, and *provided further* that in no event shall the Company or any of its Subsidiaries settle any claim or litigation relating to the transactions contemplated by this Agreement, (ii) cancel any material Indebtedness or (iii) waive or assign any claims or rights of substantial value;

(p) file for, or otherwise seek, any material modification of any Communications License, other than in the ordinary course of business consistent with past practice, *provided* that such modification would not reasonably be expected, individually or in the aggregate, to affect the ability of the Company and its Subsidiaries to conduct their business in substantially the same manner as conducted on the date of this Agreement;

(q) the Company will not, and will not permit any Subsidiary of the Company to, take any action that would reasonably be expected to result in any of the conditions set forth in Section 8.03(a) not being satisfied; and

(r) the Company will not, and will not permit any Subsidiary of the Company to, agree or commit to do any of the foregoing.

Section 5.02. *Stockholder Meeting; Board Recommendation.* (a) The Company shall cause the Company Stockholders' Meeting to be duly called and held as soon as reasonably practicable after the date of this Agreement for the purpose of voting on the adoption of this Agreement, regardless of whether an Adverse Recommendation Change has occurred or of the commencement, public proposal, public disclosure or communication to the Company of any Acquisition Proposal. The Board of Directors of the Company shall recommend adoption of this Agreement by the Company's stockholders (the "**Company Stockholder Approval**") and shall include such recommendation in the Proxy Statement, in each case subject to its rights under Section 5.02(b).

(b) Neither the Board of Directors of the Company nor any committee thereof shall (i) (A) withdraw (or modify in a manner adverse to Parent), or publicly propose to withdraw (or modify in a manner adverse to Parent), the approval or recommendation by

such Board of Directors or any such committee of this Agreement or the Merger or (B) recommend the approval or adoption of, or approve or adopt, or publicly propose to recommend, approve or adopt, any Acquisition Proposal (any action described in this clause (i) being referred to as an "**Adverse Recommendation Change**") or (ii) approve or recommend, or publicly propose to approve or recommend, or cause or permit the Company or any of its Subsidiaries to execute or enter into, any letter of intent, memorandum of understanding, agreement in principle, merger agreement, acquisition agreement, joint venture agreement, partnership agreement or other similar agreement that, in any such case, provides for or is related to an Acquisition Proposal (which, for the avoidance of doubt, shall not include, any confidentiality agreement referred to in Section 5.03) (any of the foregoing, an "**Acquisition Agreement**"); *provided that*, at any time prior to obtaining the Company Stockholder Approval, the Board of Directors of the Company shall be permitted, after consultation with its outside counsel and financial advisors, (A) to make an Adverse Recommendation Change or (B) cause the Company to terminate this Agreement, but, in each case, only if and to the extent that the Company has complied with Section 5.03 and a Superior Proposal is pending at the time the Board of Directors of the Company determines to take such action or, in the case of clause (A) of this proviso, if the Board of Directors of the Company determines in good faith that a Parent Material Adverse Effect has occurred and, as a result, such an Adverse Recommendation Change is consistent with the fiduciary duties of the Board of Directors of the Company under Applicable Law (an "**MAE Adverse Recommendation Change**"); *provided further, however*, that (1) except in the case of an MAE Adverse Recommendation Change, the Board of Directors of the Company shall not make an Adverse Recommendation Change, and the Company may not so terminate this Agreement, until after the *fifth Business Day* following Parent's receipt of written notice (a "**Notice of Superior Proposal**") from the Company advising Parent that the Board of Directors of the Company intends to take such action and specifying the reasons therefor, including the terms and conditions of the Superior Proposal that is the basis of such proposed action (it being understood and agreed that (A) any amendment to the financial terms or any other material term of such Superior Proposal shall require a new Notice of Superior Proposal and a new three-Business Day period and (B) in determining whether to make an Adverse Recommendation Change or cause the Company to terminate this Agreement, the Board of Directors of the Company shall take into account any changes to the terms of this Agreement and the Merger proposed by Parent to the Company in response to a Notice of Superior Proposal or otherwise) and (2) in the case of an MAE Adverse Recommendation Change, the Board of Directors of the Company shall not make an MAE Adverse Recommendation Change until the *fifth Business Day* (or such shorter period as may be reasonable in light of the timing of the Company Stockholders' Meeting) following Parent's receipt of written notice from the Company advising Parent that the Board of Directors of the Company intends to take such action and specifying the reasons therefor.

(c) For purposes of this Agreement, "**Superior Proposal**" means any bona fide written Acquisition Proposal that involves the acquisition, directly or indirectly, of all or substantially all of the voting power of the Common Shares or of the assets of the Company and its Subsidiaries, taken as a whole, which the Board of Directors of the Company determines in its good faith judgment, after consultation with its outside counsel

and financial advisors, to be (i) more favorable and provide greater value to the Company's stockholders than this Agreement and the Merger, taken as a whole, and (ii) reasonably capable of being completed, taking into account all financial, legal, regulatory and other aspects of such proposal. For purposes of this Agreement, "Acquisition Proposal" means any Third Party offer or proposal for (A) any acquisition or purchase, direct or indirect, of 15% or more of the consolidated assets of the Company and its Subsidiaries or over 15% of any class of equity or voting securities of the Company or any of its Subsidiaries whose assets, individually or in the aggregate, constitute more than 15% of the consolidated assets of the Company, (B) any tender offer (including a self-tender offer) or exchange offer that, if consummated, would result in such Third Party's beneficially owning 15% or more of any class of equity or voting securities of the Company or any of its Subsidiaries whose assets, individually or in the aggregate, constitute more than 15% of the consolidated assets of the Company or (C) a merger, consolidation, share exchange, business combination, sale of substantially all the assets, reorganization, recapitalization, liquidation, dissolution or other similar transaction that results in any acquisition (including by shareholders of any Third Party) of over 15% of any class of equity or voting securities of the Company or any of its Subsidiaries whose assets, individually or in the aggregate, constitute more than 15% of the consolidated assets of the Company or, if the Company or any such Subsidiary is merged into another entity, of the surviving entity in such merger; *provided* that for purposes of Section 10.04(b)(ii)(C), each reference to "15%" in this definition shall be deemed to be a reference to "35%". For purposes of this Agreement, the term "Third Party" means any Person, including as defined in Section 13(d) of the 1934 Act, other than Parent or any of its Affiliates.

Section 5.03. *Non-Solicitation; Other Offers.* From the date hereof until the Effective Time, the Company and its Subsidiaries, and the officers, directors, employees, investment bankers and other agents and advisors of the Company or any of its Subsidiaries, will not (i) take any action to solicit, initiate or knowingly encourage or facilitate any Acquisition Proposal or (ii) engage in discussions or negotiations with, or disclose any nonpublic information relating to the Company or any Subsidiary of the Company or afford access to the properties, books or records of the Company or any Subsidiary of the Company to, any Person that is known by the Company to be considering making, or has made, an Acquisition Proposal (it being understood that any discussions or negotiations, or disclosure of information (other than material nonpublic information), in each case, in the ordinary course of business consistent with past practice in connection with existing commercial arrangements (and not in connection with any Acquisition Proposal) shall not be deemed to be prohibited under this clause (ii)); *provided* that, prior to obtaining the Company Stockholder Approval, nothing contained in this Section 5.03 shall prevent the Company from furnishing nonpublic information to, or entering into discussions or negotiations with, any Person in connection with an unsolicited bona fide written Acquisition Proposal received from such Person if the Board of Directors of the Company determines in good faith, after consultation with its outside counsel and financial advisors, that to engage in such discussions or negotiations or disclose such nonpublic information would reasonably be likely to result in a Superior Proposal, *provided, however*, that (A) prior to furnishing nonpublic information to, or entering into discussions or negotiations with, such Person, the Company receives from

such Person an executed confidentiality agreement with terms not materially less favorable to the Company than those contained in the Confidentiality Agreement, except that such confidentiality agreement may contain less favorable standstill provisions so long as the Company offers Parent the opportunity to amend the Confidentiality Agreement to contain the same standstill provisions, and (B) all such nonpublic information has previously been provided to Parent or is provided to Parent on a substantially concurrent basis. The Company will promptly notify, orally and in writing, Parent of the receipt of (and the material terms and conditions thereof and the identity of the Person making the same) any inquiry, offer or proposal in connection with an Acquisition Proposal or any request (other than in the ordinary course of business and not related to an Acquisition Proposal) for nonpublic information relating to the Company or any Subsidiary of the Company or for access to the properties, books or records of the Company or any Subsidiary of the Company by any Person that the Company believes may be considering making, or has made, an Acquisition Proposal. The Company will (1) keep Parent reasonably informed of the status and details (including any material change to the terms thereof) of any such inquiry, offer, proposal or request and any discussions and negotiations concerning the material terms and conditions of any Acquisition Proposal and (2) provide to Parent as soon as practicable after receipt or delivery thereof copies of all draft agreements and all other material written correspondence and documents sent by or provided to the Company or any of its Subsidiaries in connection therewith. Nothing contained in this Agreement shall prohibit the Board of Directors of the Company from (i) taking and disclosing to the Company's shareholders a position (or issuing a "stop, look and listen" announcement) with respect to a tender offer for the Common Shares by a Third Party pursuant to Rules 14d-9 and 14e-2 promulgated under the Exchange Act, (ii) making such disclosure to the Company's shareholders as, in the judgment of the Board of Directors of the Company, with the advice of outside counsel, may be required under Applicable Law or under the rules of the NASDAQ National Stock Market System ("NASDAQ"), or (iii) responding to any unsolicited proposal or inquiry by advising the Person making such proposal or inquiry of the terms of this Section 5.03 (it being understood, however, that nothing in this sentence shall be deemed to permit the Board of Directors of the Company to make an Adverse Recommendation Change or take any of the actions referred to in clause (ii) of Section 5.02(b) except, in each case, to the extent permitted by Section 5.02(b); it being understood that any accurate disclosure of factual information to the shareholders of the Company that is required to be made to such shareholders under Applicable Law shall not be an action prohibited by Section 5.02(b)). The Company will immediately cease, and cause its advisers and agents to cease, any and all existing activities, discussions or negotiations regarding any Acquisition Proposal with any parties previously contacted (provided that the Company may inform such parties that this Agreement has been entered into) and will request the prompt return or destruction of all confidential information previously furnished to any such parties.

Section 5.04. *Affiliates.* Prior to the Effective Time, the Company shall cause to be delivered to Parent a letter identifying, to the best of the Company's knowledge, all Persons who are, at the time of the Company Stockholders' Meeting, "affiliates" of the Company for purposes of Rule 145 under the Securities Act. The Company shall use its reasonable best efforts to cause each Person who is so identified as an affiliate to deliver

to Parent on or prior to the Effective Time a letter agreement substantially in the form of Exhibit B to this Agreement.

ARTICLE 6  
COVENANTS OF PARENT

Parent agrees that:

Section 6.01. *Conduct of Parent.* Except as otherwise contemplated herein, as set forth in Section 6.01 of the Parent Disclosure Schedule or as may be required by Applicable Law, from the date hereof until the Effective Time, without the consent of the Company:

(a) Parent will not, and, in the case of clause (ii) below, will not permit any Subsidiary of Parent to, (i) except for regular quarterly dividends not to exceed \$0.25 per share, declare, set aside or pay any dividend or other distribution (whether in cash, stock or property or any combination thereof) in respect of its capital stock or (ii) redeem, repurchase or otherwise acquire, or offer to redeem, repurchase or otherwise acquire, any Parent Securities;

(b) Parent will not, and will not permit any Subsidiary of Parent to, enter into or acquire any new line of business that (i) is material to Parent and its Subsidiaries, taken as a whole, and (ii) is not related to the provision of communications services;

(c) Parent shall not, and shall not permit any of its Subsidiaries to, enter into any acquisition that would reasonably be expected to prevent or materially delay the completion of the Merger;

(d) Parent will not, and will not permit any Subsidiary of Parent to, take or agree or commit to take any action that would reasonably be expected to result in any of the conditions set forth in Section 8.04(a) not being satisfied; and

(e) Parent will not, and will not permit any Subsidiary of Parent to, agree or commit to do any of the foregoing.

Section 6.02. *Obligations of Merger Subsidiary.* Parent shall take all action necessary to cause Merger Subsidiary to perform its obligations under this Agreement and to consummate the Merger on the terms and conditions set forth in this Agreement.

Section 6.03. *Voting of Shares.* Parent agrees to vote all Common Shares, if any, beneficially owned by it, and to cause all Common Shares, if any, beneficially owned by its Subsidiaries to be voted, in favor of adoption of this Agreement at the Company Stockholders' Meeting.

Section 6.04. *Director and Officer Liability.* (a) For six years after the Effective Time, Parent shall, and shall cause the Surviving Corporation to, (i) indemnify and hold harmless the present and former officers, directors, employees and agents of the

Company (each, an “**Indemnified Person**”) in respect of acts or omissions occurring prior to the Effective Time (including, without limitation, in respect of acts or omissions in connection with this Agreement, the Merger and the other transactions contemplated hereby) to the fullest extent permitted under Applicable Law and (ii) promptly advance to such Indemnified Persons expenses incurred in defending any action, suit or other proceeding with respect thereto to the fullest extent permitted under Applicable Law. In the event any claim is asserted or made within such six-year period, all rights to indemnification in respect of such claim shall continue until disposition of such claim. For six years after the Effective Time, Parent will cause the Surviving Corporation to use its reasonable best efforts to provide officers’ and directors’ liability insurance and fiduciary liability insurance in respect of acts or omissions occurring on or prior to the Effective Time covering each such Indemnified Person currently covered by the Company’s officers’ and directors’ liability insurance policy and fiduciary liability insurance policy, respectively, on terms with respect to coverage and amount no less favorable than those of such policies in effect on the date hereof; *provided* that (i) in satisfying its obligation under this Section, Parent shall not be obligated to cause the Surviving Corporation, and the Surviving Corporation shall not be obligated, to pay annual premiums in excess of \$1,487,700; *provided, further*, that if the premiums would exceed such amount in a given year, Parent shall cause the Surviving Corporation to use its reasonable best efforts to purchase coverage that in the reasonable opinion of Parent is the best available for such amount per year; and (ii) Parent may satisfy its obligation under this Section by causing the Surviving Corporation to obtain, at the Effective Time, prepaid (or “tail”) officers’ and directors’ liability insurance and fiduciary liability insurance policies in respect of acts or omissions occurring on or prior to the Effective Time covering each Indemnified Person currently covered by the Company’s officers’ and directors’ liability insurance policy and fiduciary liability insurance policy. Parent shall cause the Surviving Corporation to indemnify and hold harmless each Indemnified Person under this Section 6.04 in respect of the reasonable costs and expenses incurred by such Indemnified Person in enforcing his or her rights hereunder.

(b) If Parent, the Surviving Corporation or any of their successors or assigns (i) consolidates with or merges into any other Person and shall not be the continuing or surviving corporation or entity of such consolidation or merger, or (ii) transfers or conveys all or substantially all of its properties and assets to any Person, then, and in each such case, to the extent necessary, proper provision shall be made so that the successors and assigns of Parent or the Surviving Corporation, as the case may be, shall assume the obligations set forth in this Section 6.04.

(c) The rights of each Indemnified Person under this Section 6.04 shall be in addition to any rights such Person may have under the articles of incorporation or bylaws of the Company or any of its Subsidiaries, or under Pennsylvania Law or any other Applicable Law or under any agreement of any Indemnified Person with the Company or any of its Subsidiaries. These rights shall survive the consummation of the Merger and are intended to benefit, and shall be enforceable by, each Indemnified Person.

Section 6.05. *Stock Exchange Listing.* Parent shall use its reasonable best efforts to cause the shares of Parent Stock to be issued in connection with the Merger to be listed on the NYSE, subject to official notice of issuance.

Section 6.06. *Personnel Matters.* (a) On and after the Effective Time, Parent shall (or shall cause the Surviving Corporation and Parent's other Subsidiaries to) honor, without offset, deduction, counterclaim, interruption or deferment, the obligations of the Company and its Subsidiaries under all Employee Plans in existence on the Closing Date in accordance with the terms thereof; *provided*, that nothing in this Agreement shall be interpreted as limiting the power of Parent, the Surviving Corporation or any of their Subsidiaries to amend or terminate any Employee Plan in accordance with its terms or as requiring Parent, the Surviving Corporation or any of their Subsidiaries to offer to continue (other than as required by its terms) any written employment contract or to continue the employment of any given employee; *provided, further, however*, that, until the first anniversary of the Closing Date, (i) Parent shall continue the Company's past practice with respect to severance as set forth in Section 6.06 of the Company Disclosure Schedule) and (ii) no amendment to or termination of the Company's Key Employee Severance Plan shall be made without the consent of Eligible Employees (as defined in such plan).

(b) To the extent any benefit plan of Parent (or any plan of the Surviving Corporation or any of Parent's other Subsidiaries) shall be made applicable to any employee of the Company or any of its Subsidiaries, Parent shall (or shall cause the Surviving Corporation and Parent's other Subsidiaries to) grant to such employees credit for service with the Company or any of its Subsidiaries or predecessors prior to the Effective Time for all purposes under such plan, except for purposes of benefit accrual under any defined benefit pension plans and except to the extent a duplication of benefits would thereby result. In addition, to the extent any benefit plan of Parent (or any plan of the Surviving Corporation or any of Parent's other Subsidiaries) that constitutes an "employee welfare benefit plan," as defined in Section 3(3) of ERISA, shall be made applicable to any employee of the Company or any of its Subsidiaries, Parent shall (or shall cause the Surviving Corporation and Parent's other Subsidiaries to) waive all preexisting condition exclusions and waiting periods otherwise applicable to such employees, except to the extent any such limitations or waiting periods in effect under comparable plans of the Company and its Subsidiaries have not been satisfied as of the date such plan is made so applicable.

(c) If at any time between the Closing and December 31, 2007, the employment of any person who was an employee of the Company or any of its Subsidiaries immediately prior to Closing is terminated without Cause or for Good Reason (as each such term is defined in the Company's Key Employee Severance Plan), Parent shall (or shall cause the Surviving Corporation or one of Parent's other Subsidiaries to) pay to such employee promptly after such termination of employment, in addition to any other amounts due, a cash amount equal to a prorated portion of such employee's target 2007 bonus (having terms and in amounts consistent with past practice), with such proration based upon the portion of the 2007 calendar year that has elapsed at the time of such termination.

ARTICLE 7  
OTHER AGREEMENTS OF PARENT AND THE COMPANY

The parties hereto agree that:

Section 7.01. *Proxy Statement; Registration Statement.* (a) As promptly as practicable after the execution of this Agreement, Parent and the Company shall prepare the Proxy Statement and the Registration Statement, the Company shall file the Proxy Statement with the SEC, and Parent shall file the Registration Statement (in which the Proxy Statement shall be included) with the SEC, and Parent and the Company shall cooperate with each other and use their respective reasonable best efforts in connection with the foregoing. In addition, Parent and the Company shall use their respective reasonable best efforts to cause the Registration Statement to become effective under the Securities Act and the Proxy Statement to be cleared by the SEC, in each case as soon after such filing as practicable, and to keep the Registration Statement effective as long as is necessary to consummate the Merger. The Company shall use its reasonable best efforts to cause the Proxy Statement to be mailed to the Company's stockholders as promptly as practicable after the Registration Statement becomes effective. Parent and the Company shall promptly provide to each other copies of, consult with each other regarding and together prepare written responses with respect to any written comments received from the SEC with respect to the Proxy Statement or the Registration Statement and shall advise each other of any oral SEC comments. The Registration Statement and the Proxy Statement shall comply as to form in all material respects with the Securities Act and the Exchange Act, respectively.

(b) Parent and the Company shall make all necessary filings with respect to the Merger and the other transactions contemplated hereby under the Securities Act, the Exchange Act and applicable foreign or state securities or "blue sky" laws and the rules and regulations thereunder. Parent and the Company shall advise the other party, promptly after receipt of notice thereof, of the time of the effectiveness of the Registration Statement, the filing of any supplement or amendment thereto, the issuance of any stop order relating thereto, the suspension of the qualification of Parent Stock issuable in connection with the Merger for offering or sale in any jurisdiction, or of any SEC request for amendment to the Proxy Statement or the Registration Statement, SEC comments thereon and each party's responses thereto or SEC request for additional information. No amendment or supplement to the Proxy Statement or the Registration Statement shall be filed without the approval of each of Parent and the Company, which approval shall not be unreasonably withheld or delayed; *provided* that, with respect to documents filed by the Company or Parent which are incorporated by reference in the Proxy Statement and/or the Registration Statement, this right of approval shall apply only with respect to information relating to the other party or its business, financial condition or results of operations.

(c) If, at any time prior to the Effective Time, Parent or the Company should discover any information relating to either party, or any of their respective Affiliates, officers or directors, that should be set forth in an amendment or supplement to the Registration Statement or the Proxy Statement, so that such documents would not include any misstatement of a material fact or omit to state any material fact necessary to make

the statements therein, in light of the circumstances under which they were made, not misleading, the party that discovers such information shall promptly notify the other party hereto and an appropriate amendment or supplement describing such information shall be promptly filed with the SEC and, to the extent required by Applicable Law, disseminated to the stockholders of the Company.

Section 7.02. *Reasonable Best Efforts.* Subject to the terms and conditions of this Agreement, each of the parties hereto agrees to use its reasonable best efforts to take, or cause to be taken, all appropriate action, and to do, or cause to be done, all things necessary, proper or advisable under Applicable Laws to consummate and make effective the transactions contemplated by this Agreement in the most expeditious manner practicable, including but not limited to the satisfaction of all conditions to the Merger and seeking to remove promptly any injunction or other legal barrier that may prevent or delay such consummation. Each of the parties shall promptly notify the other whenever a material consent is obtained and shall keep the other informed as to the progress in obtaining such material consents.

Section 7.03. *Certain Filings.* (a) The Company and Parent agree to use their respective reasonable best efforts to obtain all authorizations, consents, orders and approvals of Governmental Authorities and non-governmental third parties that may be or become necessary to consummate the transactions contemplated by this Agreement or for performance of their respective obligations pursuant to this Agreement, and will cooperate fully with the other parties in promptly seeking to obtain all such authorizations, consents, orders and approvals; *provided* that the Company and Parent will not be permitted or required to agree or proffer to divest or hold separate any assets or business of the Company, Parent or any of their respective Subsidiaries, or to take any other action (including agreeing to any condition in respect of, or any amendment to, any License or any other concession), that, in each case, individually or in the aggregate, would reasonably be expected to have an impact (whether affecting the Company, Parent or any of their respective Subsidiaries) equivalent to a Company Material Adverse Effect. The Company shall have primary responsibility, with the assistance and cooperation of Parent, for obtaining all authorizations, consents, orders and approvals with respect to the Company's and its Subsidiaries' Licenses; *provided* that the Company and Parent will have joint responsibility with respect to the joint applications required for the transfer of control of any such Licenses under the rules and regulations of the FCC and the PPUC. Each of Parent and the Company will use its reasonable best efforts to ensure that all necessary applications in connection with the transfer of control of any such Licenses are filed within ten Business Days of the date hereof, except that PPUC transfer of control notifications that do not require affirmative approval may be filed within 20 Business Days of the date hereof. Without limitation, the Company and Parent shall each make an appropriate filing of a Notification and Report Form pursuant to the HSR Act with respect to the transactions contemplated hereby as promptly as practicable but in no event later than ten Business Days from the date hereof (and each such filing shall request early termination of the waiting period imposed by the HSR Act), supply as promptly as practicable any additional information and documentary material that may be requested pursuant to the HSR Act and take all other actions necessary to cause the expiration or termination of the applicable waiting periods under the HSR Act as soon as practicable.

For purposes of this Agreement, “Licenses” means approvals, consents, rights, certificates, orders, franchises, determinations, permissions, licenses, authorities or grants issued, declared, designated or adopted by any Governmental Authority.

(b) Any application to any Governmental Authority for any authorization, consent, order or approval necessary for the transfer of control of any License of the Company or any of its Subsidiaries shall be reasonably acceptable to the Company and Parent. Without limiting the obligations of the Company and Parent under Section 7.03(a), each of the Company and Parent agrees, upon reasonable prior notice, to make appropriate representatives available for attendance at meetings and hearings before applicable Governmental Authorities in connection with the transfer of control of any such License.

(c) The Company and Parent shall cooperate with one another (i) in determining whether any action by or in respect of, or filing with, any Governmental Authority is required, or any actions, consents, approvals or waivers are required to be obtained from parties to any material contracts, in connection with the consummation of the transactions contemplated by this Agreement and (ii) in seeking any such actions, consents, approvals or waivers, or making any such filings, furnishing information required in connection therewith or with the Proxy Statement, the Registration Statement or any amendments or supplements thereto, and seeking timely to obtain any such actions, consents, approvals or waivers.

Section 7.04. *Public Announcements.* Parent and the Company will consult with each other before issuing any press release, making any public statement or scheduling any press conference or conference call with investors or analysts with respect to this Agreement and the transactions contemplated hereby, and will not issue any such press release, make any such public statement or schedule any such press conference or conference call without the consent of the other party, which shall not be unreasonably withheld; *provided* that Parent and the Company may, without the prior consent of the other party, issue such press release or make such public statement if such party has used all reasonable efforts to consult with the other party and to obtain the prior consent of the other party but has been unable to do so prior to the time such press release or public statement is required to be released pursuant to Applicable Law or any listing agreement with any applicable national securities exchange or association.

Section 7.05. *Notices of Certain Events.* Each of the Company and Parent shall promptly notify the other of:

(a) any notice or other communication from any Person alleging that the consent of such Person is or may be required in connection with the transactions contemplated by this Agreement;

(b) any notice or other communication from any Governmental Authority in connection with the transactions contemplated by this Agreement; and

(c) any actions, suits, claims, investigations or proceedings commenced or, to its knowledge, threatened against, relating to or involving or otherwise affecting the Company or Parent, as the case may be (or any of their respective Subsidiaries), that, if pending on the date of this Agreement, would have been required to have been disclosed pursuant to any Section of Article 3 or 4, as the case may be, or that relate to the consummation of the transactions contemplated by this Agreement;

*provided* that, the delivery of any notice pursuant to this Section 7.05 shall not limit or otherwise affect the remedies available hereunder to the party receiving such notice or constitute an admission that any event communicated is material or could give rise to a Company Material Adverse Effect or a Parent Material Adverse Effect.

Section 7.06. *Further Assurances.* At and after the Effective Time, the officers and directors of the Surviving Corporation will be authorized to execute and deliver, in the name and on behalf of the Company or Merger Subsidiary, any deeds, bills of sale, assignments or assurances and to take and do, in the name and on behalf of the Company or Merger Subsidiary, any other actions and things to vest, perfect or confirm of record or otherwise in the Surviving Corporation any and all right, title and interest in, to and under any of the rights, properties or assets of the Company acquired or to be acquired by the Surviving Corporation as a result of, or in connection with, the Merger.

Section 7.07. *Access to Information.* (a) From the date hereof until the Effective Time and subject to Applicable Law, the Company will give to Parent, its counsel, financial advisors, auditors and other authorized representatives reasonable access, during regular business hours and upon reasonable notice, to the offices, properties, books and records of the Company and its Subsidiaries, including personnel records, and will furnish to Parent, its counsel, financial advisors, auditors and other authorized representatives such financial and operating data and other information as such Persons may reasonably request and will instruct employees, counsel, financial advisors, auditors and other representatives of the Company and its Subsidiaries to cooperate with Parent in its investigation of the Company and its Subsidiaries, *provided* that Parent shall reimburse the Company and its Subsidiaries for any reasonable third party expenses incurred by them in connection with the foregoing. Without limiting generality of the foregoing, the Company shall provide to Parent, as promptly as practicable after the completion of each fiscal month of the Company, copies of the final financial and operating monthly reports described in Section 7.07(a) of the Company Disclosure Schedule. No access to or disclosure of information shall be required to the extent such access or disclosure would jeopardize the work product privilege or the attorney-client privilege of the Company or any of its Subsidiaries or violate any binding agreement entered into prior to the date of this Agreement (it being agreed that the Company and its Subsidiaries shall use their reasonable best efforts to cause such access or disclosure to be provided in a manner that does not cause such jeopardization or violation). Any investigation pursuant to this Section shall be conducted in such manner as not to interfere unreasonably with the conduct of business of the Company and its Subsidiaries.

(b) From the date hereof until the Effective Time and subject to Applicable Law, Parent will give to the Company, its counsel, financial advisors, auditors and other

authorized representatives reasonable access, during regular business hours and upon reasonable notice, to the offices, properties, books and records of Parent and its Subsidiaries at a level consistent with such access provided for due diligence purposes prior to the date of this Agreement or, in the event of a material change or development with respect to Parent or its Subsidiaries, at a level reasonable under all of the circumstances. Without limiting the generality of the foregoing, Parent shall provide to the Company, as promptly as practicable after the completion of each fiscal month of Parent, copies of the final financial and operating monthly reports described in Section 7.07(b) of the Parent Disclosure Schedule.

(c) All such access and information obtained by any party and its counsel, financial advisors, auditors and other authorized representatives shall be subject to the terms and conditions of the letter agreement between the Company and Parent dated June 26, 2006 (the “**Confidentiality Agreement**”). No representation as to the accuracy of any information provided pursuant to this Section is made, and the parties may not rely on the accuracy of any such information other than as expressly set forth in the representations and warranties in Articles 3 and 4. No information obtained in any investigation pursuant to this Section shall be deemed to modify any representation or warranty in Article 3 or 4.

Section 7.08. *Section 16 Matters.* Prior to the Effective Time, Parent and the Company shall take all such steps as may be required to cause any dispositions of Common Shares (including derivative securities with respect to Common Shares) or acquisitions of Parent Stock (including derivative securities with respect to Parent Stock) resulting from the transactions contemplated by this Agreement by each individual who is subject to the reporting requirements of Section 16(a) of the Exchange Act with respect to the Company and/or Parent, as applicable, to be exempt under Rule 16b-3 promulgated under the Exchange Act, such steps to be taken in accordance with the No-Action Letter dated January 12, 1999, issued by the SEC. Prior to the Effective Time, the Company shall deliver to Parent all information necessary for Parent to comply with the foregoing.

Section 7.09. *Company Convertible Notes.* Prior to the Closing, the Company will, and following the Closing, Parent will, and will cause the Surviving Corporation to, comply with the terms and conditions of the Company Convertible Notes. It is understood and agreed that, to the extent permitted by the terms of the Company Convertible Notes, the Company shall settle in cash its obligations under the Company Convertible Notes arising upon the conversion thereof.

Section 7.10. *Performance Awards.* If the Closing occurs prior to December 31, 2006, the Compensation Committee of the Board of Directors of the Company may, in its sole discretion, determine immediately prior to the Closing that the performance conditions in the Performance Awards outstanding as of the date hereof are deemed to be fully satisfied, and if such Compensation Committee makes such a determination, the Restricted Share Units issuable pursuant to such Performance Awards shall be issued immediately prior to the Closing.

Section 7.11. *Stockholder Litigation.* The Company shall give Parent the opportunity to participate in the defense or settlement of any stockholder litigation against the Company and/or its directors relating to the transactions contemplated by this Agreement, and no such settlement shall be agreed to without the prior written consent of Parent, which shall not be unreasonably withheld or delayed in the event that the settlement would not be material.

Section 7.12. *Cooperation with Respect to Financing.* The Company shall provide, and shall cause its Subsidiaries and its and their officers and employees to provide, on a timely basis all reasonable cooperation in connection with the arrangement of any financing to be consummated by Parent in connection with the transactions contemplated by this Agreement, including (i) facilitating the pledge of collateral (effective as of the Closing), (ii) providing financial and other pertinent information regarding the Company and its Subsidiaries as may be reasonably requested by Parent, including all financial statements and financial data of the type required by Regulation S-X and Regulation S-K under the Securities Act in a registered offering of securities, (iii) providing other reasonably requested certificates or documents, including a customary certificate of the Chief Financial Officer of the Company (in his capacity as such) with respect to solvency matters, (iv) requesting PricewaterhouseCoopers LLP to provide customary consents and comfort letters, (v) requesting such customary legal opinions as may be reasonably requested by Parent, (vi) participating in informational meetings and (vii) assisting Parent and its financing sources in the preparation of offering documents and other marketing and rating agency materials for any such financing.

## ARTICLE 8 CLOSING; CONDITIONS TO THE MERGER

Section 8.01. *Closing.* The Closing shall take place at the offices of Davis Polk & Wardwell, 450 Lexington Avenue, New York, New York, or at such other location as the parties may agree in writing.

Section 8.02. *Conditions to the Obligations of Each Party.* The obligations of the Company, Parent and Merger Subsidiary to consummate the Merger are subject to the satisfaction of the following conditions:

- (a) the Company Stockholder Approval shall have been obtained;
- (b) the applicable waiting period under the HSR Act relating to the Merger shall have expired or been terminated;
- (c) each of the approval of the FCC for the transfer of control of the Licenses of the Company and its Subsidiaries and the approval of the PPUC, in each case, required to permit consummation of the Merger shall have been obtained;
- (d) no Applicable Law shall have been adopted, promulgated or issued that prohibits the consummation of the Merger;

(e) the Registration Statement shall have been declared effective and no stop order suspending the effectiveness of the Registration Statement shall be in effect, and no proceedings for such purpose shall be pending before or threatened by the SEC; and

(f) the shares of Parent Stock to be issued in the Merger shall have been approved for listing on the NYSE, subject to official notice of issuance.

Section 8.03. *Conditions to the Obligations of Parent and Merger Subsidiary.*

The obligations of Parent and Merger Subsidiary to consummate the Merger are subject to the satisfaction of the following further conditions:

(a) (i) The Company shall have performed in all material respects all of its obligations hereunder required to be performed by it at or prior to the Effective Time, (ii) (A) the representations and warranties of the Company contained in the third and fourth sentences of Section 3.01 and Sections 3.04, 3.05 (other than the last sentence thereof), 3.06(b), 3.10(b)(iv), 3.14(e) and 3.21 shall be true and correct in all material respects, in each case, at and as of the Effective Time as if made at and as of such time (except that the accuracy of representations and warranties made as of a specific date will be determined at and as of such date) and (B) all other representations and warranties of the Company contained in this Agreement shall be true and correct (disregarding all exceptions therein for materiality and Company Material Adverse Effect) at and as of the Effective Time as if made at and as of such time (except that the accuracy of representations and warranties made as of a specific date will be determined at and as of such date), with such exceptions as have not had and would not reasonably be expected to have, individually or in the aggregate, a Company Material Adverse Effect, and (iii) Parent shall have received a certificate signed by an executive officer on behalf of the Company to the foregoing effect.

(b) There shall not be pending or threatened, under or pursuant to any Applicable Laws regulating competition, any claim, suit, action or proceeding by any federal or state Governmental Authority (i) challenging or seeking to restrain or prohibit the consummation of the Merger, (ii) seeking to prohibit or limit in any respect, or place any conditions on, the ownership or operation by the Company, Parent or all or any of their respective Subsidiaries of all or any portion of the business or assets of the Company, Parent or any of their respective Subsidiaries or to require any such Person to divest or hold separate any assets or business of the Company, Parent or any of their respective Subsidiaries, or to take any other action (including agreeing to any condition in respect of, or any amendment to, any License or any other concession), in each case as a result of or in connection with the transactions contemplated by this Agreement, where the foregoing, individually or in the aggregate, would reasonably be expected to have an impact (whether affecting the Company, Parent or any of their respective Subsidiaries) equivalent to a Company Material Adverse Effect or (iii) seeking to impose limitations on the ability of Parent or any of its Affiliates to acquire or hold, or exercise full rights of ownership of, any Common Shares or any shares of common stock of the Surviving Corporation, including the right to vote the Common Shares or the shares of common stock of the Surviving Corporation on all matters properly presented to the stockholders of the Company or the Surviving Corporation, respectively. No Applicable Law that would

reasonably be expected to result, directly or indirectly, in any of the effects referred to clauses (i) through (iii) above shall be in effect.

Section 8.04. *Conditions to the Obligations of the Company.* The obligations of the Company to consummate the Merger are subject to the satisfaction of the following further conditions:

(a) (i) Each of Parent and Merger Subsidiary shall have performed in all material respects all of its obligations hereunder required to be performed by it at or prior to the Effective Time, (ii) (A) the representations and warranties of Parent contained in the third and fourth sentences of Section 4.01 and Sections 4.04, 4.05 (other than the last sentence thereof) and 4.17 shall be true and correct in all material respects, in each case, at and as of the Effective Time as if made at and as of such time (except that the accuracy of representations and warranties made as of a specific date will be determined at and as of such date) and (B) all other representations and warranties of Parent contained in this Agreement shall be true and correct (disregarding all exceptions therein for materiality and Parent Material Adverse Effect) at and as of the Effective Time as if made at and as of such time (except that the accuracy of representations and warranties made as of a specific date will be determined at and as of such date), with such exceptions as have not had and would not reasonably be expected to have, individually or in the aggregate, a Parent Material Adverse Effect, and (iii) the Company shall have received a certificate signed by an executive officer on behalf of Parent to the foregoing effect.

## ARTICLE 9 TERMINATION

Section 9.01. *Termination.* This Agreement may be terminated and the Merger may be abandoned at any time prior to the Effective Time (notwithstanding any approval of this Agreement by the stockholders of the Company):

- (a) by mutual written consent of the Company and Parent;
- (b) by either the Company or Parent, if the Company Stockholder Approval shall not have been obtained at the Company Stockholders' Meeting (including any postponement or adjournment thereof);
- (c) by either the Company or Parent, if the Merger has not been consummated by June 18, 2007 (the "**Termination Date**"), *provided* that no party whose willful breach of any provision of this Agreement has resulted in the Merger not being consummated by such date shall be entitled to terminate this Agreement under this subsection (c), *provided further* that, if on the Termination Date the conditions to the Closing set forth in Section 8.02(c) and/or 8.02(d) and/or 8.03(b) shall not have been fulfilled but all other conditions to the Merger shall have been fulfilled or shall be capable of being fulfilled, then the Termination Date shall be extended to September 17, 2007;

(d) by either the Company or Parent (so long as such party has complied in all material respects with its obligations under Sections 7.01, 7.02 and 7.03), if (i) any law or regulation shall have been adopted or promulgated that makes consummation of the Merger illegal or (ii) if any judgment, injunction, order or decree enjoining the parties from consummating the Merger is entered and such judgment, injunction, order or decree shall have become final and nonappealable;

(e) by the Company, if a breach of any representation, warranty, covenant or agreement on the part of Parent set forth in this Agreement shall have occurred that would cause any of the conditions set forth in Section 8.04(a) not to be satisfied, and either (i) such condition shall be incapable of being satisfied by three Business Days prior to the Termination Date (as such date has been extended in accordance with Section 9.01(c), if applicable) or (ii) Parent does not, after receiving notice of such breach, proceed in good faith to promptly cure such breach;

(f) by Parent, if a breach of any representation, warranty, covenant or agreement on the part of the Company set forth in this Agreement shall have occurred that would cause any of the conditions set forth in Section 8.03(a) not to be satisfied, and either (i) such condition shall be incapable of being satisfied by three Business Days prior to the Termination Date (as such date has been extended in accordance with Section 9.01(c), if applicable) or (ii) the Company does not, after receiving notice of such breach, proceed in good faith to promptly cure such breach;

(g) by the Company, in accordance with Section 5.02(b), *provided* that the Company shall have paid any amounts due pursuant to Section 10.04(b) in accordance with the terms specified therein;

(h) by Parent, if prior to the Company Stockholders' Meeting, the Board of Directors of the Company shall have failed to include in the Proxy Statement its approval or recommendation of this Agreement or the Merger or an Adverse Recommendation Change shall otherwise have occurred; and

(i) by Parent, if any Applicable Law having any of the effects referred to in clauses (i) through (iii) of Section 8.03(b) shall be in effect and shall have become final and nonappealable.

The party desiring to terminate this Agreement pursuant to this Section shall give written notice of such termination to the other party (or parties) hereto in accordance with Section 10.01.

Section 9.02. *Effect of Termination.* If this Agreement is terminated pursuant to Section 9.01, this Agreement shall become void and of no effect with no liability on the part of any party (or any stockholder, director, officer, employee, agent, consultant or representative of such party) to the other parties hereto; *provided* that (a) the agreements contained in this Section 9.02, Sections 10.01, 10.04, 10.05, 10.06, 10.07, 10.08, 10.09, 10.10, 10.12, 10.13 and 10.14 hereof and the Confidentiality Agreement shall survive the

termination hereof and (b) no such termination shall relieve any party hereto of any liability or damages resulting from any willful breach by such party of this Agreement.

ARTICLE 10  
MISCELLANEOUS

Section 10.01. *Notices.* All notices, requests and other communications to any party hereunder shall be in writing (including facsimile transmission, with receipt of confirmation) and shall be given,

if to Parent or Merger Subsidiary, to:

Citizens Communications Company  
3 High Ridge Park  
Stamford, Connecticut 06905  
Attention: Chief Financial Officer  
Facsimile No.: (203) 614-4602

with a copy to:

Cravath, Swaine & Moore LLP  
Worldwide Plaza  
825 Eighth Avenue  
New York, New York 10019  
Attention: Robert I. Townsend, III, Esq.  
Facsimile No.: (212) 474-3700

if to the Company, to:

Commonwealth Telephone Enterprises, Inc.  
100 CTE Drive  
Dallas, Pennsylvania 18612  
Attention: Chief Financial Officer  
Facsimile No.: (570) 631-2823

with a copy to:

Davis Polk & Wardwell  
450 Lexington Avenue  
New York, New York 10017  
Attention: William L. Taylor, Esq.  
Facsimile No.: (212) 450-3800

or such other address or facsimile number as such party may hereafter specify for the purpose by notice to the other parties hereto. Each such notice, request and other communication shall be deemed received on the date of receipt by the recipient thereof if received prior to 5:00 p.m. on a Business Day in the place of receipt. Otherwise, any

such notice, request or communication shall be deemed to have been received on the next succeeding Business Day in the place of receipt.

Section 10.02. *Survival of Representations, Warranties and Covenants.* The representations and warranties contained herein and in the certificates delivered pursuant to Sections 8.03(a) and 8.04(a) shall not survive the Effective Time. All covenants and agreements contained herein which by their terms are to be performed in whole or in part after the Effective Time shall survive the Effective Time and be enforceable in accordance with their terms.

Section 10.03. *Amendments; No Waivers.* (a) Any provision of this Agreement may be amended or waived prior to the Effective Time if, and only if, such amendment or waiver is in writing and signed, in the case of an amendment, by each party to this Agreement or, in the case of a waiver, by the party against whom the waiver is to be effective; *provided* that after the adoption of this Agreement by the stockholders of the Company, no such amendment or waiver shall, without the further approval of such stockholders, make any change that would require further stockholder approval under the Pennsylvania Law.

(b) No failure or delay by any party in exercising any right, power or privilege hereunder shall operate as a waiver thereof, nor shall any single or partial exercise thereof preclude any other or further exercise thereof or the exercise of any other right, power or privilege. The rights and remedies herein provided shall be cumulative and not exclusive of any rights or remedies provided by Applicable Law.

Section 10.04. *Expenses.* (a) Except as set forth herein, all costs and expenses incurred in connection with this Agreement shall be paid by the party incurring such cost or expense; *provided* that the Company and Parent shall share equally all fees and expenses, other than attorneys' and accounting fees and expenses, incurred in relation to the printing and filing of the Registration Statement and to the printing, filing and distribution of the Proxy Statement.

(b) If (i) the Company shall terminate this Agreement pursuant to Section 9.01(g) hereof or Parent shall terminate this Agreement pursuant to Section 9.01(h) hereof (other than as a result of an MAE Adverse Recommendation Change) or (ii)(A) any Person has publicly announced an intention (whether or not conditional and whether or not withdrawn) to make an Acquisition Proposal or an Acquisition Proposal otherwise becomes known to the stockholders of the Company, (B) thereafter this Agreement is terminated by either Parent or the Company pursuant to Section 9.01(c) (but only if the Company Stockholders' Meeting shall not have been held by the date that is one Business Day prior to the date of such termination, except as a result of the Registration Statement not having been declared effective prior thereto as a result of anything affecting Parent or its business (in which event termination under Section 9.01(c) shall not result in a payment being made pursuant to this Section 10.04(b)(ii))) or Section 9.01(b) and (C) prior to the date that is 12 months after such termination, the Company or any of its Subsidiaries enters into an Acquisition Agreement to consummate or consummates the transactions contemplated by any

Acquisition Proposal, then, in any such case, the Company shall pay to Parent (by wire transfer of immediately available funds (x) in the case of payment required by clause (i) above, not later than the date of termination of this Agreement and (y) in the case of payment required by clause (ii) above, on the date of the first to occur of the events referred to in clause (ii)(C)) an amount equal to \$37 million.

(c) The Company acknowledges that the agreements contained in this Section are an integral part of this Agreement, and that, without these agreements, Parent would not have entered into this Agreement. Accordingly, if the Company fails promptly to pay the amounts due pursuant to this Section, and, in order to obtain such payment, Parent commences a suit that results in a judgment against the Company for the amounts set forth in this Section, the Company shall pay to Parent its reasonable costs and expenses (including reasonable attorneys' fees and expenses) in connection with such suit and any appeal relating thereto, together with interest on the amounts set forth in this Section at the prime rate of Citibank, N.A. in effect on the date such payment was required to be made.

Section 10.05. *Parties in Interest; Successors and Assigns.* (a) This Agreement shall be binding upon and, except as provided in Sections 1.02, 1.03, 1.04, 1.08, 6.04 and 10.06, inure solely to the benefit of the parties hereto and their respective successors and permitted assigns. Nothing in this Agreement, express or implied, is intended to confer upon any other Person any rights, benefits, remedies, obligations or liabilities of any nature whatsoever under or by reason of this Agreement, except for Sections 1.02, 1.03, 1.04, 1.08, 6.04 and 10.06 (which are also intended to be for the benefit of the Persons provided for therein and may also be enforced by such Persons).

(b) No party may assign, delegate or otherwise transfer any of its rights or obligations under this Agreement without the consent of the other parties hereto.

Section 10.06. *No Personal Liability.* This Agreement shall not create or be deemed to create or permit any personal liability or obligation on the part of any direct or indirect shareholder of any party hereto or any officer, director, employee, agent, representative or investor of any party hereto.

Section 10.07. *Governing Law.* This Agreement shall be construed in accordance with and governed by the laws of the Commonwealth of Pennsylvania.

Section 10.08. *Jurisdiction.* Any suit, action or proceeding seeking to enforce any provision of, or based on any matter arising out of or in connection with, this Agreement or the transactions contemplated by this Agreement shall be brought in any federal court in the State of Delaware or any state court in the State of Delaware and each of the parties hereto hereby irrevocably consents to the exclusive jurisdiction of such courts (and of the appropriate appellate courts therefrom) in any such suit, action or proceeding and irrevocably waives, to the fullest extent permitted by Applicable Law, any objection that it may now or hereafter have to the laying of venue of any such suit, action or proceeding in any such court or that any such suit, action or proceeding brought in any such court has been brought in an inconvenient forum. Process in any such suit, action or proceeding may be served on any party anywhere in the world, whether within

or without the jurisdiction of any such court. Without limiting the generality of the foregoing, each party hereto agrees that service of process upon such party as provided in Section 10.01 shall be deemed effective service of process upon such party.

Section 10.09. *WAIVER OF JURY TRIAL.* EACH OF THE PARTIES HERETO HEREBY IRREVOCABLY WAIVES ANY AND ALL RIGHT TO TRIAL BY JURY IN ANY LEGAL PROCEEDING ARISING OUT OF OR RELATED TO THIS AGREEMENT OR THE TRANSACTIONS CONTEMPLATED HEREBY.

Section 10.10. *Interpretation.* When a reference is made in this Agreement to an Article, Section, Exhibit or Schedule, such reference shall be to a an Article, Section or Exhibit of or a Schedule to this Agreement unless otherwise indicated. Any capitalized terms used in any Exhibit or Schedule but not otherwise defined therein shall have the meanings as defined in this Agreement. The table of contents and headings contained in this Agreement are for reference purposes only and shall not affect in any way the meaning or interpretation of this Agreement. Whenever the words "include", "includes" or "including" are used in this Agreement, they shall be deemed to be followed by the words "without limitation", whether or not they are in fact followed by those words or words of like import. The words "hereof", "herein" and "hereunder" and words of like import used in this Agreement shall refer to this Agreement as a whole and not to any particular provision of this Agreement. The phrases "the date of this Agreement", "the date hereof", and terms of similar import, unless the context otherwise requires, shall be deemed to refer to September 17, 2006. The words "properties" and "assets" shall be deemed to have the same meaning and refer to any and all tangible and intangible assets and properties. The word "or", when used in this Agreement, is not exclusive. Any singular term in this Agreement shall be deemed to include the plural, and any plural term the singular. References to any agreement or contract are to that agreement or contract as amended, modified or supplemented from time to time in accordance with the terms hereof and thereof. References to any Person include the successors and permitted assigns of that Person. In the event of any dispute concerning the construction or interpretation of this Agreement or any ambiguity hereof, there shall be no presumption that this Agreement or any provision hereof be construed against the party who drafted this Agreement.

Section 10.11. *Specific Performance.* The parties hereto agree that irreparable damage would occur in the event any provision of this Agreement was not performed in accordance with the terms hereof and that the parties shall be entitled to an injunction or injunctions (without being required to post any bond or surety instrument in connection therewith) to prevent breaches of this Agreement and to enforce specifically the terms and provisions of this Agreement in any federal court located in the State of Delaware or any state court in the State of Delaware in addition to any other remedy to which they are entitled at law or in equity.

Section 10.12. *Entire Agreement; Schedules.* This Agreement and the Schedules and Exhibits hereto and the Confidentiality Agreement constitute the entire agreement among the parties with respect to the subject matter hereof and supersede all prior written and oral and all contemporaneous oral agreements and understandings with respect to the

subject matter hereof. Each party acknowledges and agrees that each other party hereto makes no other representations or warranties, whether express or implied, other than the express representations and warranties contained herein or in the certificates to be delivered at the Effective Time. The fact that any item of information is disclosed in any Schedule to this Agreement shall not be construed to mean that such information is required to be disclosed by this Agreement. Such information shall not be used as a basis for interpreting the terms "material" or "Material Adverse Effect" or other similar terms in this Agreement.

Section 10.13. *Counterparts; Effectiveness.* This Agreement may be signed in any number of counterparts, each of which shall be an original, with the same effect as if the signatures thereto and hereto were upon the same instrument. This Agreement shall become effective when each party hereto shall have received counterparts hereof signed by the other party hereto. Until and unless each party has received a counterpart hereof signed by the other party hereto, this Agreement shall have no effect and no party shall have any right or obligation hereunder (whether by virtue of any other oral or written agreement or other communication).

Section 10.14. *Severability.* If any term, provision, covenant or restriction of this Agreement is determined by a court of competent jurisdiction to be invalid, void, illegal or incapable of being enforced by any rule of law, or public policy, the remainder of the terms, provisions, covenants and restrictions of this Agreement shall nevertheless remain in full force and effect so long as the economic or legal substance of the transactions contemplated herein is not affected in any manner materially adverse to any party hereto. Upon such determination that any term, provision, covenant or restriction is invalid, void, illegal or incapable of being enforced, the parties hereto shall negotiate in good faith to modify this Agreement so as to effect the original intent of the parties as closely as possible in a mutually acceptable manner in order that the transactions contemplated hereby be consummated as originally contemplated to the fullest extent possible.

## ARTICLE 11 DEFINITIONS

Section 11.01. *Definitions.* Each of the following terms is defined in the Article or Section set forth opposite such term:

<u>Terms</u>	<u>Section</u>
Acquisition Agreement	5.02(b)
Acquisition Proposal	5.02(c)
Adverse Recommendation Change	5.02(b)
Affiliate	3.17
Applicable Law	1.01(b)
Business Day	1.01(b)
Cash Merger Consideration	1.02(b)
Closing	1.01(a)
Closing Date	1.01(a)

Code	3.14(g)
Common Shares	3.05
Communications Licenses	3.16
Company	Preamble
Company Balance Sheet	3.08
Company Balance Sheet Date	3.08
Company Convertible Notes	3.05
Company Disclosure Schedule	Article 3
Company Environmental Licenses	3.19(a)
Company Material Adverse Effect	3.01
Company Material Agreement	3.20
Company Permitted Liens	3.18(a)
Company SEC Documents	3.07(a)
Company Securities	3.05
Company Significant Subsidiaries	3.06(a)
Company Stock Plans	1.04(a)
Company Stockholder Approval	5.02
Company Stockholders' Meeting	3.09
Company Subsidiary Securities	3.06(b)
Compensatory Awards	1.04(a)
Confidentiality Agreement	7.07(c)
Delaware Law	1.01(a)
Effective Time	1.01(b)
Employee Plan	3.14(g)
Enforceability Exceptions	3.01
Environmental Laws	3.19(b)
ERISA	3.14(g)
ERISA Affiliate	3.14(g)
ESPP Share Unit	1.04(a)
Evercore	3.04
Exchange Act	3.03
Exchange Agent	1.03(a)
FCC	3.03
GAAP	3.01
Governmental Authority	3.03
Grant Date	3.05
Grantor Trust Shares	1.04(a)
Hazardous Materials	3.19(b)
HSR Act	3.03
Indebtedness	5.01(d)
Indemnified Person	6.04(a)
internal controls	3.07(f)
Intellectual Property Rights	3.18(d)
Letter of Transmittal	1.03(a)
Licenses	7.03(a)
Lien	3.02

MAE Adverse Recommendation Change	5.02(b)
Material Adverse Effect	3.01
Material Intellectual Property	3.18(d)
Material Leased Real Property	3.18(c)
Material Owned Real Property	3.18(b)
Merger	1.01(a)
Merger Consideration	1.02(b)
Merger Consideration Value	1.04(b)
Merger Subsidiary	Preamble
NASDAQ	5.03
Notice of Superior Proposal	5.02(b)
NYSE	4.05
Option	1.06(a)
Parent	Preamble
Parent Balance Sheet	4.07
Parent Balance Sheet Date	4.07
Parent Disclosure Schedule	Article 4
Parent Environmental Licenses	4.15(b)
Parent Material Adverse Effect	4.01
Parent Options	4.05
Parent Preferred Stock	4.05(a)
Parent SEC Documents	4.06(a)
Parent Securities	4.05(a)
Parent Stock	1.02(b)
Pennsylvania Law	1.01(a)
Performance Awards	3.05
Permitted Additional Company Issuances	3.05
Permitted Share Unit Adjustments	3.05
Person	1.03(c)
PPUC	3.03
Preferred Stock	3.05
Proxy Statement	3.09
Registration Statement	3.09
Restricted Share	1.04(a)
Restricted Share Unit	1.04(a)
SEC	3.06(a)
Securities Act	3.03
Stock Merger Consideration	1.02(b)
Subsidiary	3.01
Superior Proposal	5.02(c)
Surviving Corporation	1.01(a)
Tax Return	3.13(e)
Taxes	3.13(e)
Termination Date	9.01(c)
Third Party	5.02(c)
Title IV Plan	3.14(b)

Treasury Shares

1.02(a)

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be duly executed by their respective authorized officers as of the day and year first above written.

COMMONWEALTH TELEPHONE  
ENTERPRISES, INC.,

By: Michael J. Mahoney  
Name: Michael J. Mahoney  
Title: President and Chief  
Executive Officer

CITIZENS COMMUNICATIONS  
COMPANY,

By: \_\_\_\_\_  
Name:  
Title:

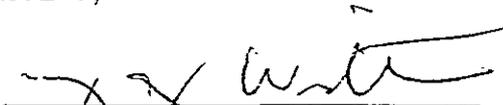
CF MERGER CORP.,

By: \_\_\_\_\_  
Name:  
Title:

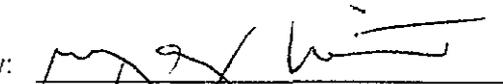
COMMONWEALTH TELEPHONE  
ENTERPRISES, INC.,

By: \_\_\_\_\_  
Name: Michael J. Mahoney  
Title: President and Chief  
Executive Officer

CITIZENS COMMUNICATIONS  
COMPANY,

By:   
Name: Mary Agnes Wilderotter  
Title: Chairman and Chief  
Executive Officer

CF MERGER CORP.,

By:   
Name: Mary Agnes Wilderotter  
Title: President

AMENDED AND RESTATED ARTICLES OF INCORPORATION

OF

COMMONWEALTH TELEPHONE ENTERPRISES, INC.

FIRST: The name of the corporation (hereinafter called the "Corporation") is Commonwealth Telephone Enterprises, Inc.

SECOND: The address, including street, number, city, and county, of the registered office of the Corporation in the Commonwealth of Pennsylvania is 100 CTE Drive, Luzerne County, Dallas, Pennsylvania 18612.

THIRD: The purpose of the Corporation is to engage in any lawful act or activity for which corporations may be organized under the Pennsylvania Business Corporation Law of 1988, as the same exists or may hereafter be amended.

FOURTH: The aggregate number of shares which the Corporation shall have authority to issue is 1,000 shares of Common Stock, par value \$0.01 per share.

FIFTH: In furtherance and not in limitation of the powers conferred upon it by law, the Board of Directors of the Corporation is expressly authorized to adopt, amend or repeal the By-laws of the Corporation.

SIXTH: To the fullest extent permitted by the Pennsylvania Business Corporation Law as it now exists and as it may hereafter be amended, no director or officer of the Corporation shall be personally liable to the Corporation or any of its stockholders for monetary damages for breach of fiduciary duty as a director or officer; provided, however, that nothing contained in this Article SIXTH shall eliminate or limit the liability of a director or officer (i) for any breach of the director's or officer's duty of loyalty to the Corporation or its stockholders, (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law, (iii) pursuant to Section 1553 of the Pennsylvania Business Corporation Law or (iv) for any transaction from which the director or officer derived an improper personal benefit. No amendment to or repeal of this Article SIXTH shall apply to or have any effect on the liability or alleged liability of any director or officer of the Corporation for or with respect to any acts or omissions of such director or officer occurring prior to such amendment or repeal.

SEVENTH: The Corporation shall, to the fullest extent permitted by Subchapter D, Sections 1741 through 1750 of the Pennsylvania Business Corporation Law, as the same may be amended and supplemented, indemnify any and all persons whom it shall have power to indemnify under said Sections from and against any and all of the expenses, liabilities, or other matters referred to in or covered by said Sections. Such indemnification shall be mandatory and not discretionary. The indemnification provided for herein shall not be deemed exclusive of any other rights to which those

indemnified may be entitled under any by-laws, agreement, vote of stockholders or disinterested directors or otherwise, both as to action in his or her official capacity and as to action in another capacity while holding such office, and shall continue as to a person who has ceased to be a director, officer, employee, or agent and shall inure to the benefit of the heirs, executors, and administrators of such a person. Any repeal or modification of this Article SEVENTH shall not adversely affect any right to indemnification of any persons existing at the time of such repeal or modification with respect to any matter occurring prior to such repeal or modification.

The Corporation shall to the fullest extent permitted by the Pennsylvania Business Corporation Law advance all costs and expenses (including, without limitation, attorneys' fees and expenses) incurred by any director or officer within 15 days of the presentation of same to the Corporation, with respect to any one or more actions, suits or proceedings, whether civil, criminal, administrative or investigative, so long as the Corporation receives from the director or officer an unsecured undertaking to repay such expenses if it shall ultimately be determined that such director or officer is not entitled to be indemnified by the Corporation under the Pennsylvania Business Corporation Law. Such obligation to advance costs and expenses shall be mandatory, and not discretionary, and shall include, without limitation, costs and expenses incurred in asserting affirmative defenses, counterclaims and cross claims. Such undertaking to repay may, if first requested in writing by the applicable director or officer, be on behalf of (rather than by) such director or officer, provided that in such case the Corporation shall have the right to approve the party making such undertaking.

EIGHTH: Unless and except to the extent that the By-laws of the Corporation shall so require, the election of directors of the Corporation need not be by written ballot.

FORM OF RULE 145 LETTER FOR COMPANY AFFILIATES

[Date]

Citizens Communications Company  
3 High Ridge Park  
Stamford, Connecticut 06905

Commonwealth Telephone Enterprises, Inc.  
100 CTE Drive  
Dallas, Pennsylvania 18612

Ladies and Gentlemen:

The undersigned has been advised that, as of the date of this letter, the undersigned may be deemed to be an "affiliate" of Commonwealth Telephone Enterprises, Inc., a Pennsylvania corporation (the "**Company**"), as the term "affiliate" is defined for purposes of paragraphs (c) and (d) of Rule 145 of the rules and regulations (the "**Rules and Regulations**") of the Securities and Exchange Commission (the "**SEC**") under the Securities Act of 1933, as amended (the "**Securities Act**"). Pursuant to the terms of the Agreement and Plan of Merger dated as of September 17, 2006 (the "**Merger Agreement**") among the Company, Citizens Communications Company, a Delaware corporation ("**Parent**"), and CF Merger Corp., a Delaware corporation and wholly-owned subsidiary of Parent ("**Merger Subsidiary**"), Merger Subsidiary will be merged with and into the Company, with the Company to be the surviving corporation in the merger (the "**Merger**").

As a result of the Merger, the undersigned may receive shares of common stock, par value \$0.25 per share, of Parent ("**Parent Common Shares**") in exchange for shares owned by the undersigned of common stock, par value \$1.00, of the Company as set forth in the Merger Agreement.

The undersigned represents, warrants and covenants to Parent and the Company, as of the date the undersigned receives any Parent Common Shares as a result of the Merger, that:

A. The undersigned shall not make any sale, transfer or other disposition of the Parent Common Shares in violation of the Securities Act or the Rules and Regulations.

B. The undersigned has carefully read this letter and the Merger Agreement and discussed, to the extent the undersigned felt necessary, with the undersigned's counsel or counsel for the Company, the requirements of such documents and other applicable limitations upon the undersigned's ability to sell, transfer or otherwise dispose of Parent Common Shares.

C. The undersigned has been advised that the issuance of Parent Common Shares to the undersigned pursuant to the Merger will be registered with the SEC under the Securities Act on a Registration Statement on Form S-4. The undersigned has also been advised that, because, at the time the Merger is submitted for a vote of the stockholders of the Company, the undersigned may be deemed an affiliate of the Company, the undersigned agrees that it shall not sell, transfer or otherwise dispose of Parent Common Shares issued to the undersigned in the Merger unless such sale, transfer or other disposition (i) has been registered under the Securities Act, (ii) is made in conformity with Rule 145 promulgated by the SEC under the Securities Act, and the undersigned has delivered to Parent evidence of compliance with Rule 145 in the form of Annex I hereto, or (iii) in the opinion of counsel reasonably acceptable to Parent, or pursuant to a "no action" letter obtained by the undersigned from the SEC staff, is otherwise exempt from registration under the Securities Act.

D. The undersigned understands and agrees that none of Parent, the Company or the Surviving Corporation (as defined in the Merger Agreement) is under any obligation to register the sale, transfer or other disposition of the Parent Common Shares by the undersigned or on the undersigned's behalf under the Securities Act or to take any other action necessary in order to enable the undersigned to make such sale, transfer or other disposition in compliance with an exemption from such registration.

E. The undersigned also understands and agrees that there will be placed on the certificates for the Parent Common Shares issued to the undersigned, or on any substitutions therefor, a legend stating in substance:

**"THE SECURITIES REPRESENTED BY THIS  
CERTIFICATE WERE ISSUED IN A  
TRANSACTION TO WHICH RULE 145  
PROMULGATED UNDER THE SECURITIES ACT  
OF 1933 APPLIES. THE SECURITIES  
REPRESENTED BY THIS CERTIFICATE MAY BE  
SOLD, TRANSFERRED OR OTHERWISE  
DISPOSED OF ONLY IN ACCORDANCE WITH  
THE TERMS OF A LETTER AGREEMENT  
BETWEEN THE REGISTERED HOLDER HEREOF  
AND CITIZENS COMMUNICATIONS COMPANY, A  
COPY OF WHICH AGREEMENT IS ON FILE AT  
THE PRINCIPAL OFFICES OF CITIZENS  
COMMUNICATIONS COMPANY."**

F. The undersigned also understands and agrees that, unless the transfer by the undersigned of the undersigned's Parent Common Shares has been registered under the Securities Act or a sale is made in conformity with the provisions of Rule 145 (and Parent receives the foregoing evidence of compliance therewith), Parent reserves the right to put the following legend on the certificates issued to the undersigned's transferee:

**“THE SECURITIES REPRESENTED BY THIS CERTIFICATE HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933 AND WERE ACQUIRED FROM A PERSON WHO RECEIVED SUCH SECURITIES IN A TRANSACTION TO WHICH RULE 145 PROMULGATED UNDER THE SECURITIES ACT OF 1933 APPLIES. THE SECURITIES HAVE NOT BEEN ACQUIRED BY THE HOLDER WITH A VIEW TO, OR FOR RESALE IN CONNECTION WITH, ANY DISTRIBUTION THEREOF WITHIN THE MEANING OF THE SECURITIES ACT OF 1933 AND MAY NOT BE SOLD, TRANSFERRED OR OTHERWISE DISPOSED OF EXCEPT PURSUANT TO AN EFFECTIVE REGISTRATION STATEMENT OR IN ACCORDANCE WITH AN EXEMPTION FROM THE REGISTRATION REQUIREMENTS OF THE SECURITIES ACT OF 1933.”**

It is understood and agreed that the legends set forth in paragraphs E and F above shall be removed by delivery of substitute certificates without such legend if (i) the securities represented thereby have been registered for sale by the undersigned under the Securities Act or (ii) Parent has received either an opinion of counsel, which opinion and counsel shall be reasonably satisfactory to Parent, or a “no-action” letter obtained by the undersigned from the SEC staff to the effect that the restrictions imposed by Rule 145 under the Securities Act no longer apply to the undersigned.

G. The undersigned further understands and agrees that the representations, warranties, covenants and agreements of the undersigned set forth herein are for the benefit of Parent, the Company and the Surviving Corporation (as defined in the Merger Agreement) and will be relied upon by such firms and their respective counsel and accountants.

H. The undersigned understands and agrees that this letter agreement shall apply to all shares of the capital stock of Parent and the Company that are deemed beneficially owned by the undersigned pursuant to applicable federal securities laws.

Parent agrees that it will (A) take all such actions as may be reasonably available to it to permit the sale or other disposition of Parent Common Shares by the undersigned under Rule 145 and (B) furnish to the undersigned upon request a written statement as to whether Parent has complied with the reporting requirements pursuant to Section 13 of the Securities Exchange Act of 1934, as amended, during the twelve months preceding any proposed sale of Parent Common Shares by the undersigned under Rule 145.

Execution of this letter should not be considered an admission on the part of the undersigned that the undersigned is an “affiliate” of the Company as described in the first paragraph of this letter, nor as a waiver of any rights that the undersigned may have to

object to any claim that the undersigned is such an affiliate on or after the date of this letter.

Very truly yours,

By: \_\_\_\_\_  
Name:

Accepted and agreed this [ ] day of  
[ ], 2006 by

CITIZENS COMMUNICATIONS  
COMPANY,

By: \_\_\_\_\_  
Name:  
Title:

[Date]

[Name]

On \_\_\_\_\_, the undersigned sold the shares of common stock, par value \$0.25 per share of Citizens Communications Company, a Delaware corporation ("Parent"), described below in the space provided for that purpose (the "Parent Common Shares"). The Parent Common Shares were received by the undersigned in connection with the merger of Commonwealth Telephone Enterprises, Inc., a Pennsylvania corporation, and CF Merger Corp., a Delaware corporation.

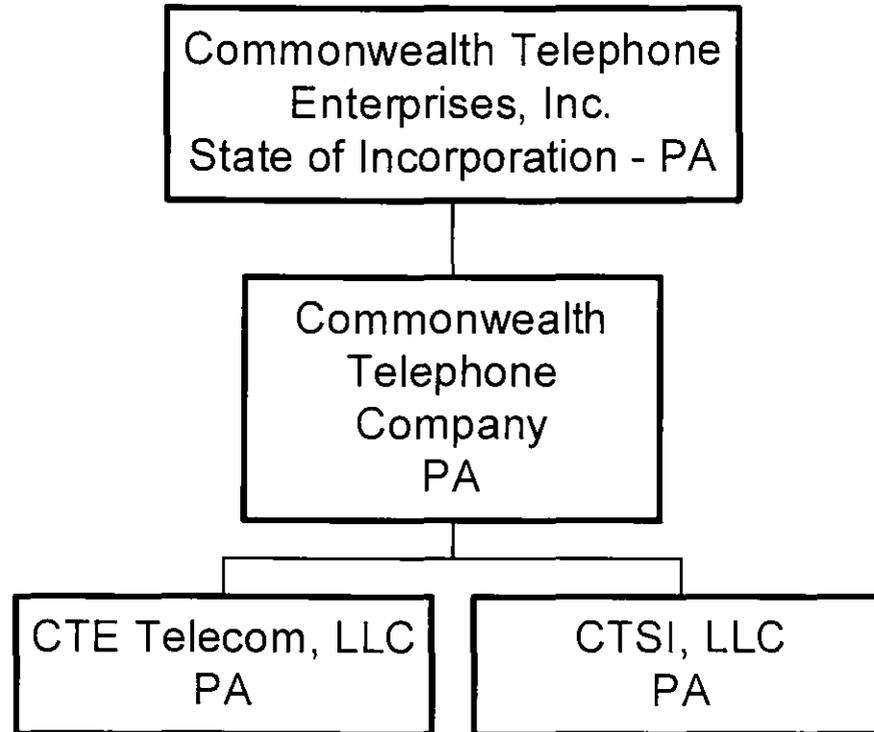
Based upon the most recent report or statement filed by Parent with the Securities and Exchange Commission, the Parent Common Shares sold by the undersigned were within the prescribed limitations set forth in paragraph (e) of Rule 144 promulgated under the Securities Act of 1933, as amended (the "Securities Act").

The undersigned hereby represents that the Parent Common Shares were sold in "brokers' transactions" within the meaning of Section 4(4) of the Securities Act or in transactions directly with a "market maker" as that term is defined in Section 3(a)(38) of the Securities Exchange Act of 1934, as amended. The undersigned further represents that the undersigned has not solicited or arranged for the solicitation of orders to buy the Parent Common Shares, and that the undersigned has not made any payment in connection with the offer or sale of the Parent Common Shares to any person other than to the broker who executed the order in respect of such sale.

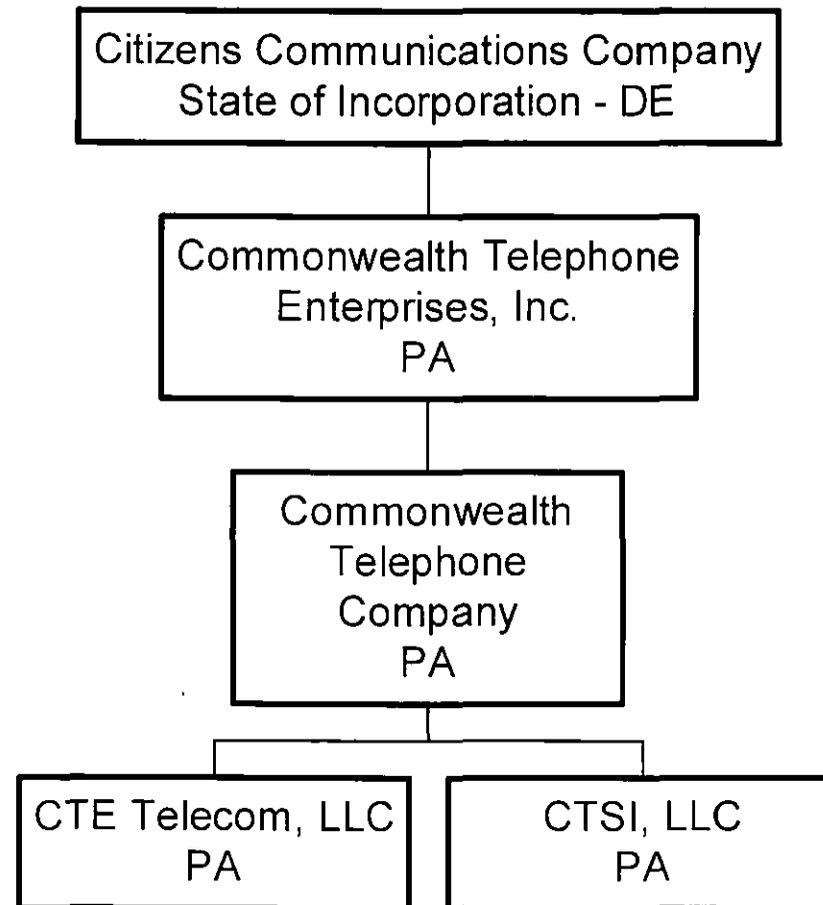
Very truly yours,

[Space to be provided for description of the Parent Common Shares]

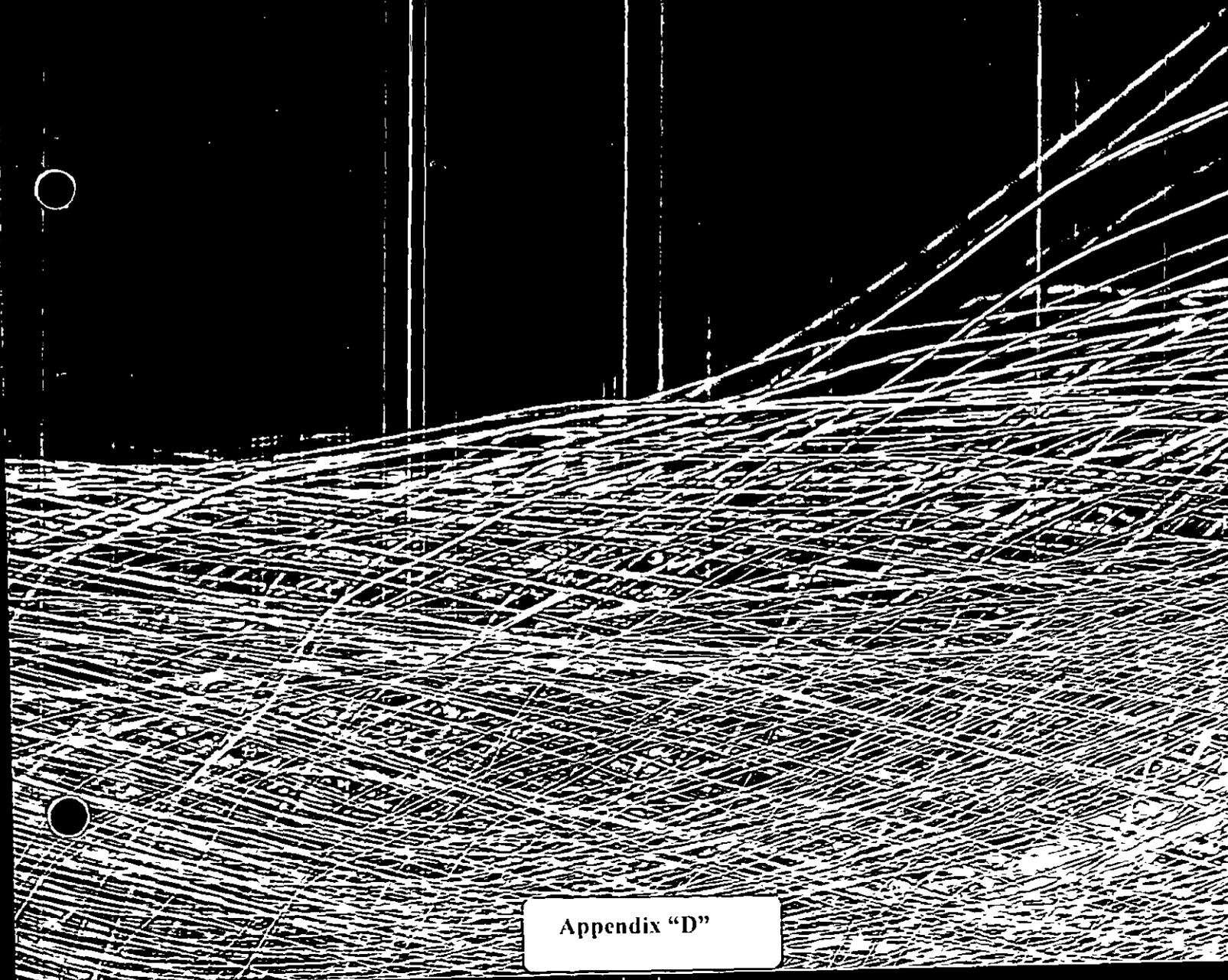
# Commonwealth Corporate Structure (Pre Transaction)



# Commonwealth Corporate Structure (Post Transaction)



102 10  
**COMMONWEALTH TELEPHONE ENTERPRISES, INC.**  
2005 ANNUAL REPORT



Appendix "D"

## ABOUT CTE

Headquartered in Dallas, PA, Commonwealth Telephone Enterprises, Inc. ("CTE"), serves business and residential customers with a full array of technologically advanced data and voice telecommunications products and services, including broadband data services and high-speed Internet access, delivered over its 100% digitally switched, fiber-rich network. CTE's primary operating segments are: Commonwealth Telephone Company ("CT"), the nation's eighth largest publicly held independent local exchange carrier, which has been operating in various rural Pennsylvania markets since 1897; and, CTSI, LLC ("CTSI"), a local exchange carrier operating in competitive markets outside CT's territory, that formally commenced operations in 1997. CTE deploys broadband DSL (digital subscriber line) technology to offer high-speed Internet access in the CT and CTSI service territories. In addition, CTE operates support businesses that provide products, services and expertise to its two principal operating segments. These businesses are reported as "Other" in CTE's results. Information about Commonwealth Telephone Enterprises, Inc., can be found at the web site address: [www.ct-enterprises.com](http://www.ct-enterprises.com).

### COMMONWEALTH TELEPHONE COMPANY

- 323,555 switched access lines in service at year-end 2005, a reduction of 3% versus year-end 2004
- Revenues of \$228.5 million in 2005, a growth rate of 0.4% versus 2004
- Operating income of \$111.9 million in 2005, a growth rate of 11% versus 2004
- 25,598 DSL subscribers at year-end 2005

### CTSI, LLC

- 137,696 switched access lines in service at year-end 2005, a reduction of 0.8% versus year-end 2004
- Revenues of \$86.5 million in 2005, an increase of 4% versus 2004
- Operating income of \$12.9 million in 2005, versus \$10.4 million in 2004
- 3,664 DSL subscribers at year-end 2005

### OTHER

- epix® Internet Services ([www.epix.net](http://www.epix.net)), one of the Northeast's largest rural dial-up Internet service providers, had 22,415 dial-up Internet subscribers at year-end 2005
- Commonwealth Communications, a provider of telecommunications equipment and facilities management services

## FINANCIAL HIGHLIGHTS

CTE Reported Consolidated Results

(\$ in Millions except Earnings Per Share)	FY05	FY04	% Inc./[Dec.] FY05 v. FY04	FY03	% Inc./[Dec.] FY04 v. FY03
Access Lines	461,251	471,842	[2%]	477,129	[1%]
Revenues	\$333.9	\$335.8	[1%]	\$335.7	-
Operating Income	\$112.1	\$106.4	5%	\$103.4	3%
Depreciation and Amortization	\$ 57.9	\$ 71.0	[18%]	\$ 71.1	-
Capital Expenditures	\$ 43.9	\$ 43.5	1%	\$ 49.5	[12%]
Reported Diluted Earnings Per Share	\$ 2.71	\$ 2.60	4%	\$ 2.92*	[11%]

\* Includes a one-time, after-tax gain of \$13.2 million, or \$0.51 per diluted share, in connection with the adoption of new accounting rules on asset retirement obligations under SFAS 143 (Statement of Financial Accounting Standards No. 143), which were effective January 1, 2003.

The Private Securities Litigation Reform Act of 1995 provides a "safe harbor" for forward-looking statements. Certain information included in this annual report is forward-looking. Such forward-looking information involves important risks and uncertainties that could significantly affect results expressed in any forward-looking statements made in this annual report. These risks and uncertainties include, but are not limited to, uncertainties related to CTE's ability to further penetrate its markets and the related costs of that effort, economic conditions, acquisitions and divestitures, government and regulatory policies, the pricing and availability of equipment, materials and inventories, technological developments, changes in the competitive environment in which CTE operates and receipt of necessary regulatory approvals.

## TO OUR SHAREHOLDERS:

We are pleased to report to you that 2005 marked another successful year for Commonwealth Telephone Enterprises, Inc.

We produced solid operating and financial results in 2005, while we also made significant progress in the areas of broadband deployment, bundling and new product introductions. Further, we returned significant cash to our shareholders by paying a \$13.00 per share special dividend and initiating a \$2.00 per share annual dividend.

### **Broadband Moves Rapidly to the Forefront**

One area in which we made great strides in 2005 was in our broadband network and product deployment.

Within the network footprint of Commonwealth Telephone Company ("CT"), we began 2005

with just under 80% of our households and business establishments being capable of receiving DSL from us. Of this addressable market, we had achieved just under 11% DSL penetration. By year-end 2005, we reached 86% capability and a 16% DSL penetration level.

We grew our consolidated DSL subscriber base by a record 57% – adding 10,650 net subscribers during the year. In fact, we ended the year by adding more subscribers in the 2005 fourth quarter – 3,125 – than in any other quarter since we launched our DSL product back in 1999. Most notably, the fourth quarter was our *eleventh* consecutive quarter in which we added more incremental net DSL subscribers versus the

number added in the comparable prior-year-same-quarter. We served 29,262 DSL subscribers at year-end.

Broadband is significant to our company's future, as it represents an attractive growth opportunity. The "need for speed" to efficiently access and transport higher bandwidth streaming video, music, digital photography and large data files on the Internet is driving growing consumer demand. Our network strategy is geared to take advantage of increasing broadband demand and future applications.

Consistent with our record of prudent capital expenditures, we plan to make appropriately timed network and product investments that are economically viable

and, therefore, value enhancing over time.

### **We grew our consolidated DSL subscriber base by a record 57% – adding 10,650 net subscribers...**

### **Bundling – Responding to Our Customers**

In 2005, we continued to develop and refine our

bundled data and voice product offerings. While we have had bundled product offerings for the last few years, we continue our efforts to be responsive to our customers' needs. In 2005, we provided customers greater choice – increasing the flexibility of both enhanced services and long-distance options – and customer response was excellent. In fact, at CT, we *more than doubled* the number of customers choosing a bundled product offering from us versus the end of 2004.

Our goal is to continue to migrate more of our customers into bundles, in order to strengthen our customer relationships and reduce churn to competitors.

### Successful New Product Launches

Part of the natural progression of our bundle development has been to initially offer certain services outside the bundle as attractive "add-ons," then look to potentially include them in the bundle value proposition as they gain market acceptance.

This past year, we successfully launched two new products that complement our bundles.

In May, we began offering the DISH Network™ satellite digital video service as an attractive "add-on" product to our bundles – a strategy aimed at increasing customer loyalty, while making us a formidable "triple play" competitor

versus the cable companies in our service territory.

The key advantages we offer customers include

one bill and one point of contact for data, video and voice services. Our alliance with EchoStar Communications to offer DISH Network™ satellite digital video services provided a low capital investment means to enter our market with a video product.

In December, we launched Internet-based electronic games offerings to our residential customers throughout the combined footprint of CT and CTSI, as well as to our epix® Internet Services customers. These new

services are provided through agreements with two premium game companies: Zone4Play, Inc., a developer of interactive software and technology for the gaming industry; and Exent Technologies, the global market leader in secure digital delivery of video games. The addition of Internet-based games brings an exciting entertainment component to our full suite of data, voice and video services. Further, our games offerings are a great example of value-added services that can be delivered over our broadband network.

### Returning Value Through Cash Dividends

In May 2005, we announced a one-time special dividend of \$13.00 per share, and a \$0.50 per share quarterly dividend in connection with our announced ongoing \$2.00 per share annual dividend.

For some time, we had been evaluating various alternatives to put our cash to work

to increase the value of our equity for our investors – and we concluded that the launching of our dividend plan would create strong shareholder value.

At the time we announced our dividend, we took several concurrent steps to further enhance our financial flexibility and increase the value of our common stock.

First, we announced an exchange offer for our Convertible Notes, which resulted in our reducing the potential dilutive effect on our common stock of future conversions of notes by up to 21%.

**Our primary focus is to expand our broadband capabilities, which will drive increased broadband penetration and support our bundling initiatives...**

We also announced that we were putting in place a new revolving credit facility, which provided us with an additional \$50 million of untapped borrowing capacity.

Further, we expressed our intention to continue to be opportunistic with respect to our authorized common share repurchase program, as well as to assess the feasibility of additional common share repurchases beyond our current authorized plan.

Throughout 2005, we have continued our ongoing focus on enhancing our financial strength and flexibility, ending the year with a strong balance sheet with relatively low leverage and a solid cash position. We believe that our balance sheet strength positions us to increase shareholder value in the future, including the option to be on either side of a value enhancing M&A transaction.

In addition to M&A, other potential future uses for our cash may include common stock repurchases, increased dividends, debt retirements and investments in new products and services.

As has been our established practice, the decision criteria we will use to determine the future use of our cash will be our best judgment regarding maximizing the total return of our common equity over the long term.

We believe that our combination of a significant dividend payout ratio with our ongoing financial flexibility – along with our record of solid operating and financial performance that has generated consistent cash flow – favorably positions us in the rural local exchange carrier segment of the telecom industry.

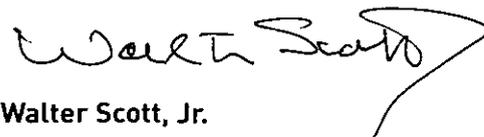
#### **Focused on 2006**

As we move into 2006, we remain financially strong and well positioned for the future.

Our primary focus is to expand our broadband capabilities, which will drive increased broadband penetration and support our bundling initiatives throughout our operations.

We are confident that we possess the people, the assets, the financial strength and the plans to achieve success in the markets in which we operate.

We appreciate your interest and support of our company, and we look forward to continuing our record of solid operating and financial performance in 2006 and beyond.



**Walter Scott, Jr.**  
Chairman



**Michael J. Mahoney**  
President and Chief Executive Officer

## BOARD OF DIRECTORS

**Walter Scott, Jr.**<sup>1</sup>  
*Chairman of the Board of Directors*  
Commonwealth Telephone Enterprises, Inc.,  
and Level 3 Communications, Inc.

**Michael J. Mahoney**<sup>1</sup>  
*President and Chief Executive Officer*  
Commonwealth Telephone Enterprises, Inc.

**John R. Birk**  
*Operating Executive*  
Evercore Partners

**James Q. Crowe**<sup>2</sup>  
*Chief Executive Officer*  
Level 3 Communications, Inc.

**Frank M. Henry**<sup>4</sup>  
*Chairman*  
Frank Martz Coach Company

**Richard R. Jaros**<sup>1,3</sup>  
*Private Investor*

**Daniel E. Knowles**<sup>2</sup>  
*President*  
Cambridge Human Resources

**David C. Mitchell**<sup>1,3,4\*</sup>  
*Former President—Telephone Group*  
Rochester Telephone Corporation

**Eugene Roth, Esq.**<sup>2,4</sup>  
*Counsel*  
Rosenn, Jenkins and  
Greenwald, L.L.P.

**John J. Whyte**<sup>3\*</sup>  
*Managing Director*  
WorldWide PCE LLC

<sup>1</sup> Executive Committee  
<sup>2</sup> Compensation/Pension Committee  
<sup>3</sup> Audit Committee  
<sup>4</sup> Corporate Governance Committee  
\* Committee Chair

## EXECUTIVE OFFICERS

**Michael J. Mahoney**  
*President and Chief Executive Officer*

**Eileen O'Neill Odum**  
*Executive Vice President*  
*and Chief Operating Officer*

**Donald P. Cawley**  
*Executive Vice President*  
*and Chief Accounting Officer*

**Raymond B. Ostroski**  
*Senior Vice President, General Counsel*  
*and Corporate Secretary*

**Scott Burnside**  
*Senior Vice President — Regulatory*  
*and Government Relations*

**David G. Weselcouch**  
*Senior Vice President — Investor Relations*  
*and Corporate Communications*

**Darryl Varnado**  
*Vice President — Human Resources*

## EXECUTIVE MANAGEMENT OF CTE OPERATING SUBSIDIARIES

**Kevin M. O'Hare**  
*Group Vice President — Strategic Development*

**Rita M. Brown**  
*Senior Vice President and General Manager*  
CTSI, LLC

**James F. Samaha**  
*Senior Vice President and General Manager*  
Commonwealth Telephone Company  
and epix® Internet Services

**Steven J. Letts**  
*Vice President and General Manager*  
Commonwealth Communications

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549**

**FORM 10-K**

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

For the fiscal year ended December 31, 2005

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
**Commission File No. 0-11053**

**Commonwealth Telephone Enterprises, Inc.**  
(Exact name of registrant as specified in its charter)

**Pennsylvania**  
(State or other jurisdiction of  
incorporation or organization)

**23-2093008**  
(I.R.S. Employer  
Identification No.)

**100 CTE Drive, Dallas, Pennsylvania 18612-9774**  
(Address of principal executive offices) (Zip Code)

**Registrant's telephone number including area code: 570-631-2700**

**Securities registered pursuant to Section 12(b) of the Act: None**

**Securities registered pursuant to Section 12(g) of the Act:**

Common Stock, par value \$1.00 per share  
(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.  Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.  Yes  No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.  Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer  Accelerated filer  Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).  Yes  No

Number of shares of the Registrant's Stock (\$1.00 par value) outstanding at February 28, 2006:

**21,848,859 Shares of Common Stock**

Aggregate market value of Registrant's voting stock held by non-affiliates at June 30, 2005 computed by reference to the closing price as reported by Nasdaq for Common Stock (\$41.91 per share), is as follows:

**\$913,185,121**

The market value is based on the value of the Common Stock that was outstanding on June 30, 2005.

**Documents Incorporated by Reference**

1. Proxy Statement for 2006 Annual Meeting of Shareholders is incorporated by reference into Part I and Part III of this Form 10-K.

COMMONWEALTH TELEPHONE ENTERPRISES, INC.

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"CTE," "the Company," "we," "us" and "our" refer to Commonwealth Telephone Enterprises, Inc.

"Our RLEC" and "CT" refer to Commonwealth Telephone Company, a rural incumbent local exchange carrier and a subsidiary of Commonwealth Telephone Enterprises, Inc.

The segment "CT" includes the results of our RLEC; Commonwealth Long Distance Company ("CLD"), a long-distance reseller; and the portion of our broadband data service that uses digital subscriber line ("DSL") technology to offer high-speed Internet access, that is in CT's territory.

"Our CLEC," "RLEC 'edge-out'" and "CTSI" refer to CTSI, LLC, a competitive local exchange carrier and a subsidiary of Commonwealth Telephone Company.

## PART I

This report contains certain forward-looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Exchange Act and we intend that such forward-looking statements be subject to these safe harbors. These statements are generally accompanied by words such as “intend,” “anticipate,” “believe,” “estimate,” “expect” or similar statements. Our forward-looking statements involve risks and uncertainties that could significantly affect expected results in the future differently than expressed in any forward-looking statements we have made. These risks and uncertainties include, but are not limited to:

- uncertainties relating to our ability to further penetrate our markets and the related cost of that effort;
- economic conditions, acquisitions and divestitures;
- *government and regulatory policies*;
- the pricing and availability of equipment, materials and inventories;
- technological developments;
- reductions in rates or traffic that is subject to access charges;
- changes in the competitive environment in which we operate; and
- *receipt of necessary regulatory approvals*.

Additional factors that could cause or contribute to such differences are set forth in the section entitled “Risk Factors” and are discussed elsewhere in this report. Although we believe that the assumptions underlying our forward-looking statements are reasonable, any of the assumptions could prove inaccurate; and, therefore, we cannot provide any assurance that the results contemplated in such forward-looking statements will be realized. The inclusion of this forward-looking information should not be regarded as a representation by us or any other person that the future events, plans or expectations that we contemplate will be achieved. Furthermore, past performance in operations and share price is not necessarily predictive of future performance.

### Item 1. *Business*

#### *General*

We are a telecommunications company providing telephony and related services in Pennsylvania markets as a rural incumbent local exchange carrier, or RLEC. We also operate as a competitive local exchange carrier, or CLEC, in three regional Pennsylvania markets that border CT’s markets, which we refer to as our RLEC “edge-out” markets. CT is the nation’s eighth largest non-Bell incumbent local exchange carrier, serving over 323,500 switched access lines as of December 31, 2005. CTSI served over 137,600 competitive switched access lines as of December 31, 2005. For the years ended December 31, 2005 and 2004, we had consolidated revenues of \$333.9 million and \$335.8 million, respectively.

CT, founded in 1897, operates in a rural, approximately 5,000-square-mile territory with a population of approximately 450,000 people, and a line density of approximately 65 access lines per square mile. Approximately three quarters of CT’s switched access lines serve residential customers. CT generated revenues of \$228.5 million and \$227.7 million, and operating income of \$111.9 million and \$100.4 million for the years ended December 31, 2005 and 2004, respectively. CT ranks among the industry leaders in penetration of residential additional lines. CT’s penetration of residential additional lines was 33% at December 31, 2005. Our residential additional line penetration rate is decreasing, partially as a result of our digital subscriber line (“DSL”) success. We continue to counter residential additional line erosion with bundled service offerings, some of which include an additional line as part of the bundle.

CTSI formally began operating in our “edge-out” markets in 1997 and currently provides a full array of competitive voice and data telecommunications services mainly to business customers. CTSI serves the three regional Pennsylvania “edge-out” markets of Wilkes-Barre/Scranton/Hazleton, Harrisburg and Lancaster/Reading/York. In the “edge-out” markets, CTSI generated revenues of \$86.5 million and \$83.6 million, and operating income of \$12.9 million and \$9.6 million for the years ended December 31, 2005 and 2004, respectively.

We also own and operate other telecommunications-related support businesses that all operate in deregulated segments of the telecommunications industry and that support the operations of our two primary operating companies. These businesses are epix® Internet Services, one of the northeast's largest rural dial-up Internet service providers with approximately 22,400 dial-up Internet access subscribers as of December 31, 2005; and Commonwealth Communications, a provider of telecommunications equipment and facilities management services. Our "Other" business segment includes these support businesses, as well as our corporate entity. Financial information about our segments is included in Note 3 of Notes to Consolidated Financial Statements on page F-37 to F-39 of this report.

A web site featuring current information regarding Commonwealth Telephone Enterprises, Inc., can be found on the Internet at [www.ct-enterprises.com](http://www.ct-enterprises.com). However, the information on our web site is not part of this annual report. Our periodic and current reports are available on our web site as soon as reasonably practicable after such material is electronically filed with, or furnished to, the Securities and Exchange Commission.

### ***Business Strategy***

We strive to grow our revenues, control our expenses and deploy our capital in a manner that maximizes our operating income. In order to achieve this goal, we have formulated the following business strategy:

#### ***Introduction of Bundled Offerings and Maximizing Revenue per Customer***

As noted earlier, we have introduced various bundled offerings at CT aimed at increasing take rates on DSL and our long-distance products, as well as slowing erosion in our additional line penetration level and retaining customers. In 2004, we announced our alliance with EchoStar Communications Corporation to provide their DISH Network™ satellite TV service to all households in our current territory. This enabled the Company to offer its customers digital television programming beginning in mid-2005. In April of 2005, we announced that we had signed agreements with two leading game providers: Zone4Play, Inc. and Exent Technologies. In the fourth quarter of 2005, we began offering Internet-based electronic games to our residential customers in the current territories of CT and CTSI, as well as to epix® customers. We are assessing the feasibility of adding additional products to our service bundles in the future such as Voice over Internet Protocol ("VoIP").

CT offers an array of enhanced services such as caller identification, voice mail and custom calling services, such as call-forwarding, call waiting and three-way calling. These services generally produce higher margins than basic telephone service. Our RLEC's network is 100% digitally-switched and all upgrades to provide these additional services to our entire customer base have been substantially completed. We have increased our efforts to market enhanced services through bundled offerings to our customers and believe we can achieve higher penetration rates that are more in line with industry averages.

During 2005, CT filed and received Pennsylvania Public Utility Commission ("PUC") approval of an amended plan to revise its price adjustment formula to eliminate the 2% annual offset to inflation, and to provide universal availability of broadband services within CT's service territory no later than December 31, 2008. Under the amended plan, CT could be required to refund some of its increased revenues to customers if it fails to meet its commitment to deploy broadband services. The alternative regulation plan, under which we operated before this amendment, permitted CT to increase its overall rates for regulated intrastate services annually by an amount equal to inflation minus 2%.

#### ***Leverage CT's Brand, Reputation and Expertise to Further Penetrate CTSI's Markets***

In the CTSI markets, we seek to increase our penetration rate by targeting business customers who have traditionally been underserved by Verizon and by offering competitive service packages that compare favorably to those being offered by Verizon. We believe our strong Commonwealth Telephone brand, reputation and expertise provide us with important competitive advantages in these markets and will allow us to continue to gain new customers and increase our market share at a low marginal operating cost.

### *Increase Sales of Data Products and Services*

We intend to capitalize on an increasing demand for business and residential data services, including demand for high bandwidth connectivity, in all of the markets we serve. We offer dial-up Internet access through epix® Internet Services and digital subscriber line, or DSL, broadband services as well as high-capacity point-to-point and virtual private network (“VPN”) circuits. We believe there is additional opportunity to increase sales of our data services at a favorable marginal operating cost in all of the markets in which we operate.

### *Continue to Provide Superior Service and Customer Care*

We intend to continue to capitalize on our customer service capabilities to provide superior service and customer care. Our RLEC has achieved the lowest level of “justified complaints,” as defined by the PUC, among Pennsylvania’s largest local exchange carriers, as well as the state’s two largest competitive exchange carriers, in ten of the past eleven years, including the last eight consecutive years. In our CTSI markets, our customer account managers provide personalized customer care to business customers, and our centralized call center operates 24 hours a day, 7 days a week to support our business and residential customers. By building on our strong service record, we plan to further differentiate ourselves from our competitors.

### *Selectively Pursue Strategic Acquisitions*

To continue the growth of our business, we will seek to selectively acquire companies that offer a strategic fit with our existing businesses. This may include companies that could help us deepen our industry focus, further penetrate or broaden our target markets or increase the breadth of services we offer.

### *CT Operations*

Our RLEC, CT, offers local, toll, network access and enhanced services in a rural, mountainous market located primarily in the eastern third of Pennsylvania.

### *Network Strategy*

CT utilizes a technologically-advanced, fiber-rich network that is based on 100% digital-switching, integrated DWDM-Sonet transport and host/remote (TR 303 Standards Based) architecture. It was the first telephone company to deploy fiber optics in a toll application and was one of the first local exchange carriers in the nation to deploy a network of all digitally-switched central offices. CT operates its own Signaling System 7, STP based network, which provides efficient call set-up and routing of telephone calls. Throughout its market, CT has 11 digital host switches and about 500 remotes. All of the trunks between the hosts and the remote wire centers are connected with fiber optic cable. Connection to our customers, or the “last mile,” is provided over our RLEC’s copper outside plant. Our network architecture provides for short loop lengths in our copper plant, which allows CT to aggregate customer lines at the remotes for transport, and concentrates costly network intelligence in a small number of host offices. Additionally, our RLEC operates a network control center, which monitors network performance 24 hours a day, 7 days a week and allows us to maintain high network performance standards. CT has undertaken a three-year network upgrade initiative that will deliver broadband to 100% of households and businesses in the CT service area by year-end 2008.

### *Customer Service*

CT has long been recognized as a customer service leader in Pennsylvania. Each year, the Pennsylvania Public Utility Commission issues a study that measures the customer service results, based on customer complaints, of the state’s five largest local exchange service providers, as well as the state’s two largest competitive local exchange carriers, which includes Alltel, MCI Local, Verizon Pennsylvania (formerly Bell Atlantic), Verizon North, Inc. (formerly GTE North, Inc.), Sprint (formerly United) and Comcast Digital Phone. CT has achieved the lowest level of justified complaints, as defined by the Pennsylvania Public Utility Commission, among Pennsylvania’s largest local exchange carriers in ten of the past eleven years, including the last eight consecutive years.

### *Regulatory Environment*

CT is subject to regulation by the PUC for intrastate rate-making purposes, which includes rates for basic local services, intraLATA toll services and access services for the origination and termination of in-state long-distance calls. CT has entered into an alternative regulatory framework with the PUC for all of its intrastate operations, under which it has agreed to meet certain broadband service delivery parameters in exchange for a price cap formula, rather than rate of return regulations. During 2005, the PUC approved an amendment to CT's plan that eliminated the previous 2% yearly offset in its price adjustment formula. Under the amended formula, CT may adjust its intrastate prices each year by an amount equal to inflation, although CT could be required to refund the additional revenues collected due to this amendment if it fails to meet its commitment to deliver broadband service capability to all customers by December 31, 2008. Additionally, CT has the ability to request relief on a dollar-for-dollar basis for certain events deemed outside of its control that result in reduced revenues or increased expenses. This may include changes in revenues that may result from portions of interstate access charge reform.

The PUC must also approve any issuance of stock, incurrence of long-term debt or acquisition or sale of material utility assets by CT. In addition, the PUC must approve any change in control of either CT or its holding company. The PUC defines a "change in control" as either an acquisition or disposition of the largest single voting interest in a company, if that interest exceeds 20%.

CT is subject to the jurisdiction of the Federal Communications Commission ("FCC") with respect to interstate rates, services, access charges and other matters, including the prescription of a uniform system of accounts. Interstate services, for the purpose of determining FCC jurisdiction, are communications that originate in one state and terminate in another state or a foreign country, including the use of CT's local telephone network to originate or terminate such communications. Prices for CT's interstate services, consisting primarily of subscriber line charges and access charges for interstate toll calls, which accounted for approximately 32.0% of our RLEC's 2005 revenues, are regulated by the FCC based on "average schedule" formulas. The formulas use the costs of other telephone companies to "simulate" the costs of the average schedule companies. Under the FCC rules, the National Exchange Carrier Association ("NECA") is required to review these formulas annually. In December 2005, NECA proposed formula changes to the FCC that, if adopted, could reduce CT's interstate revenues by approximately \$1.2 million (\$2.4 million annually) in the second half of 2006. In addition, NECA proposed a phased-in structural change to the formulas that would reduce CT's settlements by approximately \$0.4 million in 2006, \$2.2 million in 2007, \$3.9 million in 2008 and \$4.2 million thereafter. These structural changes result primarily from changes in the formula used to estimate common line (or local loop) costs and special circuit settlements. It is possible that future changes to the formulas or FCC disallowance of the phase-in may cause additional changes (either increases or decreases) in CT's interstate access revenues.

The FCC has an open rulemaking proceeding in which it is considering major changes to its rules governing interstate access charges and other forms of intercarrier compensation. We are unable to predict how any FCC action in this proceeding may affect CT's revenues. CT also receives funding from the federal Universal Service Fund, under rules established by the FCC. The FCC is considering changes in the universal service mechanism, affecting both the collection and distribution of these funds that could affect CT's prices and revenues. In addition, the FCC must also approve any sale or "transfer of control" of CT or of its holding company.

### *Competitive Environment*

Our RLEC has faced very limited competition, except for in-region toll service, during the first decade after the Telecommunications Act was passed in 1996. Part of the reason for this is that CT maintains a rural exemption from the provisions of the Telecommunications Act, including, but not necessarily limited to, unbundling, colocation and rate discounts, for all of its access lines in Pennsylvania. The rural exemption requires prospective competitors who seek resale discounts, colocation, total element long run incremental cost ("TELRIC") pricing and unbundled network elements to go through a formal review by the Pennsylvania PUC before receiving approval. The PUC may grant such approval only if it finds that the competitor's proposal is not unduly economically burdensome, is technically feasible and is consistent with the universal service provisions of the Telecommunications Act. To date, no carrier has sought such a review by the Pennsylvania PUC. In addition, competition in our markets is somewhat mitigated due to the low population density, rural nature and mountainous topography of our markets.

However, the rural exemption does not preclude competitors from providing telephone services within CT's service area *entirely* over their own facilities, or over the facilities of third parties. Further, the Act's general requirement that telecommunications carriers interconnect networks for the exchange of traffic does apply to CT. CT has received several requests for network interconnection for the exchange of traffic between its network and the networks of other facilities-based telecommunications providers, and has entered into interconnection and reciprocal compensation agreements with several national wireless carriers and wireline carriers for exchange of traffic between its network and theirs. Sprint has filed to provide facilities-based CLEC service in CT's territory; however, CT is protesting the application. It is CT's contention that Sprint is not the actual end user and, therefore, the application should be denied. In addition, Core Communications, Inc. has filed an application for the purpose of expanding its local service authority to include the service territory of CT. Service Electric Telephone Company, LLC. ("SET") filed an application for the purpose of expanding its local service authority to include the remaining service territory of CT. SET received authority to offer facilities based local exchange telecommunications services in a limited portion of CT's service area in 2001. CT is protesting both of these applications. It is not possible to predict the outcome of any of these proceedings at this time.

A variety of other factors contribute to our RLEC's relative insulation from competition. These factors include its service territory's high-cost of facilities-based entry due to low population density, the lack of concentration of any large business customers (as its top 10 business customers account for less than 5% of its revenues), its customer service record and level of customer satisfaction and its favorable regulatory environment.

Competition has, however, been increasing in recent years, due to increased marketing of calling packages by wireless carriers and the entry of new types of voice service providers. We now face competition from national ISPs such as Time Warner (AOL), from cable providers offering a cable modem product, and from providers of voice over Internet services (such as Vonage, Skype and others) who do not require access to CT's telephone network for their competitive offerings.

#### *DSL*

In the second half of 1999, we began offering our DSL service. We offer this service through our own facilities in the majority of CT's territory and on an "on-net" and an "off-net" basis in selected areas of CTSI's markets. As of December 31, 2005, most of our installed DSL lines are in CT's territory.

#### *CLD*

Since 1990, Commonwealth Long Distance Company ("CLD") has conducted the business of providing long-distance telephone services. Commonwealth Long Distance provides long-distance services to CT's customers. CLD purchases long-distance minutes on a wholesale basis from third-party providers.

#### *CTSI Operations*

We offer competitive local, toll, network access, long-distance, enhanced services, broadband data services and high-speed Internet access services in three regional "edge-out" markets, which encompass cities and surrounding areas that have total populations between 250,000 and 500,000, as well as a significant concentration of business and industry. The geographic area represented by these three markets is roughly one-third the size of CT's service territory, or about 1,750 square miles, with a population of approximately 1.4 million and approximately 600 access lines per square mile.

#### *Network Strategy*

CTSI's network strategy is to own the majority of the key elements of the local exchange network. These elements include the host switches, the remote switches and the facilities connecting the host switches to the remote switches, including both the fiber optic cable and the transport electronics. In addition, where economically viable, CTSI builds copper distribution facilities between the remote switch and customer premises. Our network strategy allows us to provide high-quality, reliable service, reduce customer churn and generate attractive margins. CTSI builds, owns and operates digitally-switched, fiber intensive networks that are DSL-capable in each of its three regional edge-out markets. As of December 31, 2005, CTSI had approximately 99% of its access lines connected to its own switches and approximately 54% of its access lines completely on its own network.

### *Customer Service*

CTSI strives to provide its customers with exceptional service and uses the same customer care procedures that have proven successful for our 109-year-old RLEC. We operate a customer service center, which takes calls 24 hours a day, 7 days a week, to handle all customer requests. We are also proficient in other customer service aspects of operating in a CLEC environment and have developed an efficient provisioning interface with the incumbent local exchange carrier. Because we own and operate a significant portion of our own network elements, we are not solely dependent upon the incumbent local exchange carrier for provisioning and maintenance resolution. We deploy leading-edge network management and support systems to support proactive fault and performance management to deliver the highest quality of service to our customers.

### *Sales Organization*

We utilize direct sales channels to target potential business, carrier and residential customers. Our direct channels include sales teams based in local offices, which are exclusively focused on selling to potential business customers with more than five lines. Each team consists of customer account managers and specialists that focus on retaining and growing accounts after the initial sale. In addition, our inside sales team is focused on residential and business customers with fewer than five lines.

### *Regulatory Environment*

The Pennsylvania PUC exercises jurisdiction over CTSI's intrastate telephone services, including basic local exchange service, intrastate access services, and intraLATA toll services. Under the PUC's current practices, CTSI's rates and services are generally subject to much less regulatory scrutiny than those of the dominant local telephone company in its markets (*i.e.*, Verizon). Additionally, municipalities and other local government agencies may regulate limited aspects of CTSI's business, such as its use of rights-of-way.

At the federal level, the FCC has jurisdiction over interstate services, including access charges, as well as long-distance services. CTSI's rates, terms, and conditions of service are filed with the FCC in tariffs and are subject to the FCC's complaint jurisdiction. The FCC has established rules limiting the rates CTSI and other competitive local exchange carriers can charge for origination and termination of long-distance calls (switched access), and for termination of local calls to Internet service providers (ISP traffic).

The Telecommunications Act of 1996 gives CTSI rights to interconnect its network with Verizon, to exchange traffic with Verizon and to obtain unbundled access to elements of Verizon's network at regulated rates based on Verizon's forward-looking costs, which may include a reasonable profit. Under this law, Verizon and CTSI may negotiate the prices and other terms and conditions of these arrangements, but in the event of an impasse, the Pennsylvania PUC has authority to arbitrate any disputes. Future rulings by the Pennsylvania PUC, or changes in the FCC rules under which the Pennsylvania PUC resolves these issues, may have a material effect on CTSI's costs and profitability.

CTSI purchases access to various network elements from Verizon under FCC rules that require the Pennsylvania PUC to determine rates for these elements based upon forward-looking incremental costs. The FCC adopted significant changes in October 2003 and February 2005 to its rules requiring incumbent carriers, like Verizon, to offer unbundled access to network elements to competing carriers, like CTSI. We believe that the new rules are not likely to have a material impact on CTSI's use of unbundled voice-grade loops. These rules remain subject to judicial review and to further FCC proceedings, which could affect the terms on which CTSI obtains access to voice-grade loops and other components of Verizon's network. We cannot offer any assurance that CTSI will continue to be able to obtain this access on favorable terms.

### *Competitive Environment*

CTSI competes principally with the services offered by the incumbent local exchange carrier, Verizon. Incumbent local exchange carriers, such as Verizon, have relationships with their customers, have the potential to subsidize services from their regulated service revenues and benefit from certain favorable state and federal regulations. Verizon is larger and has greater financial resources than CTSI. In light of the passage of the Telecommunications Act and concessions by some of the regional Bell companies, federal and state regulatory initiatives may provide increased business opportunities to CLECs, but incumbent carriers may obtain increased pricing flexibility for their services as competition increases. If, in the future, incumbent carriers are permitted by

regulators to lower their rates substantially, engage in significant volume and term discount pricing practices for their customers or charge CLECs significantly higher fees for interconnection to the incumbent carriers' networks, CTSI's competitive position would be adversely affected.

CTSI also faces, and will continue to face, competition from other current and potential future market entrants, including other CLECs, long-distance companies (MCI), cable television companies, electric utilities, microwave carriers, wireless telecommunications providers, Internet providers (XO and Level 3) and private networks built by large end users. The edge-out markets served by CTSI are served by one or more other CLECs including XO Communications, Telcove, Choice One Communications, D&E Communications and others. We expect competition from CLECs and other companies to continue in the future.

### ***Other Operations***

#### ***Commonwealth Communication, LLC***

Commonwealth Communications provides telecommunications equipment and technical services, and designs, installs and manages telephone systems for businesses, hospitals and universities located primarily in Pennsylvania. Commonwealth Communications also undertakes premises distribution systems projects (cabling projects) primarily for hospitals and educational institutions.

#### ***epix® Internet Services***

epix® Internet Services ("epix®"), founded in 1994, is our Internet service provider. epix® primarily provides dial-up Internet access at a flat rate for residential users and also provides dedicated access for business users and associated services such as web page hosting and design. epix® provides a competitive Internet product for CT and CTSI and other customers, along with network support, technical support and customer service to our DSL product. epix® had approximately 22,400 dial-up subscribers as of December 31, 2005.

### ***Employees***

We employed a total of 1,107 employees as of December 31, 2005. Approximately 38% of our employees are covered under collective bargaining agreements. Commonwealth Telephone Company bargaining employees labor contract with the Communications Workers of America expired on November 30, 2005. Currently, the Company and the union are working under the terms of the old contract. Also, in December 2005, Commonwealth Communications bargaining employees ratified a labor contract between the Company and the Communications Workers of America that will remain in effect until June 29, 2009.

## ***Item 1A. Risk Factors***

### ***Risks related to regulation of the telecommunications industry***

The telecommunications industry is subject to extensive regulation at the federal, state and local levels. The costs of complying with this regulation, delays or failures to receive required regulatory approvals, or the enactment of new, adverse regulatory requirements may have a material adverse effect upon our business. The risks presented by the regulatory environment we face include the following:

*The amounts we can charge for most of our services are subject to regulatory restrictions. Our financial results have been adversely affected by recent reductions in access rates and may be further adversely affected by future regulatory decisions.*

Approximately 14.1% of our consolidated revenues for both of the years ended December 31, 2005 and 2004 were from local service fees paid by customers of our RLEC. These fees, and other charges imposed by our RLEC for in-state services, are currently subject to an alternative regulation plan approved by the PUC. We believe that this regulatory arrangement is more favorable to us than traditional rate of return regulation.

On November 30, 2004, the Governor of Pennsylvania signed legislation that authorized CT to amend its alternative regulation plan to include a commitment to deliver broadband service to all customers by December 31, 2008. Under the legislation, this commitment entitles CT to eliminate the 2% yearly offset in its price adjustment formula, although CT could be required to refund the additional revenues collected due to this amendment if it fails to meet its broadband commitment.

Under the amended plan that is now in effect, CT can change its in-state rates, in the aggregate, based on changes in inflation or for events deemed outside of CT's control that result in reduced revenues or increased expenses. These increases may not be sufficient to cover increases in our costs.

Additionally, approximately 43.2% and 42.6% of our consolidated revenues for the years ended December 31, 2005 and 2004, respectively, came from charges paid to us by other carriers for services CT and CTSI provided in originating and terminating intrastate and interstate toll calls, and terminating local calls received from wireless carriers and other telephone companies. The payments that we receive for these services are regulated by the FCC and the Pennsylvania PUC. The amounts charged by both CT and CTSI for these services have been reduced by recent regulatory decisions.

CT currently receives its interstate access revenues pursuant to average cost schedules established by NECA. If CT should lose its average schedule status, or if NECA should make changes in its cost schedules or methodology, we could incur a significant loss of interstate access revenue.

We cannot predict whether any additional FCC or Pennsylvania PUC rules will be passed that will result in further reductions in the revenues we receive, although the FCC is currently considering proposals that could significantly change the interstate access charge system. Additionally, these agencies' current rules may change as a result of judicial review or changes in legislation.

*If any of the favorable regulatory provisions from which CT currently benefits were to be unfavorably modified or terminated, we could experience higher costs and lower revenues.*

Because of its status as a rural telephone company under the Telecommunications Act of 1996, or the Act, CT is not currently required to comply with that Act's provisions requiring an incumbent carrier to unbundle its network, provide colocation, provide resale discounts, provide interconnection at rates based on forward-looking incremental costs or other items. If this limitation were to change, more competitors could enter our RLEC markets than we currently expect. CT might have to provide these competitors with access to our facilities at rates lower than what we currently charge our customers for use of those facilities. We could also incur additional administrative and regulatory expenses as a result of such newly imposed requirements. The Pennsylvania PUC has authority under the Act to terminate CT's rural exemption if it receives a request to do so from another telecommunications carrier. To date, no other carrier has made such a request to the Pennsylvania PUC, but we have no assurance that CT's rural exemption will remain in effect indefinitely.

*Loss of our access to network elements from incumbent telephone companies or an increase in the prices we must pay for such elements would adversely affect CTSI's business.*

Approximately half of CTSI's customers are served, at least in part, by network elements leased primarily from Verizon. CTSI's business, therefore, depends in large part on our ability to provide service to our customers by leasing various elements of the incumbent telephone company's network to provide local service. The Act, and FCC and state commission rulings under the Act, require incumbent telephone companies to lease network elements. If these rules are changed by the FCC or state commissions, or are struck down by the courts, our ability to provide service in a cost-effective manner could be adversely affected. For example, the FCC could remove one or more of the necessary elements that the incumbent telephone company is required to provide to us, or permit substantial increases in the amounts the incumbent company can charge CTSI. If incumbent telephone companies were no longer required to provide unbundled network elements on favorable terms, CTSI's operating margins would be reduced and it might not be able to effectively compete.

The FCC has made several significant changes in recent years to its rules governing access to unbundled network elements. Under the new rules, Verizon is required to continue to offer access to unbundled voice-grade loops. However, we cannot assure you that these rules will not change in the future.

*Regulatory requirements could delay or prevent our ability to take actions we consider beneficial to our business.*

Pennsylvania law requires us to secure consent from the Pennsylvania PUC before CT or CTSI may issue capital stock, incur long-term debt or sell or otherwise dispose of material utility assets. Both the FCC and the PUC must review any transaction that results in a "change of control" of a regulated entity or of a holding

company of a regulated entity. The approval process for these transactions can be lengthy and could restrict our ability to offer services, set prices, obtain financing, affect mergers or otherwise arrange a sale of the Company or take other steps that we may believe to be in our best interest.

*Risks related to the competitive nature of the telecommunications industry*

The telecommunications industry is highly competitive. We face actual or potential competition from many existing and emerging companies, including other incumbent and competitive local telephone companies, long-distance carriers and resellers, wireless telephone companies, Internet service providers, satellite companies and cable companies. We may not be able to successfully anticipate and respond to various competitive factors affecting the industry, including regulatory changes that may affect our competitors and us differently, new technologies and services that may be introduced, changes in consumer preferences, demographic trends and discount pricing strategies by competitors. Also, recent consolidation in the telecommunications industry (for example, Verizon and MCI) can result in the rerouting of traffic off of our network to other carriers that could adversely affect our results of operations. The risks to our business from competition include the following:

*Verizon, as the incumbent local carrier in CTSI's markets, has competitive advantages over us which adversely affect our operating margins.*

As the incumbent carrier in CTSI's markets, Verizon enjoys competitive advantages, including its wireline connection to virtually all of our customers and potential customers, its established brand name and its substantial financial resources. As a competitive local carrier, we are effectively required to discount our services to win potential customers and to pay substantial amounts to Verizon to lease elements of its networks. These factors result in lower operating margins for CTSI, and make us especially vulnerable to any discount pricing policies that Verizon may adopt to exploit its lower-cost structure and greater financial resources. Additionally, Verizon offers in-region long-distance services to its Pennsylvania customers, which allows it to offer attractive service packages to its customers in the markets we serve, including DSL. Verizon has recently acquired MCI, another competitor in the markets we serve, which may increase Verizon's advantages.

*We face intense competition in our markets for long-distance, Internet access and other ancillary services that are important to our business and to our growth strategy.*

An important part of our business strategy is to sell additional services to local customers in both the CT and CTSI markets. The markets for these ancillary services, however, are extremely competitive, and in some cases, are dominated by companies far larger than our own with lower costs and greater name recognition and technical and financial resources, than ours. Our competitors for these services include, in addition to Verizon, long-distance companies like AT&T, Verizon Business and Sprint, and, in the Internet service provider business, Time Warner (AOL) and discounted service providers, regional Internet service providers and cable companies such as Service Electric, Blue Ridge and Comcast. In addition, as with most telephone providers today, the low-cost telephony and long-distance products being offered by Vonage and other VoIP providers are starting to have a nominal impact on our residential and business wireline service at this time. Telcove also enjoys a competitive advantage in CT and CTSI territory as a result of winning a contract with the state of Pennsylvania to provide telecommunications and data services to state government agencies, selected Pennsylvania colleges and universities and other businesses that fall under the Pennsylvania state government contract, that remains in place until 2011. To compete against these established companies, we expect to have to offer both lower prices and superior service to our customers, and we may not be able to do so on profitable terms. If we are unable to maintain a competitive offering of long-distance, Internet access and other ancillary services, we may lose local customers who prefer to obtain a package of services from one telecommunications provider.

*Technological developments could increase our costs and cause a decline in demand for our services.*

The telecommunications industry is subject to rapid and significant changes in technology. If we do not replace or upgrade technology and equipment that becomes obsolete, we will be unable to compete effectively as we will not be able to meet the needs or expectations of our customers. Additionally, replacing or upgrading our infrastructure in the future could result in significant capital expenditures.

Our wireline telecommunications services are also in competition, or potential competition, with numerous alternative technologies, including, in particular, wireless communications. The wireless telecommunications industry is experiencing significant technological change. Wireless carriers are improving the capacity and

quality of digital wireless technology; and are also expected to continue to reduce the prices for their services. These developments could reduce customer demand for our services and the prices that we will be able to charge for these services, particularly in CTSI's markets where a number of wireless providers are established competitors and in certain areas of CT's territory. We believe that future technological developments are likely to result in further improvements in wireless telecommunications services, as well as in other telecommunications technologies, and are likely to result in increased competition for our various businesses.

Voice over Internet Protocol, also known as VoIP, is a service that could cause a decrease in demand for our traditional telephone services, including the demand for additional lines. VoIP is gaining market share among business users who look to Internet telephone systems to cut costs or improve efficiency. It is also possible for residential users to use VoIP as a replacement for a traditional telephone line (for example, by obtaining Internet access over a cable television system). We cannot predict which of many possible future technologies, products or services will be significant to our competitive position or what expenditures will be required to develop and provide these technologies, products or services.

*Some of our competitors have superior resources that may place us at a cost and price disadvantage.*

Some of our current and potential competitors have market presence, technical and marketing capabilities and financial, or other resources substantially greater than ours. These competitors may be able to develop and expand their communications and network infrastructures more quickly, adapt more swiftly to new or emerging technologies and changes in customer requirements, take advantage of acquisition and other opportunities more readily and devote greater resources to the marketing and selling of their products and services than we can. Additionally, the greater brand name recognition of some competitors, such as Verizon, requires us to price CTSI's services at lower levels in order to win business. Finally, the cost advantages of some competitors may give them the ability to reduce their prices for an extended period of time if they so choose.

#### ***Other business risks***

*A substantial portion of CTSI's revenues are derived from Internet service providers, or ISPs. A decline in these ISP customers or their customer base could negatively impact our financial results.*

CTSI derives a substantial portion of its revenues directly and indirectly from ISPs. ISPs represented approximately 15.1% and 17.1% of CTSI's revenues for the years ended December 31, 2005 and 2004, respectively. These high-margin revenues include services provided directly to ISPs, including local dial tone and transport (cap-type) services, and indirect services such as reciprocal compensation, and trunking from Verizon as a result of Verizon's customers accessing these ISPs. Industry-wide trends towards declining usage of dial-up Internet access threaten the profitability or viability of our ISP customers. If we lose a large customer or a significant number of customers that are providing Internet services, or if a significant portion of these customers are unable to pay amounts owed to us, our financial results could be negatively impacted.

*Changes in the jurisdictional mix of CTSI's traffic have adversely affected its results.*

CTSI's revenues from access charges and reciprocal compensation are affected by the mix of traffic delivered to us by other carriers for termination to CTSI's customers. In late 2003, Verizon notified CTSI of a reduction in the proportion of its delivered traffic that is subject to intrastate access charges, and a corresponding increase in the proportion that is subject to reciprocal compensation rates. Because the reciprocal compensation rates are significantly lower than intrastate access charges, this change in traffic mix permanently reduced CTSI's revenues by approximately \$700,000 per month. CTSI was notified in early 2005 by Verizon North (formerly GTE), requesting a change in the PLU factor. As a result of this request, CTSI is using a direct measurement billing approach instead of a PLU factor. The effect on CTSI's revenue and operating income was a reduction of approximately \$50,000 per month beginning April 2005 based on the actual traffic mix.

*Demand for our traditional dial-up Internet access services has matured.*

Within the total Internet access market, the market for traditional, narrowband dial-up access services is shrinking. Our traditional dial-up Internet service provided by epix<sup>®</sup> Internet Services has been declining since its peak at nearly 50,000 subscribers in 2001. As of December 31, 2005, epix<sup>®</sup> had approximately 22,400 dial-up subscribers. Continued decline in these services will adversely affect our results.

*Demand for some of our services may be adversely affected by a downturn in the U.S., Pennsylvania or local economies in which we operate.*

Demand for some of our services may be adversely affected by a downturn in the U.S., Pennsylvania or local economies in which we operate. As a result, we may experience lower than expected revenues for some of our businesses. If current general economic conditions worsen, the revenues, cash flow and earnings of our company as a whole could be adversely affected.

*Our future switched access lines in service will likely be lower than our historical, and this decline may adversely affect our results.*

Additional line penetration in CT's markets has been declining. Regulatory actions in the area of intercarrier compensation could result in increases in CT's monthly per-line charges, which may discourage customers from purchasing or keeping additional lines. In addition, some customers who use an additional line for dial-up Internet access choose to cancel their additional line when they upgrade to DSL. To the extent that additional line penetration continues to decline, our ability to generate additional revenues from this source, which has been very important to our results in recent years, will decrease. Residential lines have also declined slightly due to wireless substitution.

*Our growth strategy will require us to invest significant capital in services that may not achieve the desired returns.*

We plan to continue to invest capital into services such as DSL. This business is highly competitive (with cable modem being the primary competitor), and we cannot be assured that we will be able to achieve the returns on investment that we have historically earned. Additionally, even if we are successful in our efforts to develop this new business, its operating results and margins will likely be lower than those of our core lines of business. Moreover, we expect that any success we experience in selling DSL service will, to some extent, be offset by reduced demand for additional lines when customers have been using their additional line for dial-up Internet access.

*Any disruption in our services could potentially expose us to a loss of customers or claims for damages.*

Because our services are critical to many of our customers' businesses, any significant interruption in our services could result in a loss of customers or claims by our customers for indirect or consequential damages. Although the standard terms and conditions of our tariffs and customer contracts disclaim our liability for any such damages, a customer could still bring a lawsuit against us claiming lost profits or other consequential damages as the result of a service interruption or other web site or application problems that the customer may ascribe to us. We cannot assure you that a court would enforce any limitations on our liability. In such cases, we could be liable for substantial damage awards.

*We depend on third parties, over whom we have no control, to deliver our services.*

Because of the interconnected nature of the telecommunications industry, we depend heavily on other local telephone companies, long-distance carriers and numerous other third parties to deliver our services. CTSI is particularly dependent on cooperation from Verizon in order to provide local service to a portion of its customers, slightly less than half of whom are not exclusively served by our network. We do not have a long-term agreement with Verizon to provide us with the network connections we need, and the terms of our relationship with Verizon are subject to change as the result of regulatory agency and court decisions. In addition, we are dependent on easements, franchises and licenses from various private parties such as established telephone companies and other utilities, railroads, long-distance companies, state highway authorities, local governments and transit authorities, for access to aerial pole space, underground conduits and other rights-of-way in order to construct and operate our networks. The failure to maintain the necessary third party arrangements on acceptable terms would have an adverse effect on our ability to conduct our business.

*If future acquisitions or business combinations are not successful, we could suffer an adverse effect on our business and results of operations.*

From time to time we consider acquisitions of other businesses, some of which could be material to us. To the extent that we make acquisitions in the future, we may issue common stock that would dilute the ownership of our shareholders, incur debt, assume liabilities or incur large and possibly immediate write-offs. Acquisition transactions require a significant commitment of resources and are accompanied by a number of risks, including:

- the difficulty of assimilating the operations and personnel of the acquired companies;
- the potential disruption of our ongoing business and distraction of management;
- unanticipated expenses related to technology integration;
- the maintenance of uniform standards, controls, procedures and policies;
- the impairment of relationships with employees and customers as a result of any integration of new management personnel; and
- potential unknown liabilities or risks associated with acquired businesses.

We cannot be sure that we will succeed in addressing these risks or any other problems encountered in connection with potential business combinations and acquisitions.

*As a holding company, we will require dividends from subsidiaries to meet our cash requirements.*

We are a holding company whose principal assets are the shares of capital stock of our subsidiaries, and we do not generate any significant operating revenues of our own. Consequently, we depend on dividends, advances and payments from our subsidiaries (primarily CT) to fund our activities and meet our cash needs, including our debt service requirements. Our subsidiaries are separate and distinct legal entities. The ability of our subsidiaries to make certain payments or advances to us will depend on their operating results and will be subject to existing debt covenants, various business considerations and applicable laws and regulations. Accordingly, we cannot assure you that our subsidiaries will be able to, or be permitted to, make distributions to enable us to make payments in respect to our indebtedness.

*The restrictive terms imposed by our current CoBank indebtedness may prevent us from achieving some of our business objectives.*

CT's CoBank indebtedness contains various covenants that limit its ability to engage in the following activities:

- borrow and place liens on assets;
- make investments or make certain other restricted payments;
- enter into transactions with affiliates; and
- sell assets, make acquisitions or merge with or into other companies.

Our ability to modify or comply with these covenants can be affected by events beyond our control. A breach of any of these covenants could also result in a default even if we are able to pay our debt. A default under these covenants or covenants under other financing arrangements we enter into could result in the acceleration of required payments or the inability to receive financing in the future.

### ***Risks relating to our common stock***

*Our governing documents and applicable laws and regulations may discourage a takeover attempt.*

Provisions contained in our articles of incorporation and by-laws, Pennsylvania law and industry regulations could make it difficult for a third party to acquire us, even if doing so might be beneficial to our shareholders. For example, our certificate of incorporation and by-laws impose various procedural and other requirements that could make it difficult for shareholders to affect certain corporate actions. In addition, federal and Pennsylvania regulations regarding changes of control in our business are very restrictive. These provisions could limit the price that certain investors might be willing to pay in the future for shares of our common stock and may have the effect of delaying or preventing a change in control that current shareholders deem beneficial.

*If we sell shares of our common stock the market price of our common stock could decline.*

The market price of our common stock could decline as a result of sales of a large number of shares of our common stock, or the perception that such sales could occur. These sales, or the possibility that these sales may occur, also might make it more difficult for us to sell equity securities in the future at a time and at a price that we deem appropriate.

**Item 1B. *Unresolved Staff Comments***

None

**Item 2. *Properties***

Our property consists principally of central office equipment, telephone lines, telephone instruments and related equipment and land and buildings related to telephone operations. This plant and equipment is maintained in good operating condition by CT and CTSI operations. We own substantially all of our central office buildings, administrative buildings, warehouses and storage facilities. All of the telephone lines are located either on private or public property. Locations on private land are governed by easements or other arrangements. We are not aware of any environmental liabilities which would have a material impact on our financial position or results of operations.

**Item 3. *Legal Proceedings***

In the normal course of business, there are various legal proceedings outstanding, including both commercial and regulatory litigation. We do not believe these proceedings will have a material adverse effect on our results of operations or financial condition. Additionally, there are no other legal matters pending that we expect to have a material impact on our financial condition or results of operations.

**Item 4. *Submission of Matters to a Vote of Security Holders***

None

**EXECUTIVE OFFICERS OF THE REGISTRANT**

<u>Name</u>	<u>Age</u>
Michael J. Mahoney . . . . .	55
<p>President and CEO as well as Director of CTE since July 2000; Telecommunications consultant from October 1999 to July 2000; Director of CTE (formerly C-TEC Corporation) from June 1995 to October 1999; President and Chief Operating Officer of C-TEC Corporation from February 1994 to September 1997; and Director, President and Chief Operating Officer of RCN Corporation from September 1997 to October 1999.</p>	
Eileen O'Neill Odum . . . . .	51
<p>Executive Vice President and Chief Operating Officer of CTE since July 2004; President—National Operations, the domestic wireline telecom group of Verizon Communications, Inc., from 2000 to 2004; Region President—Northwest, of GTE Corporation's domestic wireline telephone operations from 1994 to 2000; Assistant Vice President of Business Sales and Services of GTE Telephone Operations from 1992 to 1994; Vice President/General Manager—Texas Region of GTE Mobilnet from 1990 to 1992; Vice President of Marketing of GTE Mobilnet from 1988 to 1990.</p>	
Donald P. Cawley . . . . .	47
<p>Executive Vice President of CTE since September 2003; Senior Vice President of CTE from June 2000 to September 2003; Chief Accounting Officer of CTE since May 1999; Vice President and Controller of CTE from September 1997 to June 2000; Vice President and Controller of Commonwealth Telephone Company from February 1996 to September 1997; and Controller of Commonwealth Telephone Company from March 1992 to February 1996.</p>	
Kevin M. O'Hare . . . . .	45
<p>Group Vice President of Strategic Development of CTE since January 2006; President and Chief Executive Officer of Lightship Telecom from January 1998 to May 2005; President and Chief Executive Officer of US WATS, Inc., from December 1996 to November 1997; Executive Vice President of C-TEC Corporation from May 1995 to December 1996; Network Engineering Director of ACC Long Distance Corp. from February 1994 to April 1995.</p>	
Rita M. Brown . . . . .	54
<p>Senior Vice President and General Manager of CTSI, LLC ("CTSI"), since October 2004; Vice President of Strategic Initiatives of CTE from January 2004 to September 2004; Vice President of Operations of Commonwealth Telephone Company from 2002 to December 2003; Vice President of Corporate Engineering of CTE from 2001 to 2002; Vice President and General Manager of epix® Internet Services from 2000 to 2001; Vice President and General Manager of Residential Markets of CTSI during 2000; Vice President and General Manager of Commonwealth Communications from 1998 to 2000; and various positions with CTE from 1973 to 1998.</p>	
Scott Burnside . . . . .	61
<p>Senior Vice President of Regulatory and Government Relations of CTE since May 2003; Senior Vice President of Regulatory and Government Affairs of RCN Corporation from June 1997 to May 2003; Vice President of Regulatory Affairs of C-TEC Corporation from 1985 to June 1997; and various positions with Commonwealth Telephone Company from January 1978 to 1985.</p>	
Thomas M. Davis . . . . .	49
<p>Vice President of Information Technology of CTE since February 2001; Senior Vice President of Software Engineering and Vice President of Solutions Delivery of Intertech Management Group, Inc., from February 1999 to February 2001; President of Dapro, Inc., from April 1992 to February 1999; Applications Development Manager at Alltel Information Services, Inc., from September 1988 to April 1992; and various positions with Nabisco Brands, Inc., C-TEC Corporation and Pennsylvania Gas and Water Company from 1982 to 1988.</p>	
J. Christine Feeley . . . . .	44
<p>Vice President of Marketing of CTE since March 2005; Director of Marketing of Valor Communications Group, Inc., from April 2001 to January 2004; Vice President of Rapp Collins Worldwide from May 2000 to February 2001; National Consultant from December 1992 to May 2000; Promotions Manager of Berry Brown Advertising, Inc., from January 1991 to December 1992.</p>	

**EXECUTIVE OFFICERS OF THE REGISTRANT—(Continued)**

<u>Name</u>	<u>Age</u>
DG Gulati .....	56
<p>Senior Vice President of Operations Strategy and Development of CTE since April 2005; Senior Vice President of Corporate Development of CTE from 2002 to April 2005; Senior Vice President of Operations and Engineering of RCN Corporation from 2000 to 2002; Senior Vice President of Network Engineering of RCN Corporation from 1997 to 2000; Vice President of Business Operations of C-TEC Corporation from 1995 to 1997; Director of Telecommunications of Cablevision Industries from 1994 to 1995; Assistant Vice President of Network Services of Warwick Valley Telephone Company from 1993 to 1994; and various positions with Rochester Telephone Corporation from 1982 to 1993.</p>	
Todd T. Hanson .....	44
<p>Senior Vice President of Network Services and Technology of CTE since September 2004; Senior Vice President of Engineering and Operations of CTE from January 2004 to September 2004; Vice President of Engineering of CTE from April 2003 to January 2004; President of Qwest Communications International Inc., Local Broadband—Eastern Region from 1999 to 2002; Vice President of Network Engineering and Field Operations of Electric Lightwave, LLC (wholly-owned subsidiary of Citizens Communications), from 1995 to 1999; Vice President of Network Planning, Engineering and Project Management of MFS Telecom, Inc., from 1993 to 1995; and various management positions with AT&amp;T Canada, Inc. (formerly Unitel Communications Inc.), and Sprint Corporation from 1986 to 1993.</p>	
Steven J. Letts .....	48
<p>Vice President and General Manager of Commonwealth Communications since December 2002; Vice President of Sales—Advanced Building Networks of WorldCom, Inc. (“WorldCom”) from 2001 to 2002; Vice President of Shared Tenant Sales of WorldCom from 2000 to 2001; Vice President and General Manager of Integrated Communications Services (“ICS”) Division of WorldCom from 1997 to 2000; Vice President of Service and Support—ICS Division of Metropolitan Fiber Systems, Inc. (“MFS”), from 1996 to 1997; Director of Operations—Central Region of MFS from 1995 to 1996; General Manager—Texas Region of Realcom Inc., from 1993 to 1995; various positions with Intecom, Inc., from 1985 to 1993; and United States Marine Corps Officer from 1980 to 1985.</p>	
Raymond B. Ostroski .....	51
<p>Senior Vice President, General Counsel and Corporate Secretary of CTE since February 2003; Vice President, General Counsel and Corporate Secretary of CTE from December 2002 to February 2003; Senior Corporate Counsel and Assistant Corporate Secretary of CTE from January 2002 to November 2002; Legal Consultant with RBO Consulting from January 1998 to December 2001; Executive Vice President, General Counsel and Corporate Secretary of RCN Corporation from October 1997 to December 1997; Executive Vice President, General Counsel and Corporate Secretary of C-TEC Corporation from February 1991 to September 1997; Corporate Counsel and Assistant Corporate Secretary of C-TEC Corporation from August 1988 to February 1991; Associate Counsel of C-TEC Corporation from August 1985 to August 1988; and Attorney at the law firm of Hoegen &amp; Marsh, PC from August 1983 to August 1985.</p>	
James F. Samaha .....	40
<p>Senior Vice President and General Manager of Commonwealth Telephone Company and epix® Internet Services since January 2004; Senior Vice President and General Manager of Commonwealth Telephone Company from August 2001 to January 2004; Senior Vice President of Internet and Data Services of CTE from December 2000 to August 2001; Senior Vice President of Business Development of CTE from July 2000 to December 2000; Vice President and General Manager of Jack Flash® from June 1999 to July 2000; Vice President of CTE Finance from March 1998 to June 1999; Director of Corporate Development, and other management positions with AT&amp;T Local Services (formerly Teleport Communications Group) from 1993 to 1998.</p>	
Darryl Varnado .....	53
<p>Vice President of Human Resources of CTE since January 2006; Leadership Consultant of Lee Hecht Harrison, Inc., from 2005 to January 2006; Vice President and Managing Director of Human Resources of The Nature Conservancy from 2001 to 2005; Director of Global Human Resources Strategy and Design of US Airways, Inc., from 1998 to 2001; Operations Manager of Compensation and Benefits of The Coca-Cola Company from 1995 to 1998; Manager of U.S. Compensation and Employee Rewards of The Coca-Cola Company from 1994 to 1995; Director of Compensation and Employee Rewards of Tennessee Valley Authority from 1993 to 1994.</p>	
David G. Weselcouch .....	50
<p>Senior Vice President of Investor Relations and Corporate Communications of CTE since June 2000; Vice President of Investor Relations and Corporate Communications of CTE from March 1999 to June 2000; Vice President of Investor Relations of CTE from 1998 to 1999; Director—Investor Relations of GTE Corporation from 1993 to 1998; Manager—Capital Markets Development and Administration of GTE Corporation from 1989 to 1993.</p>	

## PART II

### **Item 5. Market for Registrant's Common Equity and Related Shareholder Matters**

Our Common Stock is traded on the Nasdaq National Market (Symbol: CTCO).

There were approximately 1,097 registered holders of the Company's Common Stock on February 28, 2006, based on the records of our transfer agent. Other information required under Item 5 of Part II is set forth in Management's Discussion and Analysis of Financial Condition and Results of Operations included on pages F-1 to F-22 of this report and Notes to Consolidated Financial Statements included on pages F-32 to F-54 of this report.

On April 24, 2003, we entered into a Recapitalization Agreement (the "Recapitalization Agreement") with Level 3 Communications, Inc. ("Level 3") and Eldorado Equity Holdings, Level 3's indirect, wholly-owned subsidiary. Under the terms of the Recapitalization Agreement, we agreed to amend our existing charter to: (i) reclassify and convert each outstanding share of CTE Class B Common Stock into 1.09 shares of CTE Common Stock; and (ii) eliminate from the existing charter the CTE Class B Common Stock, and all provisions related thereto, and certain miscellaneous inoperative provisions. Level 3 agreed, pursuant to the terms of the Recapitalization Agreement, to vote its shares in favor of the reclassification and the related charter amendments. On September 3, 2003, at the Annual Meeting, shareholders approved the proposal to reclassify and convert each outstanding share of CTE Class B Common Stock into 1.09 shares of CTE Common Stock. CTE now has only one class of common stock, with each share having one vote in corporate governance matters. As a result of the reclassification, Level 3's ownership was reduced to approximately 4.6% of the outstanding CTE Common Stock and correspondingly 4.6% of the voting power. Subsequently, on January 21, 2004, Level 3 announced the sale of all of its remaining CTE Common Stock to an institutional investor. In connection with this transaction, certain registration rights were assigned by Level 3 to the purchaser. As of December 31, 2005, Level 3 did not own any shares of CTE Common Stock.

In connection with the Recapitalization, the Class B common shares held as Treasury stock were retired and the shares are no longer authorized.

In July of 2003, we sold \$300 million principal amount of 3.25% convertible notes due July 15, 2023, unless earlier redeemed, repurchased or converted. On November 7, 2003, in connection with a registration rights agreement relating to the notes, we filed a resale shelf registration statement with the Securities and Exchange Commission.

On June 24, 2005, we launched an exchange offer pursuant to which we offered to exchange up to \$300 million of our then outstanding 3.25% convertible notes (the "Old Notes") for new 2005 Series A 3.25% convertible notes (the "New Notes") due 2023 in an equal principal amount plus an exchange fee of \$2.50 per \$1,000 principal amount of existing notes. The New Notes contain terms that provide us with the flexibility to settle conversions of the notes with cash, common stock or a combination of cash and common stock. The Old Notes require us to settle conversions of notes with shares of common stock. The terms of the New Notes maintain full dividend protection for the holders of the notes. The exchange offer closed on August 3, 2005, at which time a total of \$63,892,000 principal amount of New Notes were issued in exchange for the same principal amount of Old Notes and an exchange fee of \$160,000 was paid.

With respect to the New Notes and the Old Notes, interest is 3.25% per annum on the principal amount, payable semi-annually in arrears in cash on January 15 and July 15 of each year, beginning January 15, 2004. In addition, we will pay contingent interest for any six-month period from January 15 to July 14 and from July 15 to January 14, with the initial six-month period commencing July 15, 2008, if the trading price of the notes for each of the five trading days immediately preceding the first day of the applicable six-month period equals 120% or more of the principal amount of the notes. During any interest period when contingent interest shall be payable, the contingent interest payable per note will equal 0.25% of the average trading price of a note during the five trading days immediately preceding the first day of the applicable six-month interest period.

Holders of Old Notes may convert their notes into shares of our common stock and holders of New Notes may convert their notes with settlement, at our election, in our common stock, cash or a combination of cash and

our common stock prior to the close of business on the final maturity date under any of the following circumstances:

- during any fiscal quarter, but only during such fiscal quarter, if the closing sale price of our common stock exceeds 120% of the then-effective conversion price for at least 20 trading days in the 30 consecutive trading-day period ending on the last trading day of the preceding fiscal quarter;
- during the five business-day period after any five consecutive trading-day period in which the trading price per note for each day of such period was less than 98% of the product of the closing sale price of our common stock and the number of shares issuable upon conversion of \$1,000 principal amount of the notes;
- if the notes have been called for redemption; or
- upon the occurrence of specified corporate events.

We may redeem any of the Old Notes or New Notes beginning July 18, 2008, by giving holders at least 30 days' notice. We may redeem the notes either in whole or in part at a cash redemption price of 100% of their principal amount, plus accrued and unpaid interest, including contingent interest, if any, and additional interest, if any, to, but excluding, the redemption date.

If a designated event occurs prior to maturity, holders of Old Notes or New Notes may require us to repurchase all or part of their notes at a cash repurchase price equal to 100% of their principal amount, plus accrued and unpaid interest, including contingent interest, if any, and additional interest, if any, to, but excluding, the repurchase date.

Holders of Old Notes or New Notes may require us to repurchase all or part of their notes on July 15 of 2008, 2013 and 2018 at a cash repurchase price equal to 100% of their principal amount, plus accrued and unpaid interest, including contingent interest, if any, and additional interest, if any, to, but excluding, the repurchase date.

**Item 5. (c) Purchases of Equity Securities by the Issuer and Affiliated Purchasers**

Effective November 13, 2003, our Board of Directors authorized a Stock Repurchase Program of up to \$100 million of CTE's Common Stock. On February 9, 2004, our Board of Directors increased the size of the total stock repurchase program to up to \$150 million of CTE Common Stock. No time limit has been set for the completion of the Stock Repurchase Program. The purchases have and will be made in open market, negotiated or block transactions. The transactions will be executed at CTE's discretion, based on ongoing assessments of our capital needs, and the market value of CTE Common Stock. Repurchased shares have and will be placed in Treasury and may be used for our employee benefit plans or for other general corporate purposes. The table below provides information regarding purchases of CTE Common Stock made by us during the fourth quarter of the fiscal year covered by this report:

<u>Period</u>	<u>Total Number of Shares Purchased</u>	<u>Average Price Paid per Share</u>	<u>Total Number of Shares Purchased as Part of Publicly Announced Program</u>	<u>Approximate Dollar Value of Shares that May Yet Be Purchased Under the Program (dollars in thousands)</u>
October 1, 2005—October 31, 2005 .....	—	—	—	\$31,456
November 1, 2005—November 30, 2005 .....	—	—	—	\$31,456
December 1, 2005—December 31, 2005 .....	—	—	—	\$31,456

**Notes**

The \$100 million Stock Repurchase Program was announced on November 13, 2003; the \$50 million addition to the program was announced on February 10, 2004. The Stock Repurchase Program has no expiration date. We had no other stock repurchase plan or program expire during the period covered by the table. Also, no plans or programs were terminated prior to expiration. All purchases were made in accordance with the safe harbor in Rule 10b-18 under the Securities Exchange Act of 1934.

**Item 6. Selected Financial Data**

Information required under Item 6 of Part II is included on page F-23 of this report.

**Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**

Information required under Item 7 of Part II is included on pages F-1 to F-22 of this report.

**Item 7A. Quantitative and Qualitative Disclosures About Market Risk**

Information required under Item 7A of Part II is included on page F-15 to F-16 of this report. Additional information is contained in Note 14 "Off Balance Sheet Risk and Concentration of Credit Risk" of the Consolidated Financial Statements included on page F-52 of this report.

**Item 8. Financial Statements and Supplementary Data**

The Consolidated Financial Statements and supplementary data required under Item 8 of Part II are included on pages F-27 to F-54 of this report.

**Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure**

During the two years preceding December 31, 2005, there has been neither a change of accountants of the Registrant nor any disagreement on any matter of accounting principles, practices or financial statement disclosures.

**Item 9A. Controls and Procedures**

The management of Commonwealth Telephone Enterprises, Inc. ("the Company"), under the supervision and with the participation of the Company's Chief Executive Officer and Chief Accounting Officer, conducted an evaluation of the Company's "disclosure controls and procedures" (as defined in Exchange Act Rules 13a-15(e) or 15d-15(e)) as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and Chief Accounting Officer concluded that the Company's disclosure controls and procedures were effective as of the end of the period covered by this report. See Management's Report on Internal Control over Financial Reporting on page F-24.

During 2005, we engaged the tax consulting services of KPMG LLP to supplement our internal controls over income taxes.

There was no change in the Company's internal control over financial reporting identified in connection with the evaluation required by paragraph (d) of Exchange Act Rules 13a-15 or 15d-15 that occurred during the Company's last fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

**Item 9B. Other Information**

None

**PART III****Item 10. Directors and Executive Officers of the Registrant**

The information required under Item 10 of Part III with respect to the Directors of the Registrant is set forth in the definitive proxy statement relating to the Registrant's Annual Meeting of Shareholders to be filed by the Registrant with the Commission pursuant to Section 14(a) of the Securities Exchange Act of 1934 (the "1934 Act") and is hereby specifically incorporated herein by reference thereto.

The information required under Item 10 of Part III with respect to the executive officers of the Registrant is set forth at the end of Part I hereof.

Additional information required under Item 10 of Part III with respect to the executive officers of the Registrant, if applicable, will be set forth in the definitive proxy statement relating to the Registrant's Annual Meeting of Shareholders to be filed by the Registrant with the Commission pursuant to Section 14(a) of the 1934 Act, and is hereby specifically incorporated herein by reference thereto.

The full text of our Code of Ethical Conduct is published on our web site at [www.ct-enterprises.com](http://www.ct-enterprises.com). We intend to disclose future amendments to our Code of Ethical Conduct, and waivers of its provisions granted to executive officers and directors, on our web site within four business days following the date of such amendment or waiver.

**Item 11. *Executive Compensation***

The information required under Item 11 of Part III is set forth in the definitive proxy statement relating to the Registrant's Annual Meeting of Shareholders to be filed by the Registrant with the Commission pursuant to Section 14(a) of the 1934 Act, and is hereby specifically incorporated herein by reference thereto.

**Item 12. *Security Ownership of Certain Beneficial Owners and Management and Related Shareholder Matters***

The information required under Item 12 of Part III is included in the definitive proxy statement relating to the Registrant's Annual Meeting of Shareholders to be filed by the Registrant with the Commission pursuant to Section 14(a) of the 1934 Act, and is hereby specifically incorporated herein by reference thereto.

**Item 13. *Certain Relationships and Related Transactions***

The information required under Item 13 of Part III is included in the definitive proxy statement relating to the Registrant's Annual Meeting of Shareholders to be filed by the Registrant with the Commission pursuant to Section 14(a) of the 1934 Act, and is hereby specifically incorporated herein by reference thereto.

**Item 14. *Principal Accountant Fees and Services***

The information required under Item 14 of Part III is included in the definitive proxy statement relating to the Registrant's Annual Meeting of Shareholders to be filed by the Registrant with the Commission pursuant to Section 14(a) of the 1934 Act, and is hereby specifically incorporated herein by reference thereto.

**PART IV**

**Item 15. *Exhibits, Financial Statement Schedules***

**Item 15. (a)(1) *Financial Statements***

Management's Discussion and Analysis of Financial Condition and Results of Operations (Unaudited)

Selected Financial Data (Unaudited)

Management's Report on Internal Control over Financial Reporting

Report of Independent Registered Public Accounting Firm

Consolidated Statements of Operations for Years Ended December 31, 2005, 2004 and 2003

Consolidated Balance Sheets—December 31, 2005 and 2004

Consolidated Statements of Cash Flows for Years Ended December 31, 2005, 2004 and 2003

Consolidated Statements of Changes in Common Shareholders' Equity for Years Ended December 31, 2005, 2004 and 2003

Notes to Consolidated Financial Statements

**Item 15. (a)(2) *Financial Statement Schedules***

***Description***

Condensed Financial Information of the Registrant for Years Ended December 31, 2005, 2004 and 2003 (Schedule I)

Valuation and Qualifying Accounts and Reserves for Years Ended December 31, 2005, 2004 and 2003 (Schedule II)

All other financial statement schedules not listed have been omitted since the required information is included in the Consolidated Financial Statements or the Notes thereto, or is not applicable or required.

**Item 15. (a)(3) Exhibits**

Exhibits marked with an asterisk are filed herewith. The remaining exhibits have been filed with the Commission and are incorporated herein by reference.

(2) Plan of acquisition, reorganization, arrangement, liquidation or succession

2.1 Limited Liability Company Operating Agreement of CTSI, LLC dated June 30, 2001 is incorporated herein by reference to the Company's Annual Report on Form 10-K for the year ended December 31, 2001, (Commission File No. 0-11053).

2.2 Agreement and Plan of Merger between CTSI, Inc. and CTSI, LLC dated June 22, 2001 is incorporated herein by reference to the Company's Annual Report on Form 10-K for the year ended December 31, 2001, (Commission File No. 0-11053).

2.3 Limited Liability Company Operating Agreement of CTE Telecom, LLC dated December 2, 2002 is incorporated herein by reference to the Company's Annual Report on Form 10-K for the year ended December 31, 2002, (Commission File No. 0-11053).

2.4 Agreement and Plan of Merger between Commonwealth Long Distance Company and CTE Telecom, LLC dated December 31, 2002 is incorporated herein by reference to the Company's Annual Report on Form 10-K for the year ended December 31, 2002, (Commission File No. 0-11053).

2.5 Agreement and Plan of Merger between epix\* Internet Services, Inc. and CTE Telecom, LLC dated December 31, 2002 is incorporated herein by reference to the Company's Annual Report on Form 10-K for the year ended December 31, 2002, (Commission File No. 0-11053).

2.6 Recapitalization Agreement dated April 24, 2003, by and among Commonwealth Telephone Enterprises, Inc., Level 3 Communications, Inc. and Eldorado Equity Holdings, Inc. is incorporated herein by reference to Exhibit 2.1 to the Company's Report on Form 8-K as filed with the Commission on April 25, 2003, (Commission File No. 0-11053).

(3) Articles of Incorporation and By-laws

3.1 Amended and Restated Articles of Incorporation dated September 3, 2003 is herein incorporated by reference to Exhibit 3.12 to the Company's Form S-1 Registration Statement as filed with the Commission on November 7, 2003, Registration No. 333-110325.

3.2 By-laws of Registrant, as amended and restated as of December 3, 2003 are incorporated herein by reference to Exhibit 3.1 to the Company's Report on Form 8-K as filed with the Commission on December 3, 2003, (Commission File No. 0-11053).

(4) Instruments Defining the Rights of Security Holders, Including Indentures

4.1 Loan Agreement dated as of March 29, 1994, made by and between Commonwealth Telephone Company and the National Bank for Cooperatives is incorporated herein by reference to the Company's Report on Form 10-Q for the quarter ended March 31, 1994, (Commission File No. 0-11053).

4.2 Line of Credit Agreement dated as of September 30, 1999 by and between Commonwealth Telephone Company as borrower and the CoBank, ACB is incorporated herein by reference to Exhibit 4(b) to the Company's Report on Form 10-Q for the quarter ended September 30, 1999, (Commission File No. 0-11053).

4.3 Line of Credit Amendment dated as of September 15, 2000 by and between Commonwealth Telephone Company as borrower and the CoBank, ACB is incorporated herein by reference to the Company's Annual Report on Form 10-K for the year ended December 31, 2000, (Commission File No. 0-11053).

4.4 Amended and Restated Line of Credit Agreement dated April 6, 2001 by and between Commonwealth Telephone Company as borrower and the CoBank, ACB is incorporated herein by reference to Exhibit 4 to the Company's Report on Form 10-Q for the quarter ended March 31, 2001, (Commission File No. 0-11053).

4.5 Second Amended and Restated Line of Credit Agreement dated June 4, 2002 by and between Commonwealth Telephone Company as borrower and the CoBank, ACB is incorporated herein by reference to Exhibit 4(a) to the Company's Report on Form 10-Q for the quarter ended June 30, 2002. (Commission File No. 0-11053).

4.6 Letter Agreement dated March 13, 2003 to amend the Loan Agreement dated as of March 29, 1994 and the Second Amended and Restated Line of Credit Agreement dated as of June 4, 2002 between Commonwealth Telephone Company and CoBank, ACB is incorporated herein by reference to Exhibit 4(a) to the Company's Report on Form 10-Q for the quarter ended March 31, 2003. (Commission File No. 0-11053).

4.7 Agreements Regarding Amendments to Loan Documents dated June 2, 2003 by and between Commonwealth Telephone Company as borrower and CoBank, ACB is incorporated herein by reference to Exhibit 4.1 to the Company's Report on Form 10-Q for the quarter ended June 30, 2003. (Commission File No. 0-11053).

4.8 Indenture for 3¼% Convertible Notes due 2023 dated July 18, 2003 between Commonwealth Telephone Enterprises, Inc. and the Bank of New York, as Trustee is incorporated herein to Exhibit 4.10 to the Company's Form S-1 Registration Statement as filed with the Commission on November 7, 2003. Registration No. 333-110325.

4.9 Form of 3¼% Convertible Notes due 2023 is incorporated herein to Exhibit 4.10 to the Company's Form S-1 Registration Statement as filed with the Commission on November 7, 2003. Registration No. 333-110325.

4.10 Registration Rights Agreement dated July 18, 2003 by and among Commonwealth Telephone Enterprises, Inc. and Morgan Stanley & Co. Incorporated, Legg Mason Wood Walker, Incorporated and Wachovia Capital Markets, LLC, as Initial Purchasers is incorporated herein by reference to Exhibit 4.11 to the Company's Form S-1 Registration Statement as filed with the Commission on November 7, 2003. Registration No. 333-110325.

4.11 Amendment to Line of Credit Agreement entered into as of May 20, 2004 by and between Commonwealth Telephone Company and CoBank, ACB is incorporated herein by reference to Exhibit No. 4.6 to the Company's Post Effective Amendment No. 4 to Form S-1 on Form S-3 Registration Statement as filed with the Commission on July 26, 2004. Registration No. 333-110325.

4.12 Indenture between Commonwealth Telephone Enterprises, Inc. and The Bank of New York, as Trustee, dated as of August 3, 2005 related to Series A 3¼% Convertible Notes due 2023 (including form of 2005 Series A 3¼% Convertible Notes due 2023) is incorporated herein to Exhibit 4.1 to the Company's Report on Form 10-Q for the quarter ended June 30, 2005. (Commission File No. 0-11053).

4.13 Third Amended and Restated Line of Credit Agreement entered into as of May 31, 2005 by and between Commonwealth Telephone Company and CoBank, ACB is incorporated herein by reference to Exhibit No. 10.1 to the Company's Report on Form 8-K dated May 31, 2005. (Commission File No. 0-11053).

#### (10) Material Contracts

10.1 C-TEC Corporation, 1994 Stock Option Plan is incorporated herein by reference to the Company's Report on Form 10-Q for the quarter ended March 31, 1994. (Commission File No. 0-11053).

10.2 C-TEC Corporation 1994 Stock Option Plan, as amended, is incorporated herein by reference to Form S-8 Registration Statement of Registrant filed with the Commission, Registration No. 33-64563.

10.3 C-TEC Corporation Executive Stock Purchase Plan is incorporated herein by reference to Form S-8 Registration Statement of Registrant filed with the Commission, Registration No. 33-64677.

10.4 Registration Rights Agreement dated October 23, 1998 among Registrant, Walter Scott, Jr., James Q. Crowe and David C. McCourt is incorporated herein by reference to Exhibit 10.1 to the Company's Form 8-K dated October 28, 1998. (Commission File No. 0-11053).

10.5 1997 Non-Management Directors' Stock Compensation Plan effective February 12, 1997, as amended is incorporated herein by reference to Exhibit 10 to the Company's Annual Report on Form 10-K for the year ended December 31, 1998. (Commission File No. 0-11053).

10.6 Commonwealth Telephone Enterprises, Inc. Executive Stock Purchase Plan as amended and restated, effective December 21, 1998 is incorporated herein by reference to Exhibit 99.1 to the Company's Report on Form 10-Q for the quarter ended September 30, 1999, (Commission File No. 0-11053).

10.7 1997 Non-Management Directors' Stock Compensation Plan effective February 12, 1997, as amended and restated, is incorporated herein by reference to Exhibit 10(a) to the Company's Report on Form 10-Q for the quarter ended March 31, 2000, (Commission File No. 0-11053).

10.8 Registration Rights Agreement dated February 7, 2002, between Registrant and Level 3 Communications, Inc. is incorporated herein by reference to Exhibit 10.13 of Form S-3 Registration Statement of Registrant filed with the Commission, Registration No. 333-82366.

10.9 Consulting Agreement dated March 1, 2002, by and between CTE Services, Inc. and James DePolo d/b/a Westminster Marketing Associates is incorporated herein by reference to Exhibit 10(n) to the Company's Report on Form 10-K for the year ended December 31, 2001, (Commission File No. 0-11053).

10.10 Amendment No. 1 effective May 15, 2002, to the CTE Equity Incentive Plan (formerly known as the C-TEC Corporation 1996 Equity Incentive Plan) is incorporated herein by reference to Exhibit 10(a) to the Company's Report on Form 10-Q for the quarter ended June 30, 2002, (Commission File No. 0-11053).

10.11 Commonwealth Telephone Enterprises, Inc. Bonus Plan is incorporated herein by reference to Exhibit 10(b) to the Company's Report on Form 10-Q for the quarter ended June 30, 2002, (Commission File No. 0-11053).

10.12 Commonwealth Telephone Enterprises, Inc. Executive Stock Purchase Plan as amended and restated, effective September 5, 2002 is incorporated herein by reference to Exhibit 10(a) to the Company's Report on Form 10-Q for the quarter ended September 30, 2002, (Commission File No. 0-11053).

10.13 Shelf Registration Agreement dated as of November 12, 2002 among Registrant, Level 3 Communications, Inc. and Eldorado Equity Holdings, Inc. is incorporated herein by reference to Exhibit 10.1 of Form S-3 Registration Statement of Registrant filed with the Commission, Registration No. 333-101127.

10.14 Amendment No. 1 to the Registration Rights Agreement dated April 23, 2003, by and among Commonwealth Telephone Enterprises, Inc., Level 3 Communications, Inc. and Eldorado Equity Holdings, Inc. is incorporated herein by reference to Exhibit 10.1 to the Company's Report on Form 8-K as filed with the Commission on April 25, 2003, (Commission File No. 0-11053).

10.15 Non-Management Directors' Stock Compensation Plan effective February 25, 2004, is incorporated herein by reference to Exhibit 10.2 to the Company's Report on Form 10-Q for the quarter ended June 30, 2004, (Commission File No. 0-11053).

10.16 Commonwealth Telephone Enterprises, Inc. Commonwealth Builder 401(k) Plan (As Amended 2004) is incorporated herein by reference to Exhibit 4.3 to Form S-8 Registration Statement of Registrant filed with the Commission, Registration No. 333-117450.

10.17 Agreement and Release dated as of July 20, 2004 entered into by and between Commonwealth Telephone Enterprises, Inc. and James DePolo is incorporated herein by reference to Exhibit No. 10.16 to the Company's Post Effective Amendment No. 4 to Form S-1 on Form S-3 Registration Statement as filed with the Commission on July 26, 2004, Registration No. 333-110325.

\* (21) Subsidiaries of the Registrant

\* (23) Consent of Independent Registered Public Accounting Firm

\* (24) Powers of Attorney

\* (31.1) Rule 13a-14(a) Certification of Chief Executive Officer

\* (31.2) Rule 13a-14(a) Certification of Chief Accounting Officer

\* (32) Section 1350 Certifications

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: March 10, 2006

COMMONWEALTH TELEPHONE ENTERPRISES, INC.

By:           /s/ DONALD P. CAWLEY            
Donald P. Cawley  
Executive Vice President and  
Chief Accounting Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

<u>Signature</u>	<u>Title</u>	<u>Date</u>
<b>PRINCIPAL EXECUTIVE AND ACCOUNTING OFFICERS:</b>		
<u>          /s/ MICHAEL J. MAHONEY          </u> Michael J. Mahoney	President and Chief Executive Officer, principal executive officer	March 10, 2006
<u>          /s/ DONALD P. CAWLEY          </u> Donald P. Cawley	Executive Vice President and Chief Accounting Officer, principal financial officer, principal accounting officer	March 10, 2006
<b>DIRECTORS:</b>		
<u>          /s/ WALTER SCOTT, JR.          </u> Walter Scott, Jr.		March 10, 2006
<u>          /s/ MICHAEL J. MAHONEY          </u> Michael J. Mahoney		March 10, 2006
<u>          /s/ JOHN R. BIRK          </u> John R. Birk		March 10, 2006
<u>          /s/ JAMES Q. CROWE          </u> James Q. Crowe		March 10, 2006
<u>          /s/ FRANK M. HENRY          </u> Frank M. Henry		March 10, 2006
<u>          /s/ RICHARD R. JAROS          </u> Richard R. Jaros		March 10, 2006
<u>          /s/ DANIEL E. KNOWLES          </u> Daniel E. Knowles		March 10, 2006
<u>          /s/ DAVID C. MITCHELL          </u> David C. Mitchell		March 10, 2006
<u>          /s/ EUGENE ROTH          </u> Eugene Roth		March 10, 2006
<u>          /s/ JOHN J. WHYTE          </u> John J. Whyte		March 10, 2006

**COMMONWEALTH TELEPHONE ENTERPRISES, INC., AND SUBSIDIARIES**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION**  
**AND RESULTS OF OPERATIONS**  
**(Dollars in Thousands, Except Per Share Amounts)**  
**(Unaudited)**

This report contains certain forward-looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Exchange Act, and we intend that such forward-looking statements be subject to these safe harbors. These statements are generally accompanied by words such as "intend," "anticipate," "believe," "estimate," "expect" or similar statements. Our forward-looking statements involve risks and uncertainties that could significantly affect expected results in the future differently than expressed in any forward-looking statements we have made. These risks and uncertainties include, but are not limited to:

- uncertainties relating to our ability to further penetrate our markets and the related cost of that effort;
- economic conditions, acquisitions and divestitures;
- government and regulatory policies;
- the pricing and availability of equipment, materials and inventories;
- technological developments;
- reductions in rates or traffic that is subject to access charges;
- changes in the competitive environment in which we operate; and
- the receipt of necessary regulatory approvals.

Additional factors that could cause or contribute to such differences are set forth in the section entitled "Risk Factors" and are discussed elsewhere in this report. Although we believe that the assumptions underlying our forward-looking statements are reasonable, any of the assumptions could prove inaccurate and, therefore, we cannot provide any assurance that the results contemplated in such forward-looking statements will be realized. The inclusion of this forward-looking information should not be regarded as a representation by us or any other person that the future events, plans or expectations that we contemplate will be achieved. Furthermore, past performance in operations and share price is not necessarily predictive of future performance.

The following discussion and analysis should be read in conjunction with the Consolidated Financial Statements and Notes thereto:

## **Overview**

### ***History***

We began operations as Commonwealth Telephone in 1897 with the construction of a telephone line between two rural farms in Pennsylvania. In 1928, a prominent Pennsylvania family acquired Commonwealth Telephone and continued to grow the company through acquisition and internal growth. The company went public in 1952, but the family continued to hold a controlling stake. In the 1980's, the company expanded beyond wireline telephone into cable, cellular, paging and other telecommunications-related services through acquisition and business development. In 1986, the controlling family implemented a dual class voting structure in order to strengthen its control, with the common stock having one vote per share and Class B common stock having 15 votes per share. In 1993, the controlling family sold its ownership interest to a subsidiary of Peter Kiewit Sons', Inc., which has since become Level 3 Communications, Inc. ("Level 3"). In 1997, Commonwealth Telephone implemented a spin-off of certain operations into two new public companies, a bundled telecommunications provider (RCN Corporation) and a cable television operator (Cable Michigan, Inc.). At the conclusion of the spin-off, we became the public company that currently exists as Commonwealth Telephone Enterprises, Inc. ("CTE," "the Company," "we," "us" or "our"). In April and December of 2002, Level 3 sold approximately 9,600,000 shares of our common stock in two registered secondary offerings, which resulted in a reduction from approximately 48% of the voting power of our equity securities to approximately 29%. In September 2003, we completed a transaction pursuant to which each outstanding share of our Class B Common Stock was converted into 1.09 shares of our Common Stock (the "Recapitalization Transaction"). Following the

**COMMONWEALTH TELEPHONE ENTERPRISES, INC., AND SUBSIDIARIES**  
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Recapitalization Transaction, the 1,017,061 shares of our Class B Common Stock that Level 3 beneficially owned prior to the Recapitalization Transaction, representing approximately 29% of the voting power of our equity securities, were converted into 1,108,596 shares of our Common Stock, representing approximately 4.6% of the voting power of our equity securities. In January 2004, Level 3 announced that it had closed a privately-negotiated sale of its remaining 1,108,596 shares of our Common Stock to an institutional investor.

*Management's Overview*

*2005 Highlights*

In July of 2003, we took advantage of favorable interest rates and sold \$300,000 of 3.25% convertible notes due in 2023. On June 24, 2005, we launched an exchange offer pursuant to which we offered to exchange any and all of the \$300,000 of our then outstanding 3.25% convertible notes (the "Old Notes") for new 2005 Series A 3.25% convertible notes (the "New Notes") due 2023 in an equal principal amount plus an exchange fee of \$2.50 per \$1,000 principal amount of existing notes. The New Notes contain terms that provide us with the flexibility to settle conversion of the notes with cash, common stock or a combination of cash and common stock. The Old Notes require us to settle conversion of notes with shares of common stock. The change to the terms of the notes allows us to reduce the dilutive effect on our common stock that would be caused by future conversion of the convertible notes. The terms of the New Notes maintain full dividend protection for the holders of the notes. The exchange offer closed on August 3, 2005, at which time a total of \$63,892 principal amount of New Notes were issued in exchange for the same principal amount of Old Notes and an exchange fee of \$160 was paid. We intend to continue to consider other options to further reduce or possibly eliminate the dilutive effect of future conversions, including common share repurchases depending on market conditions.

In November of 2003, taking advantage of our strong cash position and a relatively weak stock price, our Board of Directors authorized a Stock Repurchase Program of up to \$100 million of CTE Common Stock, which was subsequently increased to \$150 million. As of December 31, 2005, we had repurchased 3,047,244 shares, at a cost of \$118,544. We have approximately \$31,456 available for repurchases under the program. Future share repurchases will be executed at our discretion, based on ongoing assessments of our capital needs, and the market value of our common stock.

On November 30, 2004, the Governor of Pennsylvania signed legislation that authorized CT to amend its alternative regulation plan to include a commitment to deliver broadband service to all customers by December 31, 2008. Under the legislation, this commitment entitles CT to eliminate the 2% yearly offset in its price adjustment formula, although CT could be required to refund the additional revenues collected due to this amendment if it fails to meet its broadband commitment. CT filed an amended plan with the PUC incorporating these changes in December 2004, which the PUC approved on March 3, 2005. On May 3, 2005, CT filed notice with the PUC that it would seek approval to raise certain rates to recover approximately \$3,200 on an annualized basis, effective September 1, 2005, which reflects changes in the rate of inflation as provided for in its alternative regulation plan. On February 1, 2006, CT filed notice with the PUC that it would seek approval to raise certain rates to recover approximately \$4,100 on an annualized basis, effective May 16, 2006.

On May 2, 2005, our Board of Directors declared a special dividend of \$13.00 per share and a \$0.50 per share dividend for the quarter ended June 30, 2005; and on June 30, 2005, \$294,138 was paid. In addition, we announced the intention to provide an ongoing annual dividend of \$2.00 per share, which will be paid quarterly. The payment of cash dividends in the future will be at the discretion of our Board of Directors and will be based on a number of factors. Additionally, other indebtedness we incur may place significant restrictions on our ability to pay dividends. The payment of dividends results in a change in the conversion rate on our convertible notes. At the conversion price in effect at December 31, 2005, our convertible debt is convertible into 7,285,200 shares of our common stock.

**COMMONWEALTH TELEPHONE ENTERPRISES, INC., AND SUBSIDIARIES**  
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*2005 Challenges and 2006 Expectations*

We faced many challenges in 2005 that will continue into the future. Wireless carriers continue to increase their coverage area and Voice over IP is evolving. In addition, there are industry-wide trends toward declining usage of dial-up Internet access and wireline long-distance services.

The legislative and regulatory landscape continues to be a challenging one. FCC-mandated interstate access rate reductions reduced revenues in 2005 for CTSI. Also, a substantial portion of CTSI's revenues are derived directly and indirectly from ISPs. Loss of a major ISP customer or consolidation within the ISP industry due to their declining dial-up customer base, bankruptcy or a major network reconfiguration could negatively impact CTSI's results.

Our primary focus in 2006 will be on the execution of our business plan in the market place. This means defending our customer base, and we plan to do this by delivering value to our customers in our bundled product offerings, including DSL, and by providing customer service that is second to none. It also means continued focus on our costs and our margins.

Despite these challenges, our operations generate a significant amount of cash flow. Our strategic plan is designed to insure that we identify and capitalize on changing consumer preferences, market trends and technological developments. CT is actively bundling voice and data products to provide our customers with convenient, attractive packages in an effort to minimize churn to cable modem and wireless.

In 2005, the Company began offering its customers, in the territories of CT and CTSI, digital television programming through a strategic alliance with EchoStar Communications Corporation to provide their DISH Network<sup>™</sup> satellite TV service. By adding the DISH Network<sup>™</sup> satellite TV services to our product suite, we are now in the market with voice, video and data, the complete "triple play." In April of 2005, we announced that we signed agreements with two leading game providers: Zone4Play, Inc. and Exent Technologies. In the fourth quarter of 2005, we began offering Internet-based electronic games to our customers in the territories of CT and CTSI, as well as epix customers. Both CT and CTSI are exploring other alliances and partnerships with other providers in order to expand our product offerings and to capitalize on our strong sales capabilities, technologically-advanced network, loyal customer base and high-speed capacity.

*Segments*

Our two primary operations are Commonwealth Telephone Company ("CT"), which is a rural incumbent local exchange carrier ("RLEC"), and CTSI, LLC ("CTSI"), which we refer to as our RLEC "edge-out" operation, and is a competitive local exchange carrier ("CLEC"). The CT segment includes the results of Commonwealth Long Distance Company ("CLD"), a long-distance reseller; and the portion of our broadband data service that uses digital subscriber line ("DSL") technology to offer high-speed Internet access, that is in CT's territory. Our "Other" segment is comprised of telecommunications-related businesses that all operate in the deregulated segments of the telecommunications industry and support the operations of our two primary operating companies. These support businesses are epix<sup>®</sup> Internet Services ("epix"), a rural Internet service provider; and Commonwealth Communication, LLC ("CC"), a provider of telecommunications equipment and facilities management services. "Other" also includes our corporate entity.

As of December 31, 2005, CT served over 323,500 switched access lines. In 1997, we formally launched our facilities-based CLEC, CTSI. CTSI operates in three "edge-out" regional Pennsylvania markets that border CT's markets and that, we believe, offer attractive market demographics, such as higher population density and a higher concentration of businesses. CTSI served over 137,600 switched access lines as of December 31, 2005, which were mainly business customers.

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*Revenue*

CT's revenue is derived primarily from access, local service, enhanced services, local long-distance (intraLATA toll), long-distance service revenue and DSL. Access revenue consists primarily of charges paid by long-distance companies and other telecommunications carriers for access to our network in connection with the completion of long-distance telephone calls. Local service revenue consists of charges for local exchange telephone services, including monthly tariffs for basic local service. Enhanced services revenue is derived from service for special calling features, including, but not limited to, Caller ID and Call Waiting. Local long-distance (intraLATA toll) and long-distance revenues consist of charges for such services paid by CT's customers. DSL revenue consists of charges for high-speed Internet access provided to CT's customers.

CTSI's revenue is derived primarily from access, local service, competitive access, both dedicated and DSL Internet access, local long-distance (intraLATA toll) and long-distance service revenue. Access revenue consists primarily of charges paid by long-distance companies and other non-CLEC customers for access to our network in connection with the completion of long-distance telephone and local calls and the delivery of other services. Access revenue also includes recurring trunking revenue and reciprocal compensation. Local service revenue consists of charges for local exchange telephone services, including monthly recurring charges for basic services and special calling features. Competitive access revenue consists of charges for point-to-point connections. Internet access revenue consists of charges for dedicated Internet access provided to CTSI's customers. DSL revenue consists of charges for high-speed Internet access provided to CTSI's customers. Long-distance revenue consists of charges for long-distance service paid by CTSI's customers.

Our "Other" business segment includes the revenue from epix and CC. epix revenue for this segment consists primarily of dial-up Internet access revenue. CC generates revenue primarily from telecommunications projects, including installation and maintenance of telephone systems for business customers, cabling projects and telecommunications systems design. Other also includes our corporate entity.

*Operating Costs*

Our operating costs and expenses for each of our segments primarily include access charges and other direct costs of sales, payroll and related benefits, selling and advertising, software and information system services and general and administrative expenses. These costs have increased over time as we have grown our operations and revenues. We expect these costs to continue to increase, but generally at a slower rate. Operating costs also include depreciation and amortization. CTSI also incurs costs related to leased local loop charges associated with providing last mile access; circuit rentals, engineering costs, colocation expense, terminating access for local calls and long-distance expense. CLD also incurs long-distance expense associated with purchasing long-distance minutes on a wholesale basis from third party providers. CC also incurs expenses primarily related to equipment and materials used in the course of the installation and provisioning of service.

*Capital Expenditures*

We incur capital expenditures associated with expenditures for infrastructure and network upgrades in CT and CTSI territories. Under the revised Chapter 30 Plan that was approved by the Pennsylvania Public Utility Commission ("PUC"), CT committed to provide universal availability of broadband services throughout its territory by December 31, 2008. In addition, at CTSI, capital expenditures associated with access line installations and high capacity services, in order to provide Internet and cellular providers and interexchange carriers (IXCs) the ability to connect their networks into the public switched network system, comprise a significant portion of its overall capital spending.

**COMMONWEALTH TELEPHONE ENTERPRISES, INC., AND SUBSIDIARIES**  
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**Selected Segment Data**

*Data Tables*

We have included certain segment financial data in the tables below. Operating income (loss) is the primary measure used by our management to assess the performance of each segment.

	For the Years Ended December 31,		
	2005	2004	2003
<b>Sales:</b>			
CT .....	\$228,464	\$227,666	\$223,827
CTSI .....	86,495	83,568	85,336
Other .....	18,897	24,577	26,559
Total .....	<u>\$333,856</u>	<u>\$335,811</u>	<u>\$335,722</u>

	For the Years Ended December 31,		
	2005	2004	2003
<b>Operating income (loss):</b>			
CT .....	\$111,872	\$100,400	\$ 97,153
CTSI—edge-out .....	12,909	9,554	8,978
CTSI—restructuring reversals* .....	31	799	1,636
Total CTSI .....	<u>12,940</u>	<u>10,353</u>	<u>10,614</u>
Other .....	(12,731)	(4,306)	(4,386)
Total .....	<u>\$112,081</u>	<u>\$106,447</u>	<u>\$103,381</u>

\* See Note 4 for additional details.

	As of December 31,		
	2005	2004	2003
<b>Access lines:</b>			
CT access lines .....	323,555	333,022	338,462
CTSI access lines .....	<u>137,696</u>	<u>138,820</u>	<u>138,667</u>
Total .....	<u>461,251</u>	<u>471,842</u>	<u>477,129</u>

**2005 vs 2004**

For the year ended December 31, 2005, our consolidated sales decreased \$1,955 and were \$333,856 and \$335,811 for the years ended December 31, 2005 and 2004, respectively. Lower sales at Other of \$5,680 contributed to the decrease, offset by an increase in CTSI sales of \$2,927 and an increase in CT sales of \$798. Consolidated costs and expenses increased \$4,725 primarily due to non-cash compensation expense of \$4,155 resulting from the dividends. This compensation is in the form of dividend equivalent units related to vested, deferred restricted stock units; amortization of unvested restricted stock units; vested, deferred Executive Stock Purchase Plan share units; amortization of unvested Executive Stock Purchase Plan share units; and unvested 401(k) shares. This charge was partially offset by a favorable sales and use tax settlement of \$2,764. Operating income increased \$5,634 as a result of decreased consolidated depreciation expense of \$13,082 related to our periodic review of asset retirement activity, salvage values and fixed asset lives and certain classes of assets becoming fully depreciated, partially offset by the decrease in sales and increase in operating expenses discussed above and a positive settlement in 2004 of \$799 associated with our 2000 restructuring charge as compared to \$31 in 2005. Consolidated net income was \$70,108 or \$2.71 per diluted share for the year ended

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December 31, 2005. Consolidated net income was \$62,031 or \$2.60 per diluted share for the year ended December 31, 2004. Contributing to the increase in net income is the increase in operating income, an increase in interest income primarily from higher interest rates and a decrease in interest expense primarily due to our repayment of debt, partially offset by an increase in other expenses primarily due to the special and quarterly dividend and exchange offer costs and an increase in the provision for income taxes.

*CT*

CT's sales were \$228,464 and \$227,666 for the years ended December 31, 2005 and 2004, respectively. The sales increase of \$798 or 0.4% is primarily due to increases in intraLATA toll and long-distance revenues and DSL revenue, partially offset by lower local and inside wire maintenance revenues.

CT's additional lines declined as customers switched to DSL and other high-speed Internet access alternatives. Primary residential lines declined due in part to wireless substitution. Company lines decreased as a result of the industry wide trend of epix customers' migrating to broadband services.

IntraLATA toll and long-distance revenues increased a combined total of \$1,997. The change is due to an increase in CLD revenues of \$3,912 as we continue to promote our long-distance product in our bundles. The increase at CLD was partially offset primarily by customers selecting alternate lower cost service providers, including CLD, and calling packages offered by several non-wireline providers in certain areas of CT's territory, decreasing revenue by \$1,878. Interstate access revenue decreased \$1,450 resulting from a decline in access lines of \$1,597, a decline in minutes of use of \$771 and certain revenue settlements that occurred in 2004 of \$572. These decreases were partially offset by an increase in the National Exchange Carrier Association ("NECA") average schedule settlements of \$963 (average schedule formulas are updated annually in July) and an increase in special access circuit revenue of \$804. State access revenue increased \$1,357 from increased state access settlement revenues of \$2,526 and a favorable effect of \$1,196 resulting from a certain access revenue settlement due to a jurisdictional shift in traffic to a high access rate. These increases were partially offset by a decrease of \$997 due to a decrease in minutes of use, a decrease of \$483 due to a reduction in access lines and wireless interconnection rate reductions of \$446. Local service revenue decreased \$216 primarily as a result of a decrease in access lines and the loss of an Internet service provider ("ISP") from our network, partially offset by a line rate increase of approximately \$1.00 per average line per month effective September 2005. Other revenue decreased \$779 as a result of a decrease in inside wire maintenance revenue of \$1,002, an increase in the provision for bad debt of \$1,006 and a lower message volume for billing and collection of \$492. These decreases were partially offset by an increase in DSL revenue of \$1,819 from an increase in subscribers, partially offset by a price reduction.

CT's costs and expenses, excluding depreciation and amortization, ("costs and expenses") were \$79,153 and \$79,219 for the years ended December 31, 2005 and 2004, respectively. Costs and expenses decreased \$66 or 0.1% due to a reversal of a sales and use tax accrual of \$2,764 in connection with the completion of a state audit focused on the taxability of wholesale purchases of Internet services, lower advertising expense of \$683 and lower terminating access expense of \$673 due to CT's lower intraLATA toll minutes. These lower costs were partially offset by higher material expense of \$733 primarily from DSL modems and higher payroll and benefits from salary increases, increases in insurance premiums and overtime.

Depreciation and amortization expense decreased \$10,608 or 22.1% for the year ended December 31, 2005. The change was the result of certain assets becoming fully depreciated and lengthening the estimated useful lives of certain asset classes after completing our periodic review in the second quarter of 2005 of asset retirement activity, salvage values and fixed asset lives.

CT's operating income increased \$11,472 or 11.4% to \$111,872 for the year ended December 31, 2005. The increase was a result of the items discussed above.

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*CTSI*

CTSI's sales were \$86,495 and \$83,568 for the years ended December 31, 2005 and 2004, respectively. The increase of \$2,927 primarily represents an increase in access revenue of \$1,479, and increases in customer point-to-point circuit revenues of \$1,013 and data revenues of \$727, partially offset by a decrease in long-distance revenue of \$288.

Access revenues increased due to a favorable effect of \$2,608 resulting from certain access revenue settlements, an increase of \$515 resulting from the FCC ruling that no longer enforces the cap on the number of minutes for which compensation on local telephone calls that terminate to ISPs can be collected and an increase in circuits of \$765. These increases were partially offset by the FCC rate ceilings, as further described in the Legislative and Regulatory section, which have reduced the revenues CTSI receives from interstate access charges. CTSI's revenues from access charges and reciprocal compensation are also affected by the mix of traffic delivered to it by other carriers for termination to CTSI customers. In addition, continued industry-wide trends towards declining usage of dial-up Internet access and of wireline long-distance services generally, will continue to have a negative impact on access revenues.

CTSI recorded approximately \$5,829 or 6.7% of its revenues from compensation revenue associated with Internet service provider ("ISP") traffic as compared to \$6,335 or 7.6% for 2004. Effective October 8, 2004, the FCC no longer enforces the cap on the number of minutes for which compensation can be collected, but continues to limit the rate that can be charged. At current traffic levels, this FCC decision has resulted in an increase in the amount of reciprocal compensation received by CTSI, although the order may be subject to court appeals, and we cannot predict the outcome of any such proceeding.

CTSI derives a substantial portion of its revenues directly and indirectly from ISPs. ISPs represented approximately 15.1% and 17.1% of CTSI's revenues (after excluding the effect of the previously mentioned access revenue settlements) for the years ended December 31, 2005 and 2004, respectively. These high-margin revenues include services provided directly to the ISP including local and high-capacity services and indirect services including reciprocal compensation and trunking from Verizon as a result of Verizon's customers accessing these ISPs. Industry-wide trends toward declining usage of dial-up Internet access threaten the profitability or viability of our ISP customers. If we lose a large customer or a significant number of customers that are providing Internet services, or if a significant portion of these customers are unable to pay amounts owed to us, our financial results could be negatively impacted.

The increase in point-to-point circuit revenue is due to Internet and cellular providers and IXC's using our network to connect their networks into the public switched network system. Data revenues increased due to subscriber growth. Long-distance revenue decreased due to a decrease in minutes of use and a decrease in the average blended rate per minute.

Costs and expenses were \$54,315 and \$53,809 for the years ended December 31, 2005 and 2004, respectively. The increase of \$506 is primarily due to an increase in high capacity circuit expense of \$683, an increase in DSL and Internet expense of \$611 due to an increase in customers and increased network circuit costs of \$410. These increases were partially offset by a reduction in the long-distance termination rate of \$458, reductions in rates for unbundled loops of \$441 and lower headcount in telemarketing and sales of \$327. Also, favorable effects of \$1,646 resulting from certain network costs settlements were partially offset by a reserve reversal in 2004 linked to network cost settlements of \$1,701.

Depreciation and amortization expense decreased \$934 or 4.6% to \$19,271 as a result of lengthening the estimated useful lives of certain asset classes after completing our periodic review of asset retirement activity, salvage values and fixed asset lives. The change was also the result of certain assets becoming fully depreciated. Restructuring reversals associated with our 2000 restructuring charge were \$768 lower for the year ended December 31, 2005 as compared to the year ended December 31, 2004.

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CTSI's operating income increased \$2,587 or 25.0% to \$12,940 for the year ended December 31, 2005. The increase was a result of the items discussed above.

*Other*

Other sales were \$18,897 and \$24,577 for the years ended December 31, 2005 and 2004, respectively. The decrease of \$5,680 or 23.1% is due to a decrease in CC and epix sales.

CC sales decreased \$3,013 or 20.1% to \$12,007 primarily due to a decrease in new installations of business systems due to sales personnel turnover and lower revenues from communications facilities management services. The operating results of CC are subject to fluctuations due to its less predictable revenue streams, market conditions and the effect of competition on margins. epix sales decreased \$2,667 or 27.9% to \$6,890 due to a decrease in dial-up subscribers as customers move to DSL or other high-speed products or lower-cost providers and a price reduction implemented in May 2005.

Costs and expenses in Other were \$30,446 and \$26,161 for the years ended December 31, 2005 and 2004, respectively. Expenses at the corporate entity increased primarily due to non-cash compensation expense of \$4,155 resulting from the dividends, reversal of certain health care accruals of \$1,513 in 2004 and increased restricted stock amortization of \$935. This increase was partially offset by decreased costs and expenses at CC of \$1,554 to \$12,039 for the year ended December 31, 2005. This change was primarily due to the decrease in sales and associated cost of goods sold. epix expenses decreased \$1,048 primarily as a result of lower transport costs due to a price reduction, line disconnects and lower advertising expense.

Depreciation and amortization expense decreased \$1,540 or 56.6% to \$1,182. The change was due to a smaller base of depreciable plant and certain assets, primarily at epix, becoming fully depreciated.

The operating loss in Other was (\$12,731) for the year ended December 31, 2005 as compared to (\$4,306) for the year ended December 31, 2004. The change was a result of the items discussed above.

*Restructuring Charges (Reversals)*

In December 2000, we announced that we would exit CTSI's five expansion markets launched over the preceding two years. Related to this strategy, we recorded an estimated restructuring charge of \$99,713 (pre-tax) and \$64,813 (after-tax), or (\$2.79) (after-tax) per common share (including effects of anti-dilutive options). At December 31, 2005, there is no remaining liability. See Note 4 to the Consolidated Financial Statements for additional information.

*Interest and Dividend Income*

Interest and dividend income was \$8,375 for the year ended December 31, 2005 as compared to \$5,773 for the year ended December 31, 2004. The increase of \$2,602 or 45.1% is primarily the result of higher interest rates, partially offset by lower average cash balances.

*Interest Expense*

Interest expense includes interest on our convertible notes, interest on CT's revolving credit facility with CoBank, ACB ("CoBank") and amortization of debt issuance costs. We employed an interest rate swap on \$35,000 of floating rate debt to hedge against interest rate exposure. Interest expense was \$14,084 for the year ended December 31, 2005 as compared to \$16,800 for the year ended December 31, 2004. The decrease of \$2,716 or 16.2% is primarily a result of repayment of high cost debt in 2004 and the resulting lower loan balances.

*Income Taxes*

Our effective tax rates were 35.5% and 37.6% for the years ended December 31, 2005 and 2004, respectively. The lower rate in 2005 is due to a detailed review of all deferred tax items and supporting schedules

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of net book vs net tax values that we performed in 2005. This review resulted in a net deferred tax benefit of approximately \$3,154 (\$2,239 impact to the fourth quarter) related to prior years that we recorded in the fourth quarter of 2005. We estimate that, excluding these corrections, our effective tax rate would have been approximately 38.4%. This adjustment did not have a material effect on the current or any prior period's financial statements. We anticipate our 2006 effective tax rate to be approximately 38% to 39%. For an analysis of the change in income taxes, see Note 11 to the Consolidated Financial Statements.

**2004 vs 2003**

For the year ended December 31, 2004, our consolidated sales increased \$89 and were \$335,811 and \$335,722 for the years ended December 31, 2004 and 2003, respectively. Higher sales at CT of \$3,839 contributed to the increase, offset by a decline in CTSI sales of \$1,768 and a decline in Other sales of \$1,982. Consolidated costs and expenses decreased \$3,651 primarily due to lower headcount (primarily at CTSI), lower transport costs of \$750 at epix, lower corporate spending of \$461 and network cost settlements of \$1,701 at CTSI which contributed to lower operating expenses of \$2,977. Operating income increased \$3,066 as a result of the increase in sales and the decrease in operating expenses discussed above. Consolidated net income was \$62,031 or \$2.60 per diluted share for the year ended December 31, 2004. Consolidated net income was \$72,865 or \$2.92 per diluted share for the year ended December 31, 2003, including a cumulative effect accounting adjustment of \$13,230 or \$0.51 per diluted share from the adoption of SFAS No. 143, "Accounting for Asset Retirement Obligations." Contributing to the decrease in net income is the cumulative effect accounting adjustment and an increase in interest expense due to the sale of convertible notes in July 2003, partially offset by the increase in operating income and an increase in interest income.

**CT**

CT's sales were \$227,666 and \$223,827 for the years ended December 31, 2004 and 2003, respectively. The sales increase of \$3,839 or 1.7% is primarily due to higher local, enhanced services, DSL and intraLATA toll and long-distance revenues, partially offset by lower access revenue and a recovery of \$965 of our WorldCom receivables in 2003 that did not recur in 2004. CT's primary residential lines declined slightly primarily due to wireless substitution. Additional lines declined as customers switched to DSL and other high-speed products, and customers look to find ways to lower personal spending.

Interstate access revenue increased \$3,319 primarily resulting from an increase in units that drive settlements of \$1,801, an increase in special access circuit revenue of \$998 and an increase in the NECA average schedule settlements of \$1,019. Due to a slight decline in the NECA average schedule formulas that was placed into effect July 1, 2004, the increase in interstate access revenue occurred during the first half of 2004; the average schedule formulas are updated annually. State access revenue decreased \$7,652 primarily as a result of the State Access Reform rate decrease of \$4,571, wireless interconnection rate reductions of \$1,311 and a decrease in minutes of use of \$438. Local service revenue increased \$3,916 primarily as a result of the State Access Reform rate increase. In addition, enhanced service revenue increased \$2,395 as a result of the State Access Reform price increase of \$1,801 and increases in custom calling, Caller ID and certain other enhanced services. IntraLATA toll and long-distance revenues increased \$931 due to an increase in revenue of \$3,910 resulting from an increase in subscribers from a long-distance product offering that began in early 2003. The increase was partially offset by lower market share in CT intraLATA toll due to customers selecting alternate lower cost service providers, including CLD, and calling packages offered by several non-wireline providers in certain areas of CT's territory, decreasing revenue by \$2,997, a trend we expect to continue. Other revenue increased \$934 as a result of an increase in DSL revenue of \$1,740 from an increase in subscribers, an increase in inside wire maintenance revenue of \$1,125 due to a price increase and price increases on other services as a result of State Access Reform of \$572. These increases were partially offset by a recovery of \$965 in 2003 related to a third party vendor assuming our WorldCom receivables that were previously written-off and a lower volume of non-recurring equipment sales and time and material work of \$1,664 due to a lower demand in 2004 as compared to 2003.

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CT's costs and expenses, excluding depreciation and amortization, ("costs and expenses") were \$79,219 and \$79,730 for the years ended December 31, 2004 and 2003, respectively. Costs and expenses decreased \$511 or 0.6% due to a decrease in corporate expenses due to decreased spending, lower material expense due to lower CPE equipment sales of \$545 and lower terminating access expense due to CT's lower intraLATA toll minutes. These lower costs were partially offset by higher expenses due to an increase in pole attachments and associated higher rates of \$783 and higher repairs and maintenance expense of \$423.

Depreciation and amortization expense increased \$1,103 or 2.3% for the year ended December 31, 2004. The increase was a result of capital expenditures in 2003 and 2004, partially offset by changes in CT's overall composite rate.

CT's operating income increased \$3,247 or 3.3% to \$100,400 for the year ended December 31, 2004. The increase was a result of the items discussed above.

*CTSI*

CTSI's sales were \$83,568 and \$85,336 for the years ended December 31, 2004 and 2003, respectively. The decrease of \$1,768 primarily represents a decrease in access revenue of \$5,046, partially offset by an increase in local service of \$884, from installed access lines; and increases in customer point-to-point circuit revenues of \$801 and data revenues of \$849. CTSI's sales include a \$760 Verizon trunking dispute settlement.

The FCC rate ceilings, as further described in the Legislative and Regulatory section, have resulted in reductions in the revenues CTSI receives from interstate access charges. In addition, continued industry-wide trends towards declining usage of dial-up Internet access and of wireline long-distance services generally, will have a negative impact on these revenues. CTSI's revenues from access charges and reciprocal compensation are also affected by the mix of traffic delivered to it by other carriers for termination to CTSI customers. In late 2003, Verizon notified CTSI of a reduction in the proportion of its delivered traffic that will be subject to intrastate access charges, and a corresponding increase in the proportion that will be subject to reciprocal compensation rates based on a revised Percent Local Usage ("PLU") factor. Because the reciprocal compensation rates are much lower than access charges, this change in traffic mix negatively affected CTSI's revenues by approximately \$700 per month.

In late 2004, CTSI was notified by Verizon North (formerly GTE) requesting a change in the PLU factor. As a result of this request, CTSI will be using a direct measurement billing approach instead of a PLU factor. The effect on CTSI's revenue and operating income is a reduction of approximately \$50 per month beginning April 2005.

CTSI recorded approximately \$6,335 or 7.6% of its revenues from compensation revenue associated with Internet service provider ("ISP") traffic as compared to \$12,258 or 14.4% for 2003. As was the case in 2003, all of the allowable billable minutes on local ISP reciprocal compensation above the 3 to 1 ratio available to be billed in 2004 were billed in the first quarter. Effective October 8, 2004, the FCC no longer enforces the cap on the number of minutes for which compensation can be collected, but will continue to limit the rate that can be charged.

CTSI derives a substantial portion of its revenues directly and indirectly from ISPs. ISPs represented approximately 17.1% and 23.2% of CTSI's revenues for the years ended December 31, 2004 and 2003, respectively. This percentage has decreased as a result of our approximately \$700 per month reduction in revenue from our revised PLU factor with Verizon. These high-margin revenues include services provided directly to the ISP including local and point-to-point circuit revenue and indirect services including reciprocal compensation and trunking from Verizon as a result of Verizon's customers calling these ISPs. Industry-wide trends toward

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declining usage of dial-up Internet access threaten the profitability or viability of our ISP customers. If we lose a large customer or a significant number of customers that are providing Internet services, or if a significant portion of these customers are unable to pay amounts owed to us, our financial results could be negatively impacted.

The decrease in revenue was partially offset by the increase in local service. At December 31, 2004, CTSI had 138,820 installed access lines as compared to 138,667 at December 31, 2003, an increase of 153 or 0.1%. Additionally, the increase in point-to-point circuit revenue is due to Internet and cellular providers and IXCs using our circuits to allow their networks to tie into the switched network system. The decrease in revenue was also partially offset by increases in DSL and Internet revenues of \$849 due to subscriber growth.

Costs and expenses were \$53,809 and \$55,610 for the years ended December 31, 2004 and 2003, respectively. The decrease of \$1,801 is primarily due to reserve reversals linked to network cost settlements of \$1,701, reductions in collocate power requirements of \$289 and a reduction in headcount, partially offset by an increase in long-distance minutes of \$297.

Depreciation and amortization expense decreased \$543 or 2.6% to \$20,205 as a result of certain assets becoming fully depreciated. Restructuring reversals associated with our 2000 restructuring charge were \$837 lower for the year ended December 31, 2004 as compared to the year ended December 31, 2003.

CTSI's operating income decreased \$261 or 2.5% to \$10,353 for the year ended December 31, 2004. The decrease was a result of the items discussed above.

*Other*

Other sales were \$24,577 and \$26,559 for the years ended December 31, 2004 and 2003, respectively. The decrease of \$1,982 or 7.5% is due to a decrease in epix and CC sales.

epix sales decreased \$1,631 or 14.6% to \$9,557 due to a decrease in dial-up subscribers as customers move to DSL or other high-speed products or lower cost dial-up providers. CC sales decreased \$351 or 2.3% to \$15,020 primarily due to lower revenues from communications facilities management services, a decrease in premises distribution systems sales and a decrease in drop shipments, partially offset by an increase in new installations of business systems. The operating results of CC are subject to fluctuations due to its less predictable revenue streams, market conditions and the effect of competition on margins.

Costs and expenses in Other were \$26,161 and \$27,500 for the years ended December 31, 2004 and 2003, respectively. epix expenses decreased \$1,502 primarily as a result of a decrease in subscribers, lower transport costs, lower headcount and lower bad debt expense. Expenses at the corporate entity decreased primarily due to certain expenses related to the Recapitalization Transaction in 2003 that did not recur, partially offset by a charge for severance expense incurred in the third quarter of 2004. This decrease was partially offset by increased costs and expenses at CC of \$624 to \$13,593 for the year ended December 31, 2004. This change was due to a favorable settlement of an outstanding project dispute of \$965 in 2003.

Depreciation and amortization expense decreased \$723 or 21.0% to \$2,722. The change was due to a smaller base of depreciable plant and certain assets becoming fully depreciated.

The operating loss in Other was (\$4,306) for the year ended December 31, 2004 as compared to (\$4,386) for the year ended December 31, 2003. The change was a result of the items discussed above.

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*Restructuring Charges (Reversals)*

In December 2000, we announced that we would exit CTSI's five expansion markets launched over the preceding two years. Related to this strategy, we recorded an estimated restructuring charge of \$99,713 (pre-tax) and \$64,813 (after-tax), or (\$2.79) (after-tax) per common share (including effects of anti-dilutive options). At December 31, 2004, we carried a liability of \$344 associated with certain outstanding liabilities. See Note 4 to the Consolidated Financial Statements for additional information.

*Interest and Dividend Income*

Interest and dividend income was \$5,773 for the year ended December 31, 2004 as compared to \$3,372 for the year ended December 31, 2003. The increase of \$2,401 or 71.2% is primarily the result of the higher temporary cash investment balances as a result of proceeds received from the \$300,000 convertible notes offering in July 2003 and a higher Rural Telephone Bank dividend rate of 6% versus 4.2% in 2003.

*Interest Expense*

Interest expense includes interest on our convertible notes, CT's mortgage note payable to CoBank, interest on revolving credit facilities and amortization of debt issuance costs. We employed an interest rate swap on \$35,000 of floating rate debt to hedge against interest rate exposure. Interest expense was \$16,800 for the year ended December 31, 2004 as compared to \$13,560 for the year ended December 31, 2003. The increase of \$3,240 or 23.9% is primarily a result of our issuance of convertible notes in July 2003, partially offset by lower expense due to repayment of high cost debt and the resulting lower loan balances.

*Income Taxes*

Our effective tax rates were 37.6% and 37.2% for the years ended December 31, 2004 and 2003, respectively. In December 2002, we reorganized our legal entity structure to allow the Pennsylvania state taxable losses of CLD and epix to be offset against state taxable income of CT, a benefit we realized in 2003. Also, we utilize various tax strategies to provide effective state income tax planning. For an analysis of the change in income taxes, see Note 11 to the Consolidated Financial Statements.

**Liquidity and Capital Resources**

	December 31,	
	2005	2004
Cash and temporary cash investments . . . . .	\$104,968	\$312,260
Working capital . . . . .	55,466	253,092
Long-term debt (including current maturities, notes payable and capital lease obligations) . . . . .	335,360	336,082

Cash and temporary cash investments were \$104,968 at December 31, 2005, as compared to \$312,260 at December 31, 2004. We consider all highly liquid investments with an original maturity of three months or less to be temporary cash investments. Temporary cash investments are investments in high quality, diversified money market mutual funds. We monitor fund performance of money market mutual funds available to us on a quarterly basis to maximize returns and insure investment quality. Our working capital ratio was 1.52 to 1 at December 31, 2005, as compared to 3.08 to 1 at December 31, 2004. The net decrease in cash is primarily due to the dividend payments, partially offset by cash generated by operations and stock option exercises.

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We have the following financing arrangements in place:

	<u>December 31, 2005</u>		<u>December 31, 2004</u>	
	<u>Balance</u>	<u>Available</u>	<u>Balance</u>	<u>Available</u>
Revolving line of credit—CoBank .....	\$ 35,000	\$50,000	\$ 35,000	\$—
Convertible notes .....	300,000	—	300,000	—
Total .....	<u>\$335,000</u>	<u>\$50,000</u>	<u>\$335,000</u>	<u>\$—</u>

On July 18, 2003, we sold \$300,000 of 3.25% convertible notes due 2023. On June 24, 2005, we launched an exchange offer pursuant to which we offered to exchange up to \$300,000 of our then outstanding 3.25% convertible notes (the "Old Notes") for new 2005 Series A 3.25% convertible notes (the "New Notes") due 2023 in an equal principal amount plus an exchange fee of \$2.50 per \$1,000 principal amount of existing notes. The New Notes contain terms that provide us with the flexibility to settle conversion of the notes with cash, common stock or a combination of cash and common stock. The Old Notes require us to settle conversions of notes with shares of common stock. The change to the terms of the notes allows us to reduce the dilutive effect on our common stock that would be caused by future conversion of the convertible notes. The terms of the New Notes maintain full dividend protection for the holders of the notes. The exchange offer closed on August 3, 2005, at which time a total of \$63,892 principal amount of New Notes were issued in exchange for the same principal amount of Old Notes and an exchange fee of \$160 was paid. We intend to continue to consider other options to further reduce or possibly eliminate the dilutive effect of future conversions, including common share repurchases, depending on market conditions.

On June 30, 2005, we paid a special dividend of \$13.00 per share and a \$0.50 per share dividend for the quarter ended June 30, 2005 in the amount of \$294,138. In addition, we announced the intention to provide an ongoing annual dividend of \$2.00 per share, which will be paid quarterly. A \$0.50 per share dividend was paid for the quarters ended September 30, 2005 and December 31, 2005. On February 21, 2006, our Board of Directors declared a \$0.50 per share dividend payable March 31, 2006 to shareholders of record on March 15, 2006.

The payment of cash dividends in the future will be at the discretion of our Board of Directors. The declaration of any cash dividend and the amount thereof will depend on a number of factors, including our financial condition, capital requirements, funds from operations, the dividend taxation level, our stock price, future business prospects and such other factors as our Board of Directors may deem relevant. Additionally, other indebtedness we incur may place significant restrictions on our ability to pay dividends.

An amended \$85,000 revolving line of credit agreement with CoBank was entered into on May 31, 2005, which extended the availability of credit to May 2006. The aggregate amount outstanding on this commitment was \$35,000 and \$35,000 at December 31, 2005 and 2004, respectively. This agreement contains restrictive covenants, which, among other things, requires the maintenance of a specific debt to cash flow ratio at CT. We may refinance all or a portion of this line of credit when it becomes due in May 2006. As of December 31, 2005, we were in compliance with our CoBank debt covenants.

Our financing arrangements with CoBank entitle us to receive annual patronage dividends from CoBank. Approximately 60% of the patronage dividends are received in cash, with the balance in CoBank equity. Patronage dividends in the form of equity received to date have a future value totaling approximately \$6.2 million. We will receive cash in exchange for a portion of this equity once the value of the equity reaches certain targeted levels, which are calculated based upon the amount outstanding on our CoBank loan. We will recognize the CoBank equity dividend as it is received in cash, which we currently anticipate will not begin before 2007. The cash dividend received in 2005 of \$293 is included in interest and dividend income.

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We announced a \$100 million Stock Repurchase Program on November 13, 2003 and a \$50 million addition to the program on February 10, 2004. The Stock Repurchase Program has no expiration date. No stock repurchases have occurred for the year ended December 31, 2005. As of December 31, 2005, we had repurchased 3,047,244 shares with an average purchase price of \$38.902, including commissions, for a total repurchase of approximately \$118.5 million.

<u>Net cash provided by (used in):</u>	<u>As of December 31,</u>		
	<u>2005</u>	<u>2004</u>	<u>2003</u>
Operating activities .....	\$ 128,505	\$ 142,504	\$150,275
Investing activities .....	(40,567)	(39,864)	(43,736)
Financing activities .....	(295,230)	(126,415)	194,561

For the year ended December 31, 2005, our net cash provided by operating activities was \$128,505 comprised of net income of \$70,108, non-cash depreciation and amortization of \$57,892 and other non-cash items and working capital changes of \$505. Net cash used in investing activities of \$40,567 consisted primarily of additions to property, plant and equipment of \$43,875. Net cash used in financing activities of \$295,230 consisted primarily of dividends paid of \$315,877, partially offset by proceeds of stock option exercises of \$23,678.

In accordance with the terms of our prior mortgage notes and security agreements which we redeemed in 1993, we were required to purchase common stock of the Rural Telephone Bank ("RTB") equal to approximately 5% of the amount borrowed. Such class of stock is entitled to cash dividends. As part of the 2006 Agricultural Appropriations bill, the current Administration established a process and terms to implement a dissolution of the RTB, whereby stockholders will obtain a cash payout for their stock. Our original cash investment in the RTB was approximately \$6,409. In addition, we have received stock dividends with a face value of approximately \$23,600 in accordance with the provisions of our previous financing arrangement with the RTB. These stock dividends will be recognized as income and will be subject to the statutory federal and state income tax rates when the underlying security is redeemed for cash, which we received notification from the RTB will be no later than the end of the second quarter of 2006.

We expect to have adequate resources to meet our currently foreseeable obligations and development plans for our markets and customer demand for additional capacity and service. In addition to cash generated from operations, sources of funding for any additional capital requirements or acquisitions may include financing from public offerings or private placements of equity and/or debt securities and bank loans. There can be no assurance that additional financing will be available to us or, if available, that it can be obtained on a timely basis and on acceptable terms. Failure to obtain such financing could result in the delay or curtailment of our development plans and expenditures.

**Off Balance Sheet Arrangements, Contractual Obligations and Commitments**

We have contractual obligations and commercial commitments made in the ordinary course of business. The commercial obligations, financings and commitments made by us are customary transactions, similar to those of other comparable telecommunications providers.

The tables set forth below contain information with regard to disclosures about contractual obligations and commercial commitments. These disclosures are also included in the Notes to the Consolidated Financial Statements and cross referenced in the tables below.

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The following table discloses aggregate information about our contractual obligations as of December 31, 2005, and the periods in which payments are due:

<u>Contractual obligations</u>	<u>Total</u>	<u>Payments Due by Period</u>				<u>Footnote reference(1)</u>
		<u>Less than 1 year</u>	<u>1-3 years</u>	<u>4-5 years</u>	<u>More than 5 years</u>	
Debt maturing within one year .....	\$ 35,000	\$35,000	\$ —	\$ —	\$ —	8
Long-term debt .....	300,000	—	—	—	300,000	8
Interest on long-term debt .....	171,113	9,750	29,250	19,500	112,613	8
Pension and other postretirement benefits ...	2,213	373	812	395	633	10
Capital lease obligations(2) .....	398	398	—	—	—	12
Operating leases .....	19,258	2,688	5,762	3,042	7,766	12
Purchase obligations(3) .....	69,163	11,910	17,895	12,457	26,901	12
Total contractual obligations .....	<u>\$597,145</u>	<u>\$60,119</u>	<u>\$53,719</u>	<u>\$35,394</u>	<u>\$447,913</u>	

As of December 31, 2005, we have no letters of credit or other financial guarantees outstanding.

The following table discloses aggregate information about our derivative instruments, the source of fair value of these instruments and their maturities:

<u>Source of fair value</u>	<u>Fair Value of Contracts at Period-End</u>					<u>Footnote reference(1)</u>
	<u>Total Fair Value</u>	<u>Less than 1 year</u>	<u>1-3 years</u>	<u>4-5 years</u>	<u>After 5 years</u>	
Prices provided by external sources(4) .....	\$(194)	\$(194)	\$—	\$—	\$—	13

- (1) Refers to the Notes to our Consolidated Financial Statements included herein.
- (2) Represents total obligations, including interest components.
- (3) Purchase obligations include: outstanding purchase orders and commitments, committed software purchases and pole and conduit rental payments through 2015.
- (4) The fair value of the interest rate swap at December 31, 2005, was provided by the counterparty to the underlying contract.

**Quantitative and Qualitative Disclosures about Market Risk**

We are exposed to interest rate risk primarily through our borrowing activities. There is inherent rollover risk for borrowings as they mature and are renewed at current market rates. The extent of this risk is not quantifiable or predictable because of the variability of both future interest rates and our future financing requirements.

We measure the fair value of the convertible debt based upon current market prices or by obtaining quotes from dealers. The fair value of bank debt is estimated using discounted cash flow calculations. The table that follows summarizes the fair values of our fixed and variable rate debt. The table also provides a sensitivity analysis of the estimated fair values of these financial instruments assuming 100-basis-point upward and downward shifts in the weighted average interest rate.

<u>As of December 31, 2005</u>	<u>Carrying Amount</u>	<u>Fair Value</u>	<u>Fair Value Assuming +100 Basis Point Shift</u>	<u>Fair Value Assuming -100 Basis Point Shift</u>
Fixed rate long-term debt .....	\$300,000	\$294,382	\$288,909	\$300,008
Variable rate notes payable .....	35,000	35,000	34,860	35,141

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The table below provides information about our interest rate swap. Notional amounts are used to calculate the contractual payments to be exchanged under the contract. The estimated fair value amount has been provided to us by the financial institution with which we have the swap contract using appropriate and consistent valuation methodologies.

<u>Variable to Fixed:</u>	<u>Maturity Date</u>	<u>Interest Rate</u>	<u>Fixed Notional Amount</u>	<u>Approximate Fair Value as of December 31, 2005</u>
Interest rate swap .....	2006	5.40%	\$35,000	\$(194)

**Critical Accounting Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Certain estimates require more subjectivity or judgment than others. We review the critical accounting estimates, judgments and degrees of subjectivity inherent in these estimates with the Company's Audit Committee. These critical accounting estimates are:

- We use the composite group remaining life method and straight-line composite rates to depreciate the assets of CT and CTSI. We periodically review data on asset retirement activity, salvage values and fixed asset lives in order to assess depreciation rates. If actual outcomes differ from our estimates and assumptions, we may be required to adjust depreciation, which could impact our earnings. The effect of increasing the average useful lives of our telephone plant by one year would result in a decrease in depreciation expense of approximately \$3.3 million; the effect of reducing the average useful lives of our telephone plant by one year would result in an increase in depreciation expense of approximately \$3.9 million.
- We calculate the costs of providing retiree benefits under the provisions of SFAS No. 87 and SFAS No. 106. The key assumptions used in making these calculations are disclosed in Note 10 to the Consolidated Financial Statements. The most significant of these assumptions are the discount rate used to value the future obligations and expected return on plan assets. We select discount rates commensurate with current market interest rates on high-quality, fixed-rate debt securities with terms similar to our estimated future pension distributions. The expected return on assets is based on our current view of the long-term returns on assets held by the plan, which is influenced by historical averages. Pension expense for 2005 would have increased approximately \$0.2 million if our expected return on plan assets were one quarter of one percent lower. The expense would have increased approximately \$0.4 million if our assumed discount rate were one quarter of one percent lower, and would have decreased \$0.4 million if our assumed discount rate were one quarter of one percent higher. The benefit obligation at December 31, 2005, would have been increased by approximately \$4.3 million if our assumed discount rate were one quarter of one percent lower.
- We recognize deferred tax assets and liabilities based on the differences between the financial statement carrying amounts and the tax bases of assets and liabilities. At the time deferred tax assets and liabilities are recorded, certain tax positions may require management to use judgment based on current facts and circumstances in order to develop our best estimate. We regularly review our deferred tax assets for recoverability and establish a valuation allowance based on historical taxable income, projected future taxable income and the expected timing of the reversals of existing temporary differences. The amount of the deferred tax asset valuation could change if estimates of future taxable income during the carryforward period are revised, or if the carryforward period or amounts for net operating losses in tax jurisdictions is changed.

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- The Company is routinely audited by federal, state and local taxing authorities. The outcome of these audits may result in our being assessed taxes in addition to amounts previously paid. Accordingly, we maintain tax contingency reserves for such potential assessments. The reserves are determined based upon our best estimate of possible assessments by the Internal Revenue Service ("IRS") or other taxing authorities and are adjusted, from time to time, based upon changing facts and circumstances.
- CT's interstate access charges are subject to a pooling process with the National Exchange Carrier Association. Final interstate revenues are based on nationwide average costs applied to certain demand quantities. We estimate revenues earned through this process, which are subject to adjustments that may either increase or decrease the amount of interstate access revenues and receivables.
- We review the valuation of accounts receivable on a periodic basis. The allowance for doubtful accounts is estimated based on historical experience and future expectations of conditions that may impact our ability to collect on our accounts receivable. If actual outcomes differ from our estimates and assumptions, or if our assumptions are revised based on additional or changed information, we may be required to make adjustments which could impact our earnings.
- Our determination of the treatment of contingent liabilities in the financial statements is based on our view of the expected outcome of the applicable contingency. We consult with legal counsel on matters related to litigation and other experts both within and outside the Company with respect to matters in the ordinary course of business. We record a liability if the likelihood of an adverse outcome is probable of occurrence and the amount is estimable. We disclose the matter if either the likelihood of an adverse outcome is only reasonably possible or an estimate is not determinable. If actual outcomes differ from our estimates and assumptions, or if our assumptions are revised based on additional or changed information, we may be required to make adjustments which could impact our earnings.
- Our revenues are also affected by the terms of our various carrier agreements by which certain interstate traffic is subject to a percent interstate usage ("PIU") factor and certain intrastate traffic is subject to a percent local usage ("PLU") factor. These factors may be updated based on actual traffic patterns. Revisions to the PIU and PLU factors could have an impact on our results of operations.

#### **Related Parties**

Related parties include members of the Board of Directors and their related companies, including Level 3 Communications, Inc. Three of our directors are also directors of Level 3. Our Chairman, Walter Scott, Jr. is also the Chairman of Level 3. Level 3 does not hold any equity ownership interest in the Company at this time. Related party revenues and expenses represent the telephony service provided and the fees paid to these related companies arising from the ordinary course of business.

#### **Legislative and Regulatory Developments**

##### ***Commonwealth Telephone Company***

Prices for CT's (our RLEC) local and in-state long-distance services are regulated by the Pennsylvania Public Utility Commission ("PUC"). These prices are currently set under an alternative regulation plan approved by the PUC. Under this plan, among other things, CT is protected by an exogenous events provision that recognizes and accounts for certain state/federal regulatory, legislative changes or other unique changes in the telephone industry that affect revenues or expenses, thereby allowing CT to adjust rates to compensate for changes in revenues and/or expenses due to such exogenous events.

During 2005, CT filed and received PUC approval of an amended plan revising its price adjustment formula to eliminate the 2% annual offset to inflation, and proposing to provide universal availability of broadband

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services within CT's service territory no later than December 31, 2008. Under the amended plan, CT could be required to refund some of its increased revenues to customers if it fails to meet its commitment to deploy broadband services. Effective September 1, 2005, CT raised certain rates to recover approximately \$3,200 on an annualized basis, which reflects changes in the rate of inflation as provided in its alternative regulation plan. On February 1, 2006, CT filed notice with the PUC that it would seek approval to raise certain rates to recover approximately \$4,100 on an annualized basis, effective May 16, 2006.

The PUC is currently considering changes in intrastate switched access rates and Universal Service Funding ("USF") reform for independent local exchange carriers in Pennsylvania. This proceeding, which was begun in December 2004, primarily addresses the rates that CT charges to long-distance carriers for in-state toll calls that originate or terminate on CT's local telephone lines. In previous PUC orders, reductions in in-state access charges have been offset by revenue-neutral increases in our monthly local service rates. CT also receives funding from the state USF, which could be affected by the PUC's investigation. In August 2005, the PUC issued an order deferring this investigation for twelve months or until the FCC concludes its investigation of intercarrier compensation, whichever occurs earlier. At this time, we cannot predict either the timing or the outcome of the PUC's proceeding.

Prices for CT's interstate services (consisting primarily of subscriber line charges and access charges for interstate toll calls), which currently account for approximately 32.0% of its telephone service revenues, are regulated by the Federal Communications Commission ("FCC") based on the "average schedule" formulas proposed by NECA. The purpose of the average schedule formulas is to estimate the costs of smaller telephone companies, like CT, without requiring them to perform expensive cost studies. The formulas use the costs of other telephone companies to "simulate" the costs of the average schedule companies. Under the FCC rules, NECA is required to review these formulas annually. In December 2005, NECA submitted proposed formula changes to the FCC which, if approved, would result in a reduction in CT's interstate access revenues of approximately \$1.2 million (\$2.4 million annually) in the second half of 2006. In addition, NECA proposed a phased-in structural change to the formulas that would reduce CT's settlements by approximately \$0.4 million in 2006, \$2.2 million in 2007, \$3.9 million in 2008 and \$4.2 million thereafter. These structural changes result primarily from changes in the formulas used to estimate common line (or local loop) costs and special circuit settlements. It is possible that future changes to the formulas or FCC disallowance of the phase-in may cause additional changes (either increases or decreases) in CT's interstate access revenues.

CT also receives funding from the federal USF, under formulas adopted by the FCC. During the Fund's fiscal year ending June 30, 2006, CT is entitled to receive approximately \$20.0 million in interstate common line support ("ICLS"). Changes in the federal USF formulas could have a material effect on CT's revenues. The FCC currently is considering changes to the USF funding mechanism, but at this time we are unable to predict either the timing or the impact of any changes it may adopt.

The FCC is considering adopting proposed rules that would allow telephone companies such as CT to convert to a form of incentive regulation similar in some respects to CT's alternative regulation plan in Pennsylvania. We are unable to predict the timing or outcome of this proposed rulemaking at this time.

Since 2001, the FCC has been considering proposed changes to its rules to unify several existing systems of intercarrier compensation (intrastate access, interstate access, reciprocal compensation, EAS settlements, etc.) into a single coherent structure. The FCC has recently solicited comments from the public on a variety of proposed approaches to reforming intercarrier compensation. Some of these proposals, if adopted, would also affect CT's intrastate access charges, and the amount of USF funding it receives. CTE has been active in addressing these proposals through its industry association, the United States Telecom Association ("USTA"). The FCC had expressed a tentative preference for moving to a "bill and keep" regime, whereby carriers would exchange traffic with one another without payment of compensation, but may also consider alternative

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approaches. Since CT currently derives a significant portion of its revenues from intercarrier compensation, changes in these rules may have material effects on our revenues and earnings. However, any FCC ruling is likely to address the concerns of rural carriers like CT such as the ability to raise other rates to offset reductions in intercarrier compensation, a transition period and/or increased universal service funding. Until the FCC adopts a specific proposal, it is impossible to predict how changes in this area may affect CT.

CT, CTSI and CLD are required to make contributions to the federal USF, based on their end-user revenues for interstate and international telecommunications services. Each of these companies currently passes through the cost of these contributions to its end-user customers, either as a surcharge or as part of the price of its services. The FCC is currently considering changes to its USF regulations that, if adopted, would alter the basis upon which USF contributions are determined and the means by which such contributions may be recovered from customers. The FCC has not yet acted on these proposals and it is not clear whether the FCC will adopt any of these proposals. Based on the foregoing, the application and effect of the USF requirements (and comparable state contribution requirements) on the telecommunications industry cannot be definitively ascertained at this time.

Pursuant to the "rural exemption" provision of Section 251(f)(1) of the Telecommunications Act of 1996, CT is currently exempted from offering colocation, unbundled network elements ("UNEs"), wholesale discounts and other requirements of the Act that pertain to Regional Bell Operating Companies ("RBOCs") and non-rural incumbent LECs. The rural exemption does not preclude competitors from providing telephone services within CT's service area entirely over their own facilities. However, it requires prospective competitors who seek to interconnect with our network in order to resell services or lease unbundled network elements to go through a formal review by the Pennsylvania PUC before receiving approval. The Pennsylvania PUC may grant such approval only if it finds that the competitor's proposal is not unduly economically burdensome, is technically feasible and is consistent with the Universal Service provisions of the Telecommunications Act. To date, no carrier has sought such a review by the Pennsylvania PUC. On May 4, 2005, Sprint Communications Company L.P. ("Sprint") filed an Application with the PUC for "Approval of Authority to Offer, Render, Furnish or Supply Telecommunications Services to the Public in the Commonwealth of Pennsylvania" for the purpose of expanding its local service authority to include the service territory of CT. On June 6, 2005, CT filed a Protest and Motion to Dismiss with the PUC. On June 24, 2005, Sprint filed an Answer to CT's Protest and Motion to Dismiss. On May 27, 2005, Core Communications, Inc. filed an Application with the PUC for "Approval of Authority to Offer, Render, Furnish or Supply Telecommunications Services to the Public in the Commonwealth of Pennsylvania" for the purpose of expanding its local service authority to include the service territory of CT. On July 18, 2005, as part of a group comprised of several Pennsylvania Telephone Association member companies, CT filed a Protest and Motion to Dismiss with the PUC. On September 22, 2005, Service Electric Telephone Company, LLC. ("SET") filed an Application with the PUC for "Approval of Authority to Offer, Render, Furnish or Supply Telecommunications Services to the Public in the Commonwealth of Pennsylvania" for the purpose of expanding its local service authority to include the remaining service territory of CT. CT responded to this application in a similar manner to the others that have been filed. SET received authority to offer facilities based local exchange telecommunications services in a limited portion of CT's service area in 2001. It is not possible to predict the outcome of any of these proceedings at this time.

However, the Act's general requirement that telecommunications carriers interconnect networks for the exchange of traffic does apply to CT. CT has received several requests for network interconnection for the exchange of traffic between its network and the networks of other facilities-based telecommunications providers, and has entered into interconnection and reciprocal compensation agreements with several national wireless carriers and other competitive carriers providing for exchange of traffic between its network and theirs.

On September 23, 2005, the FCC adopted an order relaxing its regulation of broadband Internet access offered by incumbent local exchange carriers, such as CT. Under this order, telephone companies will have the

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option of offering broadband Internet access either as a tariffed telecommunications service or as a non-tariffed information service. Companies will not be required to provide unbundled broadband transmission services to third-party Internet access providers. This decision, which remains subject to judicial review, does not directly affect CT because CT does not currently offer Internet access as a regulated service; rather, its affiliate epix offers unregulated Internet access services. However, we believe this decision will give CT greater flexibility in the future should it choose to offer wireline broadband Internet access.

On February 24, 2005, the FCC adopted new rules, effective April 29, 2005, which prohibit incumbent LECs such as CT from enforcing tariffs that impose compensation obligations for traffic not subject to access charges upon commercial mobile radio service providers. This order may be subject to court appeals or agency reconsideration. We do not believe that this order affects CT's ability to collect compensation from commercial mobile radio service providers under individually negotiated contracts, such as those CT has entered into with several mobile carriers. However, we cannot predict whether the mobile carriers will challenge our ability to collect this compensation, or otherwise seek to re-open our compensation arrangements. Also, other carriers that have not yet entered into contracts with CT may seek compensation terms that are less favorable to CT. Therefore, the full impact of this FCC decision on CT cannot be determined at this time.

Pursuant to FCC requirements, CT has implemented local number portability, which enables customers to keep their number when switching between carriers, without regard to whether the new carrier is a wireline or wireless service provider. The implementation of wireless number portability could negatively impact our operations, as customers become able to transfer their residential or business telephone number to a wireless telephone. In this regard, the FCC is considering shortening the time interval allowed for porting to occur. At this time, no decision has been made by the FCC.

The FCC allows telecommunications carriers to recover over five years their carrier-specific costs of implementing local number portability. The order allows for such cost recovery in the form of a surcharge from customers to whom number portability is available. CT implemented this cost recovery mechanism in 2004 to offset its costs of implementing number portability.

On June 3, 2005, the FCC released new rules requiring providers of Voice over Internet Protocol ("VoIP") telephone services to provide access to E911 emergency services. This ruling does not directly affect either CT or CTSI because they do not provide VoIP services. This decision is expected to increase the costs of entry and ongoing operation for VoIP providers and therefore, may somewhat reduce the risk of competition that CT and CTSI face from these companies. The FCC ruling may be subject to agency reconsideration or judicial review.

***CTSI, LLC***

CTSI's prices are subject to regulation by the FCC and the PUC although, as a competitive provider, its rates are typically subject to much less scrutiny than those of CT, or those of Verizon as the dominant local telephone service provider. CTSI's costs are also affected by regulatory decisions, because CTSI relies in part on facilities and services purchased from incumbent telephone companies (primarily Verizon), including interconnection for the exchange of local traffic with other companies, in providing its services. CTSI has separate month-to-month interconnection and resale agreements with Verizon covering its former Bell Atlantic and former GTE operating areas in Pennsylvania.

The FCC has made several significant changes in recent years to its rules requiring incumbent carriers like Verizon to offer unbundled access to network elements to competing carriers like CTSI, most recently in February 2005. Under the new rules, Verizon is required to continue to offer access to unbundled voice-grade loops. Verizon is not, however, required to permit unbundled access to newly-constructed fiber optic facilities serving primarily residential premises. Verizon also will no longer be required to offer unbundled local

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switching, but CTSI does not use that element significantly. Verizon will also be required to provide some other network elements (including high-capacity loops and transport facilities) in many, but not all, of the markets it serves, but CTSI does not rely extensively on these elements.

During 2003, the FCC gave notice of a proposed rulemaking in which it is considering changing the formula used by state commissions, including the Pennsylvania PUC, to determine rates for access to Verizon network elements and for interconnection to Verizon's network. It is unknown at this time when the FCC will act on this proposal or what effects any changes in the rate formula will have on CTSI's costs.

Under the Telecommunications Act of 1996, the Pennsylvania PUC has authority to arbitrate any disputes over the terms and conditions of interconnection between CTSI and Verizon, and the prices of various unbundled network elements CTSI purchases from Verizon. The PUC has taken a number of actions over the past several years affecting the prices for network elements, as well as the terms and conditions under which these elements are provided. The PUC operates within a framework of national rules adopted by the FCC governing network element unbundling. During 2004, the PUC implemented changes in Verizon's rates for unbundled local loops (that is, circuits connecting business and residential users' premises to the Verizon central office), which resulted in a modest decrease in CTSI's cost to obtain local loops in Verizon's density cell 3 exchanges (where most CTSI customers are located), but an increase in the cost to serve customers in density cell 4. Further decisions by the PUC and the FCC regarding these interconnection and unbundling obligations may have a material effect on CTSI's costs and profitability.

The FCC has adopted rules limiting the amounts that CTSI can charge other carriers for access to its network for originating and terminating interstate calls (access charges). Under these rules, carriers such as CTSI are permitted to charge interstate access rates no higher than those charged by Verizon.

The FCC also has limited the right of competitive local carriers, such as CTSI, to collect reciprocal compensation on local telephone calls that terminate to ISPs. Under these rules, the amount of compensation payable to CTSI on calls to ISPs above a 3 to 1 ratio generally is limited to \$0.0007 per minute. In 2002, the U.S. Court of Appeals for the D.C. Circuit remanded the order in which the FCC adopted these rules, on the grounds that the FCC did not provide proper statutory authority for its order. The Court did not vacate the rules, however, and so the current compensation scheme will remain in effect pending the remand. To date, the FCC has taken no action in response to the Court's remand.

Although declining from historical levels, CTSI derives a substantial portion of its revenues from ISPs. We expect that this reliance will continue in the foreseeable future. ISPs represented approximately 15.1% and 17.1% of CTSI's revenues for the year ended December 31, 2005 and 2004, respectively. These revenues include services provided directly to the ISP such as local and transport services and indirect services such as reciprocal compensation, and trunking from Verizon as a result of Verizon's customers calling these ISPs. Industry-wide trends towards declining usage of dial-up Internet access threaten the profitability or viability of our ISP customers. If we lose a large customer or a significant number of customers that are providing dial-up Internet services, or if a significant portion of these customers are unable to pay amounts owed to us, our financial results could be negatively impacted.

The FCC rate ceilings have resulted in continued reductions in the revenues CTSI receives from interstate access charges and reciprocal compensation, both in dollar amount and as a percentage of total annual revenues. CTSI's revenues from access charges and reciprocal compensation are also affected by the mix of traffic delivered to it by other carriers for termination to CTSI customers. For the year ended December 31, 2005, CTSI recorded approximately \$5,829 or 6.7% of its revenues from compensation revenue from ISP traffic. This compares to \$6,335 or 7.6% for the same period in the previous year. Of these amounts, local reciprocal compensation associated with ISP traffic was \$3,331 or 1.0% and \$2,854 or 0.9% of our total consolidated revenues for the year ended December 31, 2005 and 2004, respectively. Revenues from interstate access charges represented approximately 0.3% and 0.5% of our consolidated revenues, for the year ended December 31, 2005

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and 2004, respectively. In addition, industry-wide trends towards declining usage of dial-up Internet access and of wireline long-distance services generally, may continue to have a negative impact on these revenues.

CTSI may also be affected by any changes in FCC rules governing intercarrier compensation, as discussed above with respect to CT.

CTSI has received several requests for network interconnection for the exchange of traffic between its network and the networks of other facilities-based telecommunications providers, and has entered into interconnection and reciprocal compensation agreements with several national wireless carriers providing for exchange of traffic between its network and theirs.

CTSI may also be affected by the introduction of wireless number portability in November 2003, for the same reasons discussed above with respect to CT. CTSI is permitted by applicable rules to recover the cost of implementing number portability from its end users.

In January 2005, Verizon Pennsylvania and CTSI reached a mutually satisfactory settlement of a dispute over transport facilities charges that had been the subject of a complaint filed with the Pennsylvania PUC.

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**SELECTED FINANCIAL DATA**  
**(Thousands of Dollars, Except Per Share Amounts)**  
**(Unaudited)**

**For the Years Ended December 31,**

	<u>2005</u>	<u>2004</u>	<u>2003</u>	<u>2002</u>	<u>2001</u>
Sales .....	\$333,856	\$335,811	\$335,722	\$318,555	\$306,614
Net income .....	70,108	62,031	72,865	57,124	43,132
Diluted earnings per share .....	2.71	2.60	2.92	2.42	1.84
Dividends per share .....	14.50	—	—	—	—
Total assets as of period end .....	555,394	783,431	851,653	554,039	564,604
Long-term debt, net of current maturities as of period end ..	300,000	300,000	323,898	77,299	151,309

- 2003 includes the effects of SFAS No. 143, "Accounting for Asset Retirement Obligations."
- 2003 includes the issuance of \$300,000 of convertible notes.
- 2005 includes the payment of \$315,877 cash dividends.

## MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Management is responsible for establishing and maintaining adequate internal control over financial reporting, and for performing an assessment of the effectiveness of internal control over financial reporting as of December 31, 2005. Internal control 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 generally accepted accounting principles. The Company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Company's assets that could have a material effect on the financial statements.

Internal control over financial reporting cannot provide absolute assurance of achieving financial reporting objectives because of its inherent limitations. Internal control over financial reporting is a process that involves human diligence and compliance and is subject to lapses in judgment and breakdowns resulting from human failures. Internal control over financial reporting also can be circumvented by collusion or improper management override. Because of such limitations, there is a risk that material misstatements may not be prevented or detected on a timely basis by internal control over financial reporting. However, these inherent limitations are known features of the financial reporting process. Therefore, it is possible to design into the process safeguards to reduce, though not eliminate, this risk.

Management performed an assessment of the effectiveness of the Company's internal control over financial reporting as of December 31, 2005 based upon criteria in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). Based on our assessment, management determined that the Company's internal control over financial reporting was effective as of December 31, 2005 based on the criteria in Internal Control—Integrated Framework issued by COSO.

Our management's assessment of the effectiveness of the Company's internal control over financial reporting as of December 31, 2005 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report which appears herein.

Dated March 10, 2006

/s/ Michael J. Mahoney  
Michael J. Mahoney  
President and  
Chief Executive Officer

/s/ Donald P. Cawley  
Donald P. Cawley  
Executive Vice President and  
Chief Accounting Officer

## Report of Independent Registered Public Accounting Firm

To the Board of Directors and  
Shareholders of Commonwealth Telephone Enterprises, Inc.:

We have completed integrated audits of Commonwealth Telephone Enterprises, Inc.'s 2005 and 2004 consolidated financial statements and of its internal control over financial reporting as of December 31, 2005, and an audit of its 2003 consolidated financial statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Our opinions, based on our audits, are presented below.

### Consolidated financial statements and financial statement schedules

In our opinion, the consolidated financial statements listed in the index appearing under Item 15(a)(1) of this Form 10-K present fairly, in all material respects, the financial position of Commonwealth Telephone Enterprises, Inc. and its subsidiaries at December 31, 2005 and 2004, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2005 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedules listed in the index appearing under Item 15(a)(2) of this Form 10-K present fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. These financial statements and financial statement schedules are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and financial statement schedules based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). 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 of financial statements includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

### Internal control over financial reporting

Also, in our opinion, management's assessment, included in "Management's Report on Internal Control Over Financial Reporting" appearing under Item 15(a)(1) of this Form 10-K, that the Company maintained effective internal control over financial reporting as of December 31, 2005 based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), is fairly stated, in all material respects, based on those criteria. Furthermore, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2005, based on criteria established in Internal Control—Integrated Framework issued by the COSO. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express opinions on management's assessment and on the effectiveness of the Company's internal control over financial reporting based on our audit. We conducted our audit of internal control over financial reporting in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. An audit of internal control over financial reporting includes obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we consider necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company's internal control 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 generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance

with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject 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.

/s/ PRICEWATERHOUSECOOPERS LLP

PricewaterhouseCoopers LLP

Philadelphia, Pennsylvania

March 10, 2006

**COMMONWEALTH TELEPHONE ENTERPRISES, INC., AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**

	For the Years Ended December 31,		
	2005	2004	2003
	(Thousands of Dollars, Except Per Share Amounts)		
Sales .....	\$ 333,856	\$ 335,811	\$ 335,722
Costs and expenses (excluding other operating expenses itemized below) .....	163,914	159,189	162,840
Depreciation and amortization .....	57,892	70,974	71,137
Restructuring reversals (see Note 4) .....	(31)	(799)	(1,636)
Operating income .....	112,081	106,447	103,381
Interest and dividend income .....	8,375	5,773	3,372
Interest expense .....	(14,084)	(16,800)	(13,560)
Other income (expense), net .....	(896)	686	(884)
Equity in income of unconsolidated entities .....	3,177	3,236	2,698
Income before income taxes .....	108,653	99,342	95,007
Provision for income taxes .....	38,545	37,311	35,372
Income before cumulative effect of accounting change .....	70,108	62,031	59,635
Cumulative effect of accounting change, net of tax (see Note 2) .....	—	—	13,230
Net income .....	70,108	62,031	72,865
Unrealized gain on derivative instruments, net of tax .....	703	1,660	1,632
Minimum pension liability adjustment, net of tax .....	(2,288)	—	2,839
Comprehensive net income .....	\$ 68,523	\$ 63,691	\$ 77,336
Basic earnings per share:			
Income before cumulative effect of accounting change .....	\$ 3.24	\$ 2.91	\$ 2.54
Cumulative effect of accounting change, net of tax .....	—	—	0.56
Net income .....	\$ 3.24	\$ 2.91	\$ 3.10
Weighted average shares outstanding .....	21,617,630	21,325,907	23,515,367
Diluted earnings per share:			
Income before cumulative effect of accounting change .....	\$ 2.71	\$ 2.60	\$ 2.41
Cumulative effect of accounting change, net of tax .....	—	—	0.51
Net income .....	\$ 2.71	\$ 2.60	\$ 2.92
Weighted average shares and common stock equivalents outstanding .....	28,592,549	26,779,685	26,105,917

See accompanying notes to Consolidated Financial Statements.

**COMMONWEALTH TELEPHONE ENTERPRISES, INC., AND SUBSIDIARIES**

**CONSOLIDATED BALANCE SHEETS**  
**(Thousands of Dollars, Except Par Value)**

	December 31,	
	2005	2004
<b>ASSETS</b>		
Current assets		
Cash and temporary cash investments . . . . .	\$104,968	\$ 312,260
Accounts receivable, net of allowance for doubtful accounts of \$1,362 in 2005 and \$2,185 in 2004 . . . . .	25,312	27,173
Unbilled revenues . . . . .	11,216	12,916
Material and supply inventory, at average cost . . . . .	5,395	6,071
Prepayments and other . . . . .	3,435	2,734
Deferred income taxes . . . . .	11,275	13,388
<b>Total current assets</b> . . . . .	<b>161,601</b>	<b>374,542</b>
Property, plant and equipment, net of accumulated depreciation of \$550,007 in 2005 and \$506,711 in 2004 . . . . .	368,506	382,523
Investments . . . . .	10,269	10,338
Other assets . . . . .	15,018	16,028
<b>Total assets</b> . . . . .	<b>\$555,394</b>	<b>\$ 783,431</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities		
Capital lease obligation . . . . .	\$ 360	\$ 721
Accounts payable . . . . .	26,590	25,012
Notes payable . . . . .	35,000	35,000
Advance billings and customer deposits . . . . .	5,248	5,316
Accrued interest . . . . .	5,083	5,995
Accrued restructuring expense . . . . .	—	344
Accrued expenses . . . . .	33,854	49,062
<b>Total current liabilities</b> . . . . .	<b>106,135</b>	<b>121,450</b>
Long-term debt . . . . .	300,000	300,000
Capital lease obligation . . . . .	—	361
Deferred income taxes . . . . .	72,490	77,279
Other liabilities . . . . .	20,904	18,411
Commitments and contingencies (see Note 12)		
Common shareholders' equity		
Common Stock (\$1 par value, authorized: 85,000,000 and 85,000,000; issued: 24,226,482 and 24,172,376; outstanding: 21,842,918 and 21,123,262, in 2005 and 2004, respectively) . . . . .	24,226	24,172
Additional paid-in capital . . . . .	118,723	284,358
Deferred compensation . . . . .	(16,861)	(10,093)
Accumulated other comprehensive loss . . . . .	(2,415)	(830)
Retained earnings . . . . .	26,327	86,931
Treasury stock at cost (2,383,564 and 3,049,114 shares in 2005 and 2004, respectively) . . . . .	(94,135)	(118,608)
<b>Total common shareholders' equity</b> . . . . .	<b>55,865</b>	<b>265,930</b>
<b>Total liabilities and shareholders' equity</b> . . . . .	<b>\$555,394</b>	<b>\$ 783,431</b>

See accompanying notes to Consolidated Financial Statements.

**COMMONWEALTH TELEPHONE ENTERPRISES, INC., AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

(Thousands of Dollars)

	<b>For the Years Ended December 31,</b>		
	<b>2005</b>	<b>2004</b>	<b>2003</b>
<b>Cash flows from operating activities:</b>			
Net income .....	\$ 70,108	\$ 62,031	\$ 72,865
<b>Adjustments to reconcile net income to net cash provided by operating activities:</b>			
Cumulative effect of accounting change, net of tax .....	—	—	(13,230)
Depreciation and amortization .....	57,892	70,974	71,137
Deferred income taxes, net .....	(1,669)	137	14,791
Provision for loss on accounts receivable .....	712	736	1,230
Dividend and debt exchange fees .....	1,399	—	—
Equity in income of unconsolidated entities .....	(3,177)	(3,236)	(2,698)
Tax benefit on stock compensation .....	3,410	880	744
Non-cash compensation .....	10,203	4,671	3,145
Non-cash amortization of debt issuance costs .....	1,774	1,758	1,298
Non-cash restructuring (reversals) provisions .....	32	(332)	(790)
Gain on sale of expansion market assets .....	(63)	(467)	(846)
Other non-cash items .....	—	100	6
<b>Net change in certain assets and liabilities:</b>			
Accounts receivable .....	1,149	7,414	1,266
Accounts receivable/payable related parties .....	—	188	492
Unbilled revenues .....	1,700	1,803	(362)
Material and supply inventory .....	676	787	888
Income taxes receivable .....	—	—	30
Prepayments and other .....	(700)	17	(167)
Other assets .....	2,775	483	439
Accounts payable .....	1,578	(4,113)	(1,368)
Advance billings and customer deposits .....	(68)	104	(658)
Accrued expense—restructuring .....	(376)	(136)	(427)
Accrued expenses .....	(15,370)	726	4,376
Other liabilities .....	(3,480)	(2,021)	(1,886)
Net cash provided by operating activities .....	<u>128,505</u>	<u>142,504</u>	<u>150,275</u>
<b>Cash flows from investing activities:</b>			
Additions to property, plant and equipment .....	(43,875)	(43,519)	(47,372)
Proceeds on sale of expansion market assets .....	63	245	846
Other .....	3,245	3,410	2,790
Net cash used in investing activities .....	<u>(40,567)</u>	<u>(39,864)</u>	<u>(43,736)</u>
<b>Cash flows from financing activities:</b>			
Redemption of long-term debt .....	—	(29,521)	(56,788)
Proceeds from the exercise of stock options .....	23,678	9,136	3,881
Proceeds from borrowings of long-term debt .....	—	—	300,000
Redemption of short-term debt .....	—	(30,000)	—
Capital lease payments .....	(722)	(777)	(491)
Stock repurchases .....	—	(75,177)	(43,367)
Dividends paid .....	(315,877)	—	—
Dividend and debt exchange fees paid .....	(2,149)	—	—
Payment made for debt issuance costs .....	(160)	(76)	(8,674)
Net cash (used in)/provided by financing activities .....	<u>(295,230)</u>	<u>(126,415)</u>	<u>194,561</u>
Net (decrease)/increase in cash and temporary cash investments .....	\$(207,292)	\$ (23,775)	\$301,100
Cash and temporary cash investments at beginning of year .....	<u>\$ 312,260</u>	<u>\$ 336,035</u>	<u>\$ 34,935</u>
Cash and temporary cash investments at end of year .....	<u>\$ 104,968</u>	<u>\$ 312,260</u>	<u>\$336,035</u>
<b>Supplemental disclosures of cash flow information:</b>			
<b>Cash paid during the year for:</b>			
Interest .....	\$ 12,035	\$ 14,246	\$ 8,228
Income taxes .....	\$ 45,506	\$ 26,923	\$ 20,904
<b>Supplemental disclosures of non-cash information:</b>			
Equipment acquired under capital lease obligation .....	\$ —	\$ —	\$ 2,163
Stock based compensation .....	\$ 14,008	\$ 7,482	\$ 6,576

See accompanying notes to Consolidated Financial Statements.

**COMMONWEALTH TELEPHONE ENTERPRISES, INC., AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CHANGES IN COMMON SHAREHOLDERS' EQUITY**

For the Years Ended December 31, 2005, 2004 and 2003  
(Thousands of Dollars)

	Common Par Value	Class B Par Value	Additional Paid-in Capital	Deferred Compensation	Accumulated Other Comprehensive Income (Loss)	Retained Earnings (Deficit)	Treasury Stock	Total Common Shareholders' Equity
Balance, December 31, 2002	\$21,489	\$ 5,818	\$ 256,594	\$ (2,676)	\$(6,961)	\$ 77,969	\$(131,243)	\$ 220,990
Net income						72,865		72,865
Restricted stock	163		6,091	(3,622)				2,632
Conversions	8	(8)						—
Stock option plan transactions	146		3,735					3,881
Executive stock purchase plan				(153)				(153)
Tax benefits related to stock options			744					744
Recapitalization	2,208	(2,026)	(182)					—
Retire treasury stock		(3,784)				(125,934)	129,718	—
Stock repurchases							(43,367)	(43,367)
Minimum pension liability adjustment, net of tax					2,839			2,839
Unrealized gain on derivative instruments, net of tax					1,632			1,632
Other			94				572	666
Balance, December 31, 2003	24,014	—	267,076	(6,451)	(2,490)	24,900	(44,320)	262,729
Net income						62,031		62,031
Restricted stock	(115)		7,298	(3,356)				3,827
Stock option plan transactions	273		8,863					9,136
Executive stock purchase plan				(286)				(286)
Tax benefits related to stock options			880					880
Stock repurchases							(75,177)	(75,177)
Unrealized gain on derivative instruments, net of tax					1,660			1,660
401(k) match			227				846	1,073
Other			14				43	57
Balance, December 31, 2004	24,172	—	284,358	(10,093)	(830)	86,931	(118,608)	265,930
Net income						70,108		70,108
Restricted stock	2		5,717	(982)			1,241	5,978
Stock option plan transactions	52		1,614				22,012	23,678
Executive stock purchase plan				266				266
Tax benefits related to stock options			3,410					3,410
Dividends			(176,538)	(6,052)		(130,712)	78	(313,224)
Minimum pension liability adjustment, net of tax					(2,288)			(2,288)
Unrealized gain on derivative instruments, net of tax					703			703
401(k) match			164				1,091	1,255
Other			(2)				51	49
Balance, December 31, 2005	\$24,226	\$ —	\$ 118,723	\$(16,861)	\$(2,415)	\$ 26,327	\$ (94,135)	\$ 55,865

See accompanying notes to Consolidated Financial Statements.

**COMMONWEALTH TELEPHONE ENTERPRISES, INC., AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CHANGES IN COMMON SHAREHOLDERS' EQUITY**  
**COMMON STOCK**  
**For the Years Ended December 31, 2005, 2004 and 2003**

	<u>Shares Issued</u>	<u>Treasury Stock</u>	<u>Shares Outstanding</u>
Balance, December 31, 2002 .....	21,488,697	44,484	21,444,213
Conversions .....	8,654	—	8,654
Stock option plan transactions .....	146,267	—	146,267
Restricted stock .....	162,625	—	162,625
Recapitalization .....	2,207,659	—	2,207,659
Stock repurchase program .....	—	1,179,200	(1,179,200)
Other .....	—	(16,668)	16,668
Balance, December 31, 2003 .....	24,013,902	1,207,016	22,806,886
Stock option plan transactions .....	272,945	—	272,945
Restricted stock .....	(6,750)	—	(6,750)
Restricted stock conversion .....	(107,721)	—	(107,721)
Stock repurchase program .....	—	1,868,044	(1,868,044)
401(k) match .....	—	(24,646)	24,646
Other .....	—	(1,300)	1,300
Balance, December 31, 2004 .....	24,172,376	3,049,114	21,123,262
Stock option plan transactions .....	52,106	(598,468)	650,574
Restricted stock .....	2,000	(35,888)	37,888
401(k) match .....	—	(29,794)	29,794
Other .....	—	(1,400)	1,400
Balance, December 31, 2005 .....	<u>24,226,482</u>	<u>2,383,564</u>	<u>21,842,918</u>

**CLASS B COMMON STOCK**  
**For the Years Ended December 31, 2005, 2004 and 2003**

	<u>Shares Issued</u>	<u>Treasury Stock</u>	<u>Shares Outstanding</u>
Balance, December 31, 2002 .....	5,818,684	3,784,649	2,034,035
Conversions .....	(8,654)	—	(8,654)
Recapitalization .....	(2,025,381)	—	(2,025,381)
Retire treasury stock .....	<u>(3,784,649)</u>	<u>(3,784,649)</u>	—
Balance, December 31, 2003 .....	—	—	—
Balance, December 31, 2004 .....	—	—	—
Balance, December 31, 2005 .....	<u>—</u>	<u>—</u>	<u>—</u>

See accompanying notes to Consolidated Financial Statements.

# COMMONWEALTH TELEPHONE ENTERPRISES, INC., AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in Thousands, Except Per Share Amounts)

### 1. Background and Basis of Presentation

The Consolidated Financial Statements of Commonwealth Telephone Enterprises, Inc. ("CTE," "the Company," "we," "us" or "our") include the accounts of Commonwealth Telephone Company ("CT"), a rural incumbent local exchange carrier ("RLEC"); CTSI, LLC ("CTSI"), our RLEC "edge-out" operation and a competitive local exchange carrier ("CLEC"); and other operations ("Other"). The CT segment includes the results of Commonwealth Long Distance Company ("CLD"), a reseller of long-distance services and the portion of our digital subscriber line ("DSL") product offering in CT's franchise area. Other includes Commonwealth Communication, LLC ("CC"), a provider of telecommunications equipment and facilities management services; epix® Internet Services ("epix"), which provides dial-up Internet services; and our corporate entity. All significant intercompany accounts and transactions are eliminated.

For comparative purposes, certain prior period amounts have been reclassified to conform to the current year presentation.

### 2. Summary of Significant Accounting Policies

*Use of Estimates*—The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances. On an ongoing basis, we evaluate our estimates. Actual results could differ from these estimates under different assumptions or conditions.

*Revenue Recognition*—Local telephone service revenue is recorded based on tariffed rates. Telephone network access and long-distance service revenues are derived from access charges, toll rates and settlement arrangements. CT's interstate access charges are subject to a pooling process with the National Exchange Carrier Association ("NECA"). Final interstate revenues are based on nationwide average costs applied to certain demand quantities.

Internet access service revenues are recorded based on contracted fees.

Long-distance telephone service revenues are recorded based on minutes of traffic processed, tariffed rates or contracted fees.

Revenue from local telephone, Internet access and long-distance telephone services is earned and recorded when the services are provided.

Unbilled revenue represents revenue that has been earned, but has not yet been billed.

Access revenue consists primarily of charges paid by long-distance companies and other telecommunications carriers for access to our network in connection with the completion of long-distance telephone calls. If the Company determines that a portion of the amounts billed may not be realizable due to uncertainty surrounding the jurisdiction or rate applied to the billing, we defer recognition of this specific revenue because the carrier has the ability to dispute the billing within a certain timeframe depending on the jurisdiction. Upon expiration of the statute of limitations, these revenues are no longer subject to claim or refund and therefore the Company records the recognition of this revenue.

Our revenues are also affected by the terms of our various carrier agreements by which certain interstate traffic is subject to a percent interstate usage ("PIU") factor and certain intrastate traffic is subject to a percent local usage ("PLU") factor. These factors may be updated based on actual traffic patterns. Revisions to the PIU and PLU factors could have an impact (positive or negative) on our results of operations due to a shift of traffic to different jurisdictional rates.

We defer and amortize CT, CTSI and epix installation revenue as well as associated incremental service installation costs, not in excess of installation revenue, over their respective estimated customer lives that are estimated to be 7 years, 3.2 years and 1.5 years, respectively. We carry in the Consolidated Balance Sheets

**COMMONWEALTH TELEPHONE ENTERPRISES, INC., AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**(Dollars in Thousands, Except Per Share Amounts)**

deferred credits of \$6,154 and \$6,188 as of December 31, 2005 and 2004, respectively, in other liabilities representing the unamortized portion of installation revenue. Additionally, we have deferred charges of \$6,154 and \$6,188 as of December 31, 2005 and 2004, respectively, in other assets representing the unamortized portion of installation costs.

Contracts of Commonwealth Communications are accounted for on the percentage-of-completion method. Estimated sales and earnings are recognized as equipment is installed or contract services rendered, with estimated losses, if any, charged to income in the period the losses are identified.

*Estimating Valuation Allowances*—We must make estimates of the uncollectability of our accounts receivables. We specifically analyze accounts receivable and historic bad debts, customer concentrations, customer credit-worthiness, current economic trends and changes in our customer payment terms when evaluating the adequacy of the allowance for doubtful accounts.

*Advertising Expense*—Advertising costs are expensed as incurred. Advertising expense charged to operations was \$3,080, \$3,212 and \$3,027 in 2005, 2004 and 2003, respectively.

*Stock-Based Compensation*—We apply the intrinsic value method of Accounting Principles Board Opinion No. 25 “Accounting for Stock Issued to Employees” (“APB 25”) and the Financial Accounting Standards Board Interpretation No. 44 “Accounting for Certain Transactions Involving Stock Compensation” (“FIN 44”) in accounting for our stock plans. We have adopted the disclosure-only provisions of Statement of Financial Accounting Standards (“SFAS”) No. 123 “Accounting for Stock-Based Compensation” (“SFAS 123”).

At December 31, 2005, the Company had three common stock compensation plans as more fully described in Note 9 to the Consolidated Financial Statements.

Pro forma information regarding net income and earnings per share is required by SFAS 123, and has been determined as if we had accounted for our stock options under the fair value method of SFAS 123. The fair value for these options was estimated at the date of grant using a Black-Scholes option pricing model. There were no options granted in 2005, 2004 and 2003; as a result, no Black-Scholes valuation was required to be made.

The following table illustrates the effect on net income and earnings per share if we had applied the fair value recognition provisions of SFAS 123:

	<u>For the Years Ended December 31,</u>		
	<u>2005</u>	<u>2004</u>	<u>2003</u>
Net income—as reported . . . . .	\$70,108	\$62,031	\$72,865
Add: stock-based employee compensation expense included in reported net income, net of related tax effects . . . . .	6,436	3,045	2,192
Deduct: total stock-based employee compensation expense determined under fair-value based method for all awards, net of related tax effects . . . . .	(8,294)	(5,797)	(5,517)
Net income—pro forma . . . . .	\$68,250	\$59,279	\$69,540
Net income adjustment for interest on convertible debt, net of tax . . . . .	7,491	7,480	3,369
Pro forma diluted earnings per share numerator . . . . .	<u>\$75,741</u>	<u>\$66,759</u>	<u>\$72,909</u>
Net earnings per share:			
Basic earnings per share—as reported . . . . .	\$ 3.24	\$ 2.91	\$ 3.10
Basic earnings per share—pro forma . . . . .	3.16	2.78	2.96
Diluted earnings per share—as reported . . . . .	2.71	2.60	2.92
Diluted earnings per share—pro forma . . . . .	2.65	2.49	2.80

*Earnings Per Share*—Basic earnings per share amounts are based on net income divided by the weighted average number of shares of common stock outstanding during each year.

Diluted earnings per share are based on net income divided by the weighted average number of shares of common stock outstanding during each year after giving effect to dilutive common stock equivalents. Options that could potentially dilute basic earnings per share in the future that were not included in the computation of

**COMMONWEALTH TELEPHONE ENTERPRISES, INC., AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**(Dollars in Thousands, Except Per Share Amounts)**

diluted earnings per share because to do so would have been antidilutive for the periods presented, were approximately 3,508, 25,441 and 47,289 for the years ended December 31, 2005, 2004 and 2003, respectively.

In September 2004, the Emerging Issues Task Force (“EITF”) of the Financial Accounting Standards Board reached a consensus on “The Effect of Contingently Convertible Instruments on Diluted Earnings per Share” (“EITF 04-8”). EITF 04-8 requires that contingently convertible debt be included in diluted earnings per share computations regardless of whether the market price trigger has been met. EITF 04-8 is effective for reporting periods ending after December 15, 2004. Prior period diluted earnings per share amounts were restated to conform to this consensus.

	For the Years Ended December 31,		
	2005	2004	2003
<i>Basic earnings per share:</i>			
Income before cumulative effect of accounting change .....	\$ 70,108	\$ 62,031	\$ 59,635
Cumulative effect of accounting change, net of tax .....	—	—	13,230
Net income .....	<u>\$ 70,108</u>	<u>\$ 62,031</u>	<u>\$ 72,865</u>
Weighted average shares outstanding .....	21,617,630	21,325,907	23,515,367
Income before cumulative effect of accounting change .....	\$ 3.24	\$ 2.91	\$ 2.54
Cumulative effect of accounting change, net of tax .....	—	—	0.56
Net income per share .....	<u>\$ 3.24</u>	<u>\$ 2.91</u>	<u>\$ 3.10</u>
<i>Diluted earnings per share:</i>			
Income before cumulative effect of accounting change .....	\$ 70,108	\$ 62,031	\$ 59,635
Cumulative effect of accounting change, net of tax .....	—	—	13,230
Net income .....	70,108	62,031	72,865
Net income adjustment for interest on convertible debt, net of tax .....	7,491	7,480	3,369
Net income as adjusted .....	<u>\$ 77,599</u>	<u>\$ 69,511</u>	<u>\$ 76,234</u>
Weighted average shares outstanding .....	21,617,630	21,325,907	23,515,367
Dilutive shares resulting from common stock equivalents .....	262,390	190,608	182,469
Dilutive shares resulting from convertible debt .....	<u>6,712,529</u>	<u>5,263,170</u>	<u>2,408,081</u>
Weighted average shares and common stock equivalents outstanding .....	<u>28,592,549</u>	<u>26,779,685</u>	<u>26,105,917</u>
Income before cumulative effect of accounting change .....	\$ 2.71	\$ 2.60	\$ 2.41
Cumulative effect of accounting change, net of tax .....	—	—	0.51
Net income per share .....	<u>\$ 2.71</u>	<u>\$ 2.60</u>	<u>\$ 2.92</u>

*Cash and Temporary Cash Investments*—For purposes of reporting cash flows, we consider all highly liquid investments purchased with an original maturity of three months or less to be temporary cash investments. Temporary cash investments are stated at cost, which approximates market value. At times, our cash balances and temporary cash investments exceed FDIC insurance limits.

*Property, Plant and Equipment and Depreciation*—Property, plant and equipment reflects the original cost of acquisition or construction, including payroll and related costs, such as taxes, pensions and other fringe benefits and certain general administrative costs and assets held under capital lease. Major replacements and betterments are capitalized. Repairs of all property, plant and equipment are charged to expense as incurred.

Depreciation on telephone plant is based on the estimated remaining lives of the various classes of depreciable property and straight-line composite rates. The average rates were approximately 6.32%, 8.05% and 8.37% in 2005, 2004 and 2003, respectively. At the time telephone plant is retired, the original cost less salvage, is charged to accumulated depreciation. All other property, plant and equipment gain or loss is recognized on retirements and dispositions.

**COMMONWEALTH TELEPHONE ENTERPRISES, INC., AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**(Dollars in Thousands, Except Per Share Amounts)**

Late in the second quarter of 2005, we completed our periodic review of asset retirement activity, salvage values and fixed asset lives at our CT and CTSI segments. This review involved a detailed analysis of assets in our network and incorporated our expectations for expansion and customer demand for new technology. Also, the second quarter of 2005 review incorporated the results of the Chapter 30 Plan amendment that was approved by the Pennsylvania Public Utility Commission in March 2005, which prescribed the broadband capability we are required to provide to our customers by December 31, 2008, and which clarified our expectations with regard to future capital deployment requirements in CT's territory. Specifically, the revised Chapter 30 Plan allows us to build upon, in large part, our current network, which we believe justifies a longer useful life for such assets. As a result of this review, we revised the useful lives of certain classes of assets, primarily digital equipment electronic switching, digital circuit transmission and computers and software. The impact of these changes was a lengthening of useful lives that had the effect of reducing depreciation by \$7,248 (after-tax) or \$0.25 per diluted share for the twelve months ended December 31, 2005.

Effective January 1, 2003, we adopted SFAS No. 143, "Accounting for Asset Retirement Obligations" ("SFAS 143"). This statement provides the accounting for the cost of legal obligations associated with the retirement of long-lived assets. SFAS 143 requires that companies recognize the fair value of a liability for asset retirement obligations in the period in which the obligations are incurred and capitalize that amount as part of the book value of the long-lived asset. SFAS 143 also precludes companies from accruing removal costs that exceed gross salvage in their depreciation rates and accumulated depreciation balances if there is no legal obligation to remove the long-lived assets. For our outside plant accounts, such as telephone poles and cable, estimated cost of removal did exceed gross salvage.

We had historically included in our group depreciation rates estimated net removal costs associated with these outside plant assets in which estimated cost of removal exceeded gross salvage. These costs were reflected in the calculation of depreciation expense, which resulted in greater periodic depreciation expense and the recognition in accumulated depreciation of future costs of removal for existing assets. When the assets were actually retired and removal costs expended, the net removal costs were recorded as a reduction to accumulated depreciation.

In connection with the adoption of this standard, we were required to remove all existing accrued net costs of removal in excess of the related estimated salvage from our accumulated depreciation for those accounts. The adjustment is reflected in the income statement as a cumulative effect of accounting change, net of tax, which increased net income in 2003 by \$13,230 or \$0.56 per share (\$0.51 per share on a diluted basis).

The following pro forma amounts have been adjusted for the effect of retroactive application on depreciation and costs of removal expense and related income taxes which would have been made had the new method been in effect at the beginning of 2003:

	<u>For the Year Ended December 31, 2003</u>	
	<u>As Reported</u>	<u>Pro Forma</u>
Net income .....	\$72,865	\$59,635
Basic earnings per share .....	3.10	2.54
Diluted earnings per share .....	2.92	2.41

In March 2005, the FASB issued FASB Interpretation No. 47 ("FIN 47"), "Accounting for Conditional Asset Retirement Obligations—an Interpretation of FASB Statement No. 143." FIN 47 clarifies that an entity is required to recognize the liability for the fair value of a conditional asset retirement obligation when incurred if the liability's fair value can be reasonably estimated. FIN 47 clarifies when an entity would have sufficient information to reasonably estimate the fair value of an asset retirement obligation. This Interpretation is effective no later than the end of fiscal years ending after December 15, 2005. The application of this Interpretation did not have a material effect on our results of operations or financial condition.

## COMMONWEALTH TELEPHONE ENTERPRISES, INC., AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued) (Dollars in Thousands, Except Per Share Amounts)

*Leasehold Improvements*—Leasehold improvements are amortized over the lesser of the leasehold improvement's useful life or the term of the underlying lease (including renewals that are deemed to be reasonably assured) at the date the leasehold improvement is purchased.

*Derivative Instruments*—We utilize interest rate swap agreements to reduce our exposure to interest rate fluctuation on our floating rate debt. The swap agreements are contracts to exchange floating rate for fixed interest payments periodically over the life of the agreements without exchange of the underlying notional amounts. The notional amounts of interest rate swap agreements are used to measure interest to be paid or received and do not represent the amount of exposure to credit loss. Amounts to be paid or received under interest rate swap agreements are accrued and recognized over the life of the swap agreements as an adjustment to interest expense.

The interest rate swaps meet the eligibility requirements for hedge accounting and are considered to be cash flow hedges. The fair value of the interest rate swaps is recorded in other liabilities on our Consolidated Balance Sheets. The effective portion of interest rate swap gains or losses is initially reported as a component of other comprehensive loss and subsequently reclassified into earnings as an adjustment to interest expense. The ineffective portion, if any, is reported as other income (expense). The fair values of the interest rate swaps at January 1, 2003, were (\$6,341). For the year ended December 31, 2003, we recorded an adjustment of \$2,511 to adjust the fair value of the swaps to (\$3,830). For the year ended December 31, 2004, we recorded an adjustment of \$2,554 to adjust the fair value of the swaps to (\$1,276). For the year ended December 31, 2005, we recorded an adjustment of \$1,082 to adjust the fair value of the swaps to (\$194). The adjustment of \$703, net of taxes of \$379 in 2005, the adjustment of \$1,660, net of taxes of \$894 in 2004 and the adjustment of \$1,632, net of taxes of \$879 in 2003 are reported as unrealized gains (losses) on derivative instruments in accumulated other comprehensive income (loss).

The interest rate swaps are highly effective in achieving the offset of changes in cash flows of the underlying debt. We calculate the excess in the present value of the cumulative change in cash flows relating to the floating leg of the swaps as compared to the present value of the cumulative changes in interest cash outflows on the debt to measure ineffectiveness. At December 31, 2005, the swaps were 100% effective. For the years ended December 31, 2005, 2004 and 2003, the ineffectiveness charged to earnings was \$0.

*Other Assets*—Other assets principally include the unamortized portion of installation costs, costs incurred to obtain financing, prepaid pension cost and pension intangible.

*Income Taxes*—We report income for federal income tax purposes on a consolidated basis. We use an asset and liability approach for financial accounting and reporting for income taxes. This approach requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of temporary differences between financial reporting basis and tax basis of assets and liabilities. If it is more likely than not that some portion or all of a deferred tax asset will not be realized, a valuation allowance is recognized.

*Accounting for Impairments*—Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. In performing the review for recoverability, we estimate the net future cash flows expected to result from the use of the asset and its eventual disposition. If the sum of the expected net future cash flows (undiscounted and without interest charges) is less than the carrying amount of the asset, an impairment loss is recognized. Measurement of an impairment loss for long-lived assets would be based on the excess of the carrying value of the asset over the fair value. Fair value would be determined using the anticipated cash flows discounted at a rate commensurate with the risk involved.

*Recent Accounting Pronouncements*—On December 16, 2004, the Financial Accounting Standards Board ("FASB") issued FASB Statement No. 123(R) ("FAS 123(R)", "Share-Based Payment." FAS 123(R) revises FASB Statement No. 123 ("FAS 123"), "Accounting for Stock-Based Compensation." Also, FAS 123(R) supersedes Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees,"

## COMMONWEALTH TELEPHONE ENTERPRISES, INC., AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Dollars in Thousands, Except Per Share Amounts)

and amends FASB Statement No. 95, "Statement of Cash Flows." For public companies, FAS 123(R) was effective for periods beginning after June 15, 2005, however, in April of 2005, the SEC delayed the effective date. FAS 123(R) is effective for public companies for annual periods that begin after June 15, 2005.

FAS 123(R) requires companies to expense the fair value of employee stock options and other forms of stock-based compensation. Specifically, FAS 123(R) requires companies to (i) use fair value to measure stock-based compensation awards and (ii) cease using the "intrinsic value" method of accounting under APB 25 that resulted in no expense for many awards of stock options for which the exercise price of the option equaled the price of the underlying stock at the grant date. In addition, FAS 123(R) retains the modified grant date model from FAS 123 in that compensation cost is measured at the grant date fair value of the award and adjusted to reflect actual forfeitures and the outcome of certain conditions. The fair value of an award is not remeasured after its initial estimation on the grant date, except in certain cases. FAS 123(R)'s transition provisions provide a number of alternatives to address implementation issues and to increase the comparability of compensation cost.

On January 1, 2006, we adopted the "Modified Prospective Application" ("MPA") method, without restatement of prior interim periods. Under the MPA method without restatement approach, we recognize compensation cost for (1) awards that were granted or modified after the fiscal year beginning after December 15, 1994, (2) any portion of awards that have not vested by January 1, 2006, and (3) any outstanding liability awards. Compensation cost for the portion of awards for which the requisite service has not been rendered that are outstanding at January 1, 2006, is recognized using the measurement data and attribution method used in our FAS 123 pro forma disclosures as those services are received after January 1, 2006. In addition, we are required to estimate the compensation cost of awards that are likely to be forfeited during the remaining vesting period and record a cumulative effect adjustment effective January 1, 2006. These amounts will not be material to our results of operations or financial condition.

For restricted stock, we recognize compensation cost over the four-year vesting period (the "nominal vesting period approach"). For any employee that retires before the end of the vesting period, we would recognize any unamortized compensation cost at the date of retirement. With adoption of FAS 123(R), compensation cost is recognized immediately for awards granted to retirement eligible employees or over the period from the grant date to the date retirement eligibility is achieved (the "non-substantive vesting period approach"). If we had applied the non-substantive vesting period approach, compensation cost would have increased by \$0 for both of the years ended December 31, 2005 and 2004.

We have undergone an extensive study of our stock-based compensation plans in anticipation of the adoption of FAS 123(R) and recent changes in tax laws with regard to deferred compensation. Currently, we do not anticipate a change in our current compensation strategy or structure, but continue to look for ways to compensate individuals via avenues that align the interests of individuals with the interests of shareholders through ownership of company stock.

### 3. Segment Information

We operate in two principal business segments: Commonwealth Telephone Company ("CT"), a rural incumbent local exchange carrier ("RLEC"); and CTSI, LLC ("CTSI"), our RLEC "edge-out" operation, which formally commenced operations in 1997.

The CT segment includes the results of CLD, a reseller of long-distance services and the portion of the digital subscriber line ("DSL") product offering, in CT's franchise area. CT provides local and long-distance telephone service and DSL service to residential and business customers in a 19-county service territory in rural eastern and central Pennsylvania. CT also provides network access and billing/collection services to interexchange carriers and sells telecommunications products and services.

CTSI, which operates in three edge-out regional Pennsylvania markets that border CT's territory, is a competitive local exchange carrier, offering bundled local and long-distance telephone, DSL and enhanced services.

**COMMONWEALTH TELEPHONE ENTERPRISES, INC., AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**(Dollars in Thousands, Except Per Share Amounts)**

The Other segment includes the results of Commonwealth Communication, LLC (“CC”), a provider of telecommunications equipment and facilities management services; epix® Internet Services (“epix”), which provides dial-up Internet service; and CTE’s corporate entity.

No single external customer contributes ten percent or more of CTE’s consolidated revenues.

Operating income (loss) is the primary measure used by our management to assess the performance of each segment.

Financial information by business segment is as follows:

	For the Year Ended December 31, 2005			
	CT	CTSI	Other	Consolidated
Sales	\$251,066	\$ 86,954	\$ 18,948	\$356,968
Elimination of intersegment sales	22,602	459	51	23,112
External sales	228,464	86,495	18,897	333,856
Costs and expenses	79,153	54,315	30,446	163,914
Depreciation and amortization	37,439	19,271	1,182	57,892
Restructuring reversals	—	(31)	—	(31)
Operating income (loss)	111,872	12,940	(12,731)	112,081
Identifiable assets	337,795	138,521	79,078	555,394
Capital expenditures	27,174	15,320	1,381	43,875

	For the Year Ended December 31, 2004			
	CT	CTSI	Other	Consolidated
Sales	\$246,788	\$ 84,022	\$ 24,602	\$355,412
Elimination of intersegment sales	19,122	454	25	19,601
External sales	227,666	83,568	24,577	335,811
Costs and expenses	79,219	53,809	26,161	159,189
Depreciation and amortization	48,047	20,205	2,722	70,974
Restructuring reversals	—	(799)	—	(799)
Operating income (loss)	100,400	10,353	(4,306)	106,447
Identifiable assets	372,393	137,567	273,471	783,431
Capital expenditures	26,960	14,858	1,701	43,519

	For the Year Ended December 31, 2003			
	CT	CTSI	Other	Consolidated
Sales	\$237,257	\$ 86,040	\$ 26,638	\$349,935
Elimination of intersegment sales	13,430	704	79	14,213
External sales	223,827	85,336	26,559	335,722
Costs and expenses	79,730	55,610	27,500	162,840
Depreciation and amortization	46,944	20,748	3,445	71,137
Restructuring reversals	—	(1,636)	—	(1,636)
Operating income (loss)	97,153	10,614	(4,386)	103,381
Identifiable assets	374,903	156,616	320,134	851,653
Capital expenditures	26,448	19,198	1,726	47,372

**COMMONWEALTH TELEPHONE ENTERPRISES, INC., AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**(Dollars in Thousands, Except Per Share Amounts)**

The following table shows a reconciliation of operating income for the reportable business segments to income before taxes:

	<u>For the Years Ended December 31,</u>		
	<u>2005</u>	<u>2004</u>	<u>2003</u>
Operating income from reportable segments .....	\$124,812	\$110,753	\$107,767
Other segment .....	(12,731)	(4,306)	(4,386)
Interest and dividend income .....	8,375	5,773	3,372
Interest expense .....	(14,084)	(16,800)	(13,560)
Other income (expense), net .....	(896)	686	(884)
Equity in income of unconsolidated entities .....	3,177	3,236	2,698
Consolidated income before income taxes .....	<u>\$108,653</u>	<u>\$ 99,342</u>	<u>\$ 95,007</u>

**4. Restructuring Charges (Reversals)**

In order to enhance CTSI's near-term cash flow and reduce CTSI's capital requirements, in December 2000 we announced our intention to exit five CTSI expansion markets: suburban Philadelphia, PA; Binghamton, NY; Syracuse, NY; Charleston/Huntington, WV; and Youngstown, OH. Related to this, we recorded an estimated restructuring charge of \$99,713 (\$64,813 after-tax), or (\$2.79) (after-tax) per common share (including effects of anti-dilutive options).

Payments were \$376, \$136 and \$427 for the years ended December 31, 2005, 2004 and 2003, respectively. Reversals (net of provisions) were (\$32), \$332 and \$790 for the years ended December 31, 2005, 2004 and 2003, respectively. In addition, assets that we had previously written off were sold returning a gain of \$63 in 2005 and \$245 in 2004. In 2004, we reversed \$222 of our reserve associated with disposal costs of exit market inventory. As of December 31, 2005, the balance in accrued restructuring expense is \$0.

**5. Property, Plant and Equipment**

Property, plant and equipment consists of the following:

	<u>Estimated Useful Lives in Years</u>	<u>December 31,</u>	
		<u>2005</u>	<u>2004</u>
Land .....		\$ 1,738	\$ 1,738
Building and leasehold improvements .....	3-40	37,286	36,819
Central office equipment .....	5-18	405,506	389,721
Outside communications plant .....	20-40	388,571	377,043
Furniture, vehicles and other equipment .....	3-25	85,412	83,913
Total property, plant and equipment .....		918,513	889,234
Less accumulated depreciation .....		<u>(550,007)</u>	<u>(506,711)</u>
Property, plant and equipment, net .....		<u>\$ 368,506</u>	<u>\$ 382,523</u>

Depreciation and amortization expense was \$57,892, \$70,974 and \$71,137 for the years ended December 31, 2005, 2004 and 2003, respectively.

**COMMONWEALTH TELEPHONE ENTERPRISES, INC., AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**(Dollars in Thousands, Except Per Share Amounts)**

**6. Investments**

Investments are as follows:

	December 31,	
	2005	2004
Rural Telephone Bank ("RTB") Stock .....	\$ 6,409	\$ 6,409
Yellow Book, USA, L.P. Partnership .....	3,859	3,928
CoBank and other .....	1	1
Total investments .....	<u>\$10,269</u>	<u>\$10,338</u>

In accordance with the terms of our prior mortgage notes and security agreements which we redeemed in 1993, we were required to purchase common stock of the RTB equal to approximately 5% of the amount borrowed. Such class of stock is entitled to cash dividends which are included in interest and dividend income and were approximately \$1,700, \$1,800 and \$1,300 for the years ended December 31, 2005, 2004 and 2003, respectively. As part of the 2006 Agriculture Appropriations bill, the current Administration established a process and terms to implement a dissolution of the RTB, whereby stockholders will obtain a cash payout for their stock. We have received stock dividends with a face value of approximately \$23,600 in accordance with the provisions of our previous financing arrangements with the RTB. These stock dividends will be recognized as income and will be subject to the statutory federal and state income tax rates when the underlying security is redeemed for cash, which we believe will be no later than the end of the second quarter of 2006.

Our financing arrangements with CoBank entitle us to receive annual patronage dividends. Approximately 60% of the patronage dividends are received in cash, with the balance in CoBank equity. The cash portion is included in interest and dividend income and was \$293, \$197 and \$237 for the years ended 2005, 2004 and 2003, respectively. Patronage dividends in the form of equity received to date have a future value totaling approximately \$6.2 million. We will receive cash in exchange for a portion of this equity once the value of the equity reaches certain targeted levels, which are calculated based upon the amount outstanding on our CoBank loan. We will recognize the CoBank equity dividend as it is received in cash, which we currently anticipate will not begin before 2007.

CTE owns a 50% interest in the Yellow Book, USA, L.P. Partnership ("Yellow Book"), accounted for under the equity method. Yellow Book provides directory publishing services, including yellow page advertising sales, for eight telephone directories.

The Yellow Book, USA, L.P. Partnership accounts for its yellow page advertising revenue based on the delivery method, which recognizes revenue based on the directories delivered (to subscribers) as a percentage of the total directories (initial and secondary) estimated to be delivered.

**7. Other Assets**

Other assets consist of the following:

	December 31,	
	2005	2004
Unamortized debt issuance costs .....	\$ 4,596	\$ 6,210
Prepaid pension cost .....	—	3,419
Pension intangible .....	3,679	—
Unamortized installation costs .....	6,154	6,188
Other .....	589	211
Total other assets .....	<u>\$15,018</u>	<u>\$16,028</u>

COMMONWEALTH TELEPHONE ENTERPRISES, INC., AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Dollars in Thousands, Except Per Share Amounts)

8. Debt

a. *Long-term debt*—Long-term debt and capital lease obligations outstanding are as follows:

	December 31,	
	2005	2004
Convertible notes . . . . .	\$300,000	\$300,000
Capital lease obligation . . . . .	360	1,082
Due within one year . . . . .	(360)	(721)
Total long-term debt and capital lease obligations . . . . .	<u>\$300,000</u>	<u>\$300,361</u>

In July of 2003, we sold \$300,000 principal amount of 3.25% convertible notes due 2023. On June 24, 2005, we launched an exchange offer pursuant to which we offered to exchange up to \$300,000 of our then outstanding 3.25% convertible notes (the “Old Notes”) for new 2005 Series A 3.25% convertible notes (the “New Notes”) due 2023 in an equal principal amount plus an exchange fee of \$2.50 per \$1,000 principal amount of existing notes. The New Notes contain terms that provide us with the flexibility to settle conversion of the notes with cash, common stock or a combination of cash and common stock. The Old Notes require us to settle conversions of notes with shares of common stock. The change to the terms of the notes allows us to reduce the dilutive effect on our common stock that would be caused by future conversion of the convertible notes. The terms of the New Notes maintain full dividend protection for the holders of the notes. The exchange offer closed on August 3, 2005, at which time a total of \$63,892 principal amount of New Notes were issued in exchange for the same principal amount of Old Notes and an exchange fee of \$160 was paid. We intend to continue to consider other options to further reduce or possibly eliminate the dilutive effect of future conversions, including common share repurchases depending on market conditions.

Holders of Old Notes may convert their notes into shares of our common stock and holders of New Notes may convert their notes with settlement, at our election, in our common stock, cash or a combination of cash and our common stock prior to the close of business on the final maturity date under any of the following circumstances:

- during any fiscal quarter, but only during such fiscal quarter, if the closing sale price of our common stock exceeds 120% of the then-effective conversion price for at least 20 trading days in the 30 consecutive trading-day period ending on the last trading day of the preceding fiscal quarter;
- during the five business-day period after any five consecutive trading-day period in which the trading price per note for each day of such period was less than 98% of the product of the closing sale price of our common stock and the number of shares issuable upon conversion of \$1,000 principal amount of the notes;
- if the notes have been called for redemption; or
- upon the occurrence of specified corporate events.

We have applied the guidance provided in EITF Issue No. 96-19 “Debtor’s Accounting for a Modification or Exchange of Debt Instruments” and EITF Issue No. 05-7 “Accounting for Modifications to Conversion Options Embedded in Debt Securities and Related Issues” in accounting for the exchange offer. In this regard, we have determined that the exchange offer did not result in a substantial modification of terms and was not treated as an extinguishment of debt. Per the guidance, fees paid by the Company of \$160 to Holders will be amortized to the first put date, July 15, 2008, and costs incurred with third parties of approximately \$421 directly related to the exchange have been expensed as incurred.

The settlement terms of the Company’s 3.25% convertible notes were evaluated against the guidance in EITF Issue 01-6 “The Meaning of Indexed to a Company’s Own Stock” within the meaning of paragraph 11(a) of FASB Statement No. 133. As a result of this evaluation, the Company determined that the contingent interest

## COMMONWEALTH TELEPHONE ENTERPRISES, INC., AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Dollars in Thousands, Except Per Share Amounts)

portion and the trading price condition feature do not pass the requirements of paragraph 11(a) because they are dual-indexed to the trading price of the Company's common stock and debt fair values. The contingent interest feature and the trading price condition feature are bifurcated and separated from the debt host contract and accounted for as a derivative instrument in accordance with the provisions in FASB Statement No. 133. Based on fair value estimates determined with the assistance of a third party, we have determined that the impact of these embedded derivatives was not material for the years ended December 31, 2005, 2004 and 2003.

*b. Short-term debt*—An amended \$85,000 revolving line of credit agreement with CoBank was entered into on May 31, 2005, with a \$35,000 balance outstanding. The line of credit is at interest rates that are based on a LIBOR rate or floating rate option. Interest payments are payable monthly. This agreement contains restrictive covenants, which, among other things, require the maintenance of a specified debt to cash flow ratio at CT. For all periods presented, we were in compliance with our covenants. As of December 31, 2005 the weighted average interest rate, not subject to an interest rate swap, was 4.69% on borrowings of \$35,000. The revolving line of credit agreement provides for the availability of credit to May 29, 2006. We may refinance all or a portion of this line of credit when it becomes due.

#### 9. Common Stock Plans

The CTE Equity Incentive Plan, as amended, provides for the issuance of up to 5,350,000 shares of common stock pursuant to awards granted under the Plan. Awards granted under the Plan may include incentive stock options, nonqualified stock options, outperformance stock options, stock appreciation rights, performance share units, restricted stock, phantom stock units and other stock-based awards. Stock options currently granted under the Plan vest in increments of 20% commencing one year from the date of the grant and expire ten years from the date of the grant. Restricted stock awards (either in the form of restricted shares or units) currently granted under the Plan vest in increments of 25% commencing one year from the date of the grant. Restricted shares, whether or not voted, are entitled to vote and to receive dividends. Restricted share units do not give the holder any rights as a shareholder or record owner of any shares of common stock, although they are eligible to receive dividend equivalent units in an amount equal to any dividends of common stock.

Our Non-Management Directors' Stock Compensation Plan provides for the grant of up to 250,000 shares of common stock to all members of our Board of Directors who are not, as of the date of any award, our employees. Awards granted under this Plan may include nonqualified stock options, outperformance stock options, stock appreciation rights, performance share units, restricted stock, phantom stock units and other stock-based awards. The options are immediately exercisable and shall remain exercisable until the earlier of ten years from the date of grant and a period of one year from the date upon which the participant ceases to be a non-management director. Restricted stock awards (either in the form of restricted shares or units) vest fully commencing one year from the date of the grant. Restricted shares, whether or not voted, are entitled to vote and to receive dividends. Restricted share units do not give the holder any rights as a shareholder or record owner of any shares of common stock, although they are eligible to receive dividend equivalent units in an amount equal to any dividends on common stock.

In connection with the payment of the dividends on June 30, 2005, the exercise price and number of all outstanding options were adjusted such that each option had the same value to the holder after the dividend as it had before the dividend. In accordance with FASB Interpretation No. 44 "Accounting for Certain Transactions Involving Stock Compensation" and EITF 00-23 "Issues Related to the Accounting for Stock Compensation under APB No. 25 and FIN 44," there is no accounting consequence for changes made to the exercise price and the number of shares of a fixed stock option or award as a direct result of the June 2005 dividends due to the fact that the transaction was an equity restructuring. The range of exercise prices for options outstanding at December 31, 2005, was \$8.27 to \$40.47. For all options granted, the exercise price is equal to the market price of the common stock at the date of the grant.

**COMMONWEALTH TELEPHONE ENTERPRISES, INC., AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**(Dollars in Thousands, Except Per Share Amounts)**

Information relating to CTE stock options is as follows:

	<u>Number of Shares</u>	<u>Weighted Average Exercise Price</u>
Outstanding December 31, 2002 .....	1,508,648	\$35.97
Granted .....	—	\$ —
Exercised .....	(146,267)	\$26.53
Canceled .....	(53,000)	\$45.51
Outstanding December 31, 2003 .....	1,309,381	\$36.63
Granted .....	—	\$ —
Exercised .....	(272,945)	\$33.47
Canceled .....	(31,100)	\$43.11
Outstanding December 31, 2004 .....	1,005,336	\$37.29
Granted (as a result of the dividend) .....	129,110	\$ —
Exercised .....	(650,574)	\$36.40
Canceled .....	(27,313)	\$28.29
Outstanding December 31, 2005 .....	<u>456,559</u>	\$28.56
Shares exercisable December 31, 2003 .....	<u>706,181</u>	\$35.24
Shares exercisable December 31, 2004 .....	<u>645,636</u>	\$36.98
Shares exercisable December 31, 2005 .....	<u>275,119</u>	\$29.76

<u>Range of Exercise Prices</u>	<u>Options Outstanding</u>			<u>Options Exercisable</u>	
	<u>Number Outstanding at December 31, 2005</u>	<u>Weighted Average Remaining Contractual Life</u>	<u>Weighted Average Exercise Price</u>	<u>Number Exercisable at December 31, 2005</u>	<u>Weighted Average Exercise Price</u>
\$8.27 .....	939	1.2	\$ 8.27	939	\$ 8.27
\$18.35—\$28.91 .....	323,376	5.2	25.99	141,936	25.04
\$29.95—\$40.47 .....	<u>132,244</u>	4.4	34.99	<u>132,244</u>	34.99
Total/weighted average .....	<u>456,559</u>	<u>4.9</u>	<u>\$28.56</u>	<u>275,119</u>	<u>\$29.76</u>

As provided for in the CTE Equity Incentive Plan, the fair value of the restricted stock units to be recognized as compensation cost over the four year vesting period is recognized as deferred compensation, shown as a separate reduction of shareholders' equity.

<u>Year</u>	<u>Shares Issued</u>	<u>Shares Cancelled</u>	<u>Shares Vested</u>	<u>Grant Date Fair Value</u>	<u>Compensation Expense Year Ended December 31, 2005</u>	<u>Compensation Expense Year Ended December 31, 2004</u>	<u>Compensation Expense Year Ended December 31, 2003</u>
2000 .....	155,000	33,750	121,250	\$7,333	\$ —	\$ 554	\$1,331
2003 .....	162,125	24,250	74,562	6,206	1,561	1,401	1,230
2004 .....	171,550	16,375	43,388	7,106	2,000	1,405	—
2005 .....	157,995	325	—	7,487	1,922	—	—

**COMMONWEALTH TELEPHONE ENTERPRISES, INC., AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**(Dollars in Thousands, Except Per Share Amounts)**

Pursuant to the Non-Management Directors' Stock Compensation Plan, each non-employee director receives an annual grant of restricted common stock, in an amount determined by the Corporate Governance Committee, on the date of the Annual Meeting of Shareholders. The fair value of the restricted stock units is recognized as compensation cost over the one-year vesting period.

<u>Year</u>	<u>Shares Issued</u>	<u>Shares Cancelled</u>	<u>Shares Vested</u>	<u>Grant Date Fair Value</u>	<u>Compensation Expense Year Ended December 31, 2005</u>	<u>Compensation Expense Year Ended December 31, 2004</u>	<u>Compensation Expense Year Ended December 31, 2003</u>
2003 .....	9,000	—	9,000	\$370	\$—	\$247	\$124
2004 .....	9,000	—	9,000	376	157	219	—
2005 .....	9,000	—	—	462	338	—	—

The table below contains information pertaining to equity compensation plans approved and not approved by security holders:

<u>Plan category</u>	<u>Number of Securities to be Issued upon Exercise of Outstanding Options, Warrants and Rights</u>	<u>Weighted Average Exercise Price of Outstanding Options, Warrants and Rights</u>	<u>Number of Securities Remaining Available for Future Issuance under Equity Compensation Plans</u>
Equity compensation plans approved by security holders .....	1,000,501	\$36.62	2,080,225
Equity compensation plans not approved by security holders .....	—	—	—
Total/weighted average .....	<u>1,000,501</u>	<u>\$36.62</u>	<u>2,080,225</u>

We also have a nonqualified stock purchase plan for certain key executives (the "Executive Stock Purchase Plan" or "ESPP"). Under the ESPP, participants may purchase shares of common stock in an amount between 1% and 20% of their annual base compensation and between 1% and 100% of their annual bonus compensation, provided, however, that in no event shall the participant's total contribution exceed 20% of their combined base and annual bonus compensation, as defined by the ESPP. Participants' accounts are credited with the number of share units derived by dividing the amount of the participant's contribution by the average price of a share of common stock at the time such contribution is made. The share units credited to a participant's account do not give such participant any rights as a shareholder or record owner of any shares of common stock. Participants will be credited with share units equal to the value of any dividend on common stock. Amounts representing share units that have been credited to a participant's account will be distributed to the participant following the earlier of the participant's termination of employment or three calendar years following the date on which the share units were initially credited to the participant's account. It is anticipated that, at the time of distribution, a participant will receive one share of common stock for each share unit being distributed.

Following the crediting of each share unit to a participant's account, we will issue a matching share of common stock held in escrow in the participant's name. Each matching share is subject to forfeiture as provided in the ESPP. A participant will be deemed to be the holder of, and may exercise all the rights of a record owner of, the matching shares issued to such participant while such matching shares are held in escrow. The matching shares vest three years from the date of the contribution.

At December 31, 2005, there were 116,425 ESPP shares arising from participants' contributions and 115,020 matching shares. The number of shares vested, including matching shares, at December 31, 2005, was 144,982. We recognize the cost of the matching shares over the vesting period. At December 31, 2005 and 2004, deferred compensation cost relating to matching shares was \$1,914 and \$1,232, respectively. Expense recognized in 2005, 2004 and 2003, was \$1,261, \$857 and \$688, respectively. Matching shares are included in weighted average shares outstanding for purposes of computing earnings per share.

**COMMONWEALTH TELEPHONE ENTERPRISES, INC., AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**(Dollars in Thousands, Except Per Share Amounts)**

**10. Pension and Employee Benefits**

*Defined benefit pension plan:*

Substantially all of our employees are included in a non-contributory defined benefit pension plan. The plan is subject to the provisions of the Employee Retirement Income Security Act of 1974 (“ERISA”), as amended. Upon retirement, employees are provided a monthly pension based on length of service and compensation.

Pension cost is as follows:

	For the Years Ended December 31,		
	2005	2004	2003
Service cost .....	\$ 3,746	\$ 3,303	\$ 2,853
Interest cost .....	5,742	5,452	5,231
Expected return on plan assets .....	(7,285)	(6,577)	(5,817)
Amortization of net (asset) obligation .....	—	—	(494)
Amortization of prior service cost .....	530	525	524
Recognized net actuarial loss .....	386	226	481
<b>Total net periodic benefit cost .....</b>	<b>\$ 3,119</b>	<b>\$ 2,929</b>	<b>\$ 2,778</b>

We estimate pension cost of approximately \$4,300 for 2006.

Plan assets include cash, equity, fixed income securities and pooled funds under management by a financial institution. The allocation of plan assets at December 31, 2005 and 2004 is:

Asset Category	Target Allocations	Percentage of Plan Assets December 31,	
	2006	2005	2004
Equity securities .....	70%	72%	73%
Fixed income securities .....	30%	28%	27%
CTE Common Stock .....	—	—	—

The expected long-term rate of return assumption is based on the actual historical rates of return of published indices that are used to measure the plan’s target asset allocation. The historical rates are then discounted to consider fluctuations in the historical rates as well as potential changes in the investment environment. The investment strategy for plan assets is to maintain a broadly diversified portfolio designed to achieve an average long-term rate of return of 8.5% effective with the 2006 plan year. Assets are strategically allocated between equity and fixed income securities in order to achieve a diversification level that mitigates wide swings in investment returns. Asset allocation target ranges are evaluated at least every three years with the assistance of an external consulting firm. Actual asset allocations are monitored quarterly and rebalancing actions are executed at least quarterly, if required.

The majority of the plan assets are invested in equity securities because equity portfolios have historically provided higher returns than debt portfolios over the long-term and are expected to do so in the future. Correspondingly, equity investments also carry greater risks than debt investments. The risk of loss in the plan’s equity assets is mitigated by investing in a broad range of equity types; including large-cap and small-cap stock funds, and international equity funds.

**COMMONWEALTH TELEPHONE ENTERPRISES, INC., AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**(Dollars in Thousands, Except Per Share Amounts)**

The following table sets forth the defined benefit pension plan's funded status and amounts recognized in our Consolidated Balance Sheets:

	<u>December 31,</u>	
	<u>2005</u>	<u>2004</u>
Change in plan assets:		
Fair value of plan assets at beginning of year .....	\$ 85,574	\$ 76,821
Actual return on plan assets .....	5,153	11,445
Employer contributions .....	—	2,070
Benefits paid .....	<u>(4,370)</u>	<u>(4,762)</u>
Fair value of plan assets at end of year .....	<u>\$ 86,357</u>	<u>\$ 85,574</u>
Change in benefit obligation:		
Benefit obligation at beginning of year .....	\$101,020	\$ 88,468
Service cost .....	3,746	3,303
Interest cost .....	5,742	5,452
Amendments .....	83	—
Actuarial loss .....	5,527	8,142
Benefits paid .....	<u>(4,378)</u>	<u>(4,345)</u>
Benefit obligation at end of year .....	<u>\$111,740</u>	<u>\$101,020</u>
Funded status .....	\$ (25,383)	\$ (15,446)
Unrecognized actuarial loss .....	22,004	14,738
Unrecognized prior service cost .....	<u>3,679</u>	<u>4,127</u>
Prepaid pension cost .....	<u>\$ 300</u>	<u>\$ 3,419</u>

The following table details expected benefit payments for the years 2006 through 2015:

<u>Year</u>	<u>Amount</u>
2006 .....	\$ 4,402
2007 .....	4,507
2008 .....	4,709
2009 .....	4,812
2010 .....	4,888
2011-2015 .....	30,149

Amounts recognized in the Consolidated Balance Sheets consist of:

	<u>December 31,</u>	
	<u>2005</u>	<u>2004</u>
Prepaid benefit cost .....	\$ —	\$3,419
Accrued benefit liability .....	(7,054)	—
Intangible asset .....	3,679	—
Accumulated other comprehensive loss .....	<u>3,675</u>	<u>—</u>
Net amount recognized .....	<u>\$ 300</u>	<u>\$3,419</u>

In the 2005 fourth quarter, in accordance with SFAS No. 87, "Employers' Accounting for Pensions," we recorded a minimum pension liability of \$7,054 representing the difference between the accumulated benefit obligation and the fair value of the Plan assets at December 31, 2005. Also, a pension intangible equal to the unrecognized prior service cost of \$3,679 was recognized. A charge to other comprehensive income (loss) in the amount of \$3,675 (\$2,288 after-tax) represents the excess of additional minimum pension liability over unrecognized prior service cost.

**COMMONWEALTH TELEPHONE ENTERPRISES, INC., AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**(Dollars in Thousands, Except Per Share Amounts)**

The accumulated benefit obligation was \$93,410 and \$84,003 at December 31, 2005 and 2004, respectively.

The following assumptions were used in the determination of the net benefit cost:

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Weighted average discount rate .....	5.75%	6.25%	6.75%
Expected long-term rate of return on plan assets .....	8.75%	8.75%	9.00%
Weighted average rate of compensation increases .....	5.50%	5.50%	5.50%

The following assumptions were used in the determination of the benefit obligation:

	<u>December 31,</u>		
	<u>2005</u>	<u>2004</u>	<u>2003</u>
Weighted average discount rate .....	5.50%	5.75%	6.25%
Weighted average rate of compensation increases .....	5.50%	5.50%	5.50%

The discount rate we used was determined using a spot rate yield curve, based on the rates on the Citigroup yield curve, constructed to replicate Aa-graded corporate bonds. The Plan's projected cash flows were matched to this yield curve to develop an appropriate discount rate. The expected return on plan assets is based on our asset allocation mix and our historical return, taking into account current market conditions and our best estimate of future economic conditions.

Our policy with respect to funding the plan is to fund at least the minimum required by ERISA, and not more than the amount deductible for tax purposes. No contributions were required to be made to the plan in 2005, and no contributions are required in 2006. We made a required minimum contribution to the plan of \$2,070 in the third quarter 2004 for the 2003 plan year with cash generated from operations.

***Voluntary Retirement Program ("VRP") and postretirement benefits:***

For former employees included in the VRP that took place in 2001 and 2002, we provide medical benefits until age 65. For employees retiring prior to 1993, we provide certain postretirement medical benefits. We also provide nominal postretirement life insurance benefits to all vested retirees.

Net periodic postretirement (benefit) cost is as follows:

	<u>VRP</u>			<u>Postretirement</u>		
	<u>For the Years Ended</u>			<u>For the Years Ended</u>		
	<u>December 31,</u>			<u>December 31,</u>		
	<u>2005</u>	<u>2004</u>	<u>2003</u>	<u>2005</u>	<u>2004</u>	<u>2003</u>
Service cost .....	\$—	\$—	\$—	\$—	\$—	\$—
Interest cost .....	28	37	52	49	49	72
Amortization of prior service cost .....	—	—	—	—	—	13
Recognized net actuarial gain .....	(40)	(50)	(60)	(85)	(109)	(101)
Total net periodic postretirement (benefit) cost .....	<u>\$ (12)</u>	<u>\$ (13)</u>	<u>\$ (8)</u>	<u>\$ (36)</u>	<u>\$ (60)</u>	<u>\$ (16)</u>

**COMMONWEALTH TELEPHONE ENTERPRISES, INC., AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**(Dollars in Thousands, Except Per Share Amounts)**

The following table sets forth the plans' funded status and amounts recognized in our Consolidated Balance Sheets:

	<u>VRP</u>		<u>Postretirement</u>	
	<u>December 31,</u>		<u>December 31,</u>	
	<u>2005</u>	<u>2004</u>	<u>2005</u>	<u>2004</u>
Change in plan assets:				
Fair value of plan assets at beginning of year	\$ —	\$ —	\$ —	\$ —
Employer contributions	210	258	135	147
Benefits paid	(210)	(258)	(135)	(147)
Fair value of plan assets at end of year	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>
Change in benefit obligation:				
Projected benefit obligation at beginning of year	\$ 503	\$ 706	\$ 834	\$ 1,143
Service cost	—	—	—	—
Interest cost	28	37	49	49
Amendments	—	—	—	(135)
Actuarial loss (gain)	100	18	128	(76)
Benefits paid	(210)	(258)	(135)	(147)
Projected benefit obligation at end of year	<u>\$ 421</u>	<u>\$ 503</u>	<u>\$ 876</u>	<u>\$ 834</u>
Funded status	\$(421)	\$(503)	\$ (876)	\$ (834)
Unrecognized actuarial gain	(112)	(252)	(863)	(1,075)
Unrecognized prior service cost	—	—	—	—
Accrued benefit cost	<u>\$(533)</u>	<u>\$(755)</u>	<u>\$(1,739)</u>	<u>\$(1,909)</u>

The following table details expected benefit payments for the years 2006 through 2015:

<u>Year</u>	<u>VRP</u> <u>Amount</u>	<u>Postretirement</u> <u>Amount</u>
2006	\$159	\$123
2007	116	116
2008	61	108
2009	40	100
2010	30	93
2011-2015	21	355

The accrued VRP and the postretirement benefit liabilities are included in other liabilities in the accompanying Consolidated Balance Sheets. The amounts recognized were \$533 and \$755 at December 31, 2005 and 2004, respectively for the VRP and \$1,739 and \$1,909 at December 31, 2005 and 2004, respectively for the post retirement plan.

The discount rate used in determining the accumulated VRP and postretirement benefit obligations was 5.50% in 2005 and 5.75% in 2004.

Our portion of the monthly premium for retirees included in the VRP and postretirement benefit obligation is limited, and any increase in medical costs is absorbed by the retiree. As such, a negative trend in healthcare costs will have no effect on the accumulated postretirement benefit obligation or the net periodic postretirement benefit cost.

We also have a nonqualified supplemental pension plan covering certain former employees which provides for incremental pension payments from us to the extent that income tax regulations limit the amount payable

**COMMONWEALTH TELEPHONE ENTERPRISES, INC., AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**(Dollars in Thousands, Except Per Share Amounts)**

from our defined benefit pension plan. The projected benefit obligation relating to this unfunded plan was approximately \$1,213, \$1,097 and \$1,075 at December 31, 2005, 2004 and 2003, respectively. Pension expense for the plan was \$67 in 2005, \$67 in 2004 and \$67 in 2003.

We provide certain postemployment benefits to former or inactive employees who are not retirees. These benefits are primarily short-term disability salary continuance. We accrue the cost of postemployment benefits over employees' service lives. We use the services of an enrolled actuary to calculate the expense. The net periodic cost (benefit) for postemployment benefits was \$371 in 2005, \$324 in 2004 and (\$224) in 2003.

We sponsor a 401(k) savings plan covering substantially all employees. For employees who are not covered by collective bargaining agreements, we contribute to the 401(k) plan based on a specified percentage of employee contributions. Contributions charged to expense were \$1,030, \$1,020 and \$964 in 2005, 2004 and 2003, respectively.

**11. Income Taxes**

The provision for income taxes is reflected in the Consolidated Statements of Operations as follows:

	<u>For the Years Ended December 31,</u>		
	<u>2005</u>	<u>2004</u>	<u>2003</u>
Currently payable:			
Federal .....	\$35,837	\$32,066	\$10,548
State .....	4,376	5,108	1,984
Total current .....	<u>40,213</u>	<u>37,174</u>	<u>12,532</u>
Deferred, net:			
Federal .....	(9,246)	1,027	21,288
State .....	7,578	(890)	1,552
Total deferred .....	<u>(1,668)</u>	<u>137</u>	<u>22,840</u>
Total provision for income taxes .....	<u>\$38,545</u>	<u>\$37,311</u>	<u>\$35,372</u>

The following is a reconciliation of income taxes at the applicable U.S. federal statutory rate with income taxes recorded by us:

	<u>For the Years Ended December 31,</u>		
	<u>2005</u>	<u>2004</u>	<u>2003</u>
Income before provision for income taxes .....	<u>\$108,653</u>	<u>\$99,342</u>	<u>\$95,007</u>
Federal tax provision at statutory rate .....	38,029	34,770	33,252
Increase (reduction) due to:			
State income taxes, net of federal effects .....	3,626	2,159	2,090
Stock offering costs .....	—	(37)	68
Plant acquisition costs .....	12	39	39
Charitable contribution of property .....	—	(153)	—
Income tax liability true-up, federal and state .....	(3,154)	618	—
Other, net .....	32	(85)	(77)
Provision for income taxes .....	<u>\$ 38,545</u>	<u>\$37,311</u>	<u>\$35,372</u>

**COMMONWEALTH TELEPHONE ENTERPRISES, INC., AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**(Dollars in Thousands, Except Per Share Amounts)**

Temporary differences and carryforwards that give rise to a significant portion of deferred tax assets and liabilities are as follows:

	<u>December 31,</u>	
	<u>2005</u>	<u>2004</u>
Net operating loss carryforwards .....	\$ 3,409	\$ 3,535
Employee benefit plans .....	9,677	3,606
Reserve for bad debts .....	449	760
Access settlements and network costs .....	8,067	10,805
Restructuring reserve .....	—	130
All other .....	3,907	3,343
Total deferred tax assets .....	<u>25,509</u>	<u>22,179</u>
Property, plant and equipment .....	(67,772)	(74,839)
Contingent convertible debt interest .....	(15,677)	(8,918)
All other .....	(811)	(585)
Total deferred tax liabilities .....	<u>(84,260)</u>	<u>(84,342)</u>
Subtotal .....	<u>(58,751)</u>	<u>(62,163)</u>
Valuation allowance .....	(2,464)	(1,728)
Net deferred taxes .....	<u>\$(61,215)</u>	<u>\$(63,891)</u>

In our opinion, based on the future reversal of existing taxable temporary differences, primarily depreciation, and expectations of future operating results, after consideration of the valuation allowance, we will more likely than not be able to realize substantially all of our deferred tax assets.

The net change in the valuation allowance for deferred tax assets during 2005 was an increase of \$736. The net change is due primarily to an analysis of the anticipated realization of the deferred tax assets related to state NOL carryforwards under existing state tax law.

As of December 31, 2005, we have cumulative state net operating losses of \$70,000 that can be utilized through 2025. The determination of the state net operating loss carryforward is dependent upon the subsidiaries' taxable income or loss, apportionment percentages and other respective state laws, which can change from year to year and impact the amount of such carryforward.

In 2005, we performed a detailed review of all deferred tax items and supporting schedules of net book vs net tax values. This review resulted in a net deferred tax benefit of approximately \$3,154 (\$2,239 impact to the fourth quarter) related to prior years that we recorded in the fourth quarter of 2005. This adjustment did not have a material effect on the current or any prior period's financial statements.

**12. Commitments and Contingencies**

a. Total rental expense, including pole and conduit rentals, was \$7,960, \$7,916 and \$7,172 in 2005, 2004 and 2003, respectively. At December 31, 2005, rental commitments under noncancelable leases, excluding annual pole and conduit rental commitments of approximately \$4,404 that are expected to continue indefinitely, are as follows:

<u>Year</u>	<u>Aggregate Amounts</u>
2006 .....	\$2,633
2007 .....	2,051
2008 .....	1,857
2009 .....	1,674
2010 .....	1,463
After 2010 .....	8,619

## COMMONWEALTH TELEPHONE ENTERPRISES, INC., AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Dollars in Thousands, Except Per Share Amounts)

b. Effective July 2, 2004, we extended our agreement for the provision to us of data processing services including the general management of our data processing operations through December 31, 2005 (that was subsequently extended through January 31, 2006). The annual commitment, excluding annual increases based on increases in the Consumer Price Index, was \$7,479 in 2005. In the second half of 2005, the Company decided not to renew the agreement when it expired. These data processing services were brought in-house starting February 1, 2006.

c. In May 2001, CT entered into a fifteen-year, two-month agreement for the rental of a building in an area of a city qualifying for certain tax incentives offered by the state of Pennsylvania. The annual commitment through year ten is \$1,163. Annual rent for the last five years is subject to changes in the Consumer Price Index. In addition, CT also entered into a lease agreement for the rental of parking spaces for employees of the building, for a similar term. The annual commitment, excluding increases in the last five years based on increases in the Consumer Price Index, is \$168.

d. We had various purchase commitments at December 31, 2005, related to our 2006 capital budget. CTE's capital expenditures have averaged \$44,922 over the three years ended December 31, 2005.

e. In 2003, CT entered into a thirty-six month capital lease for the purchase of computer hardware. The annual commitment in 2006, excluding the interest component, is \$361.

In the normal course of business, there are various legal proceedings outstanding, including both commercial and regulatory litigation. In our opinion, these proceedings will not have a material adverse effect on our results of operations or financial condition.

### 13. Disclosures about Fair Value of Financial Instruments

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value:

a. *Cash and temporary cash investments*—The carrying amount approximates fair value because of the short maturity of these instruments.

b. *Long-term investments*—Long-term investments consist primarily of investments accounted for under the equity method for which disclosure of fair value is not required, and Rural Telephone Bank ("RTB") Stock. It is not practicable to estimate the fair value of the RTB Stock because there is no quoted market price for the stock; it is issued only at par, and can be held only by recipients of RTB loans.

c. *Debt*—The fair value of bank debt was estimated using discounted cash flow calculations. The fair value of the convertible debt is based on quoted market prices or by obtaining quotes from dealers. The fair value of floating rate debt is considered to be equal to carrying value since the debt reprices at least every six months and we believe that our credit risk has not materially changed from the time the floating rate debt was borrowed.

d. *Interest rate swap*—The fair value has been calculated by the counterparty using appropriate valuation methodologies. The fair value of the interest rate swap is recorded in other liabilities on our Consolidated Balance Sheets. The fair value of the interest rate swaps at January 1, 2004, was (\$3,830). For the year ended December 31, 2004, we recorded an adjustment of \$2,554 (\$1,660 net of tax), to adjust the fair value of the swaps to (\$1,276). For the year ended December 31, 2005, we recorded an adjustment of \$1,082 (\$703 net of tax), to adjust the fair value of the swap to (\$194). The remaining interest rate swap expires in the second quarter of 2006.

**COMMONWEALTH TELEPHONE ENTERPRISES, INC., AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**(Dollars in Thousands, Except Per Share Amounts)**

The estimated fair value of our financial instruments is as follows:

	December 31,			
	2005		2004	
	<u>Carrying Amount</u>	<u>Fair Value</u>	<u>Carrying Amount</u>	<u>Fair Value</u>
Financial assets:				
Cash and temporary cash investments . . . . .	\$104,968	\$104,968	\$312,260	\$312,260
Financial liabilities:				
Fixed rate long-term debt:				
Convertible notes . . . . .	300,000	294,382	300,000	315,750
Floating rate debt:				
Revolving line of credit . . . . .	35,000	35,000	35,000	35,000
Financial instruments:				
Interest rate swaps . . . . .	(194)	(194)	(1,276)	(1,276)

**14. Off Balance Sheet Risk and Concentration of Credit Risk**

Certain financial instruments potentially subject us to concentrations of credit risk. These financial instruments consist primarily of trade receivables and cash and temporary cash investments.

We place our cash and temporary cash investments with high credit quality financial institutions and limit the amount of credit exposure to any one financial institution. We also periodically evaluate the credit worthiness of the institutions with which we invest. We do, however, maintain unsecured cash and temporary cash investment balances in excess of federally insured limits. We limit our exposure by diversifying among counterparties and investment categories to achieve a targeted mix of interest-bearing assets while maximizing after-tax returns.

Our trade receivables reflect a customer base primarily centered in eastern and central Pennsylvania. We assess the financial strength of our customers by performing credit evaluations and requiring deposits based on the results of these evaluations; as a result, credit risk is limited. Internet service providers represented approximately 15.1% and 17.1% of CTSI's revenues for the years ended December 31, 2005 and 2004, respectively. No single customer contributed more than 5% of its revenues.

We have an interest rate swap agreement to adjust the interest rate profile of our debt obligations and to achieve a targeted mix of floating and fixed rate debt. The counterparty to the interest rate swap agreement is a major financial institution. This financial institution has been accorded high ratings by primary rating agencies. We limit the dollar amount of contracts entered into with any one financial institution and monitor the credit ratings of counterparties. While we may be exposed to credit losses due to non-performance of the counterparty, we consider the risk remote and do not expect the settlement of this transaction to have a material effect on our financial condition or results of operations.

**COMMONWEALTH TELEPHONE ENTERPRISES, INC., AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**(Dollars in Thousands, Except Per Share Amounts)**

**15. Quarterly Information (Unaudited)**

	<u>First Quarter</u>	<u>Second Quarter</u>	<u>Third Quarter</u>	<u>Fourth Quarter</u>
<b>2005</b>				
Sales .....	\$83,529	\$83,018	\$83,784	\$83,525
Operating income .....	26,050	27,478	27,942	30,611
Net income .....	15,918	17,194	16,302	20,694
<b>Basic earnings per share:</b>				
Net income per share .....	\$ 0.75	\$ 0.80	\$ 0.74	\$ 0.94
<b>Diluted earnings per share:</b>				
Net income per share .....	\$ 0.67	\$ 0.66	\$ 0.62	\$ 0.77
<b>Common Stock closing price:</b>				
High .....	\$ 50.61	\$ 52.98	\$ 43.54	\$ 37.78
Low .....	46.50	40.19	37.22	33.48
	<u>First Quarter</u>	<u>Second Quarter</u>	<u>Third Quarter</u>	<u>Fourth Quarter</u>
<b>2004</b>				
Sales .....	\$84,380	\$84,014	\$83,776	\$83,641
Operating income .....	26,386	26,735	25,668	27,658
Net income .....	14,565	16,318	15,119	16,029
<b>Basic earnings per share:</b>				
Net income per share .....	\$ 0.66	\$ 0.77	\$ 0.72	\$ 0.76
<b>Diluted earnings per share:</b>				
Net income per share .....	\$ 0.60	\$ 0.68	\$ 0.64	\$ 0.67
<b>Common Stock closing price:</b>				
High .....	\$ 41.20	\$ 44.77	\$ 45.21	\$ 49.81
Low .....	36.79	41.24	43.19	43.99

**16. Related Party Transactions**

We had the following transactions with related parties:

	<b>For the Years Ended December 31,</b>		
	<u>2005</u>	<u>2004</u>	<u>2003</u>
Purchases from Level 3 Communications, Inc. ....	\$1,254	\$ 93	\$ 418
Sales to Level 3 Communications, Inc. ....	410	144	24
Other related party revenues .....	2,163	2,635	2,316
Other related party expenses .....	9	382	1,638

At December 31, 2005, we had accounts receivable from related parties of \$0 and accounts payable to related parties of \$0.

Related parties include members of the Board of Directors and their related companies, including Level 3 Communications, Inc. Related party revenues and expenses represent the telephony service provided and the fees paid to these related companies arising from the ordinary course of business.

**17. Common Stock**

We have authorized 85,000,000 shares of \$1 par value CTE Common Stock at December 31, 2005, 2004 and 2003. At December 31, 2002, we had authorized 15,000,000 shares of \$1 par value CTE Class B Common Stock. On September 3, 2003, shareholders approved a proposal to reclassify and convert each outstanding share of CTE Class B Common Stock into 1.09 shares of CTE Common Stock. We now have only one class of common stock.

**COMMONWEALTH TELEPHONE ENTERPRISES, INC., AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**(Dollars in Thousands, Except Per Share Amounts)**

In November of 2003, our Board of Directors authorized a Stock Repurchase Program of up to \$100 million of CTE Common Stock, which was subsequently increased to \$150 million. As of December 31, 2005, we had repurchased 3,047,244 shares, at a cost of \$118,544. We have approximately \$31,456 available for repurchases under the program. Future share repurchases will be executed at our discretion, based on ongoing assessments of our capital needs, and the market value of our common stock.

On May 2, 2005, our Board of Directors declared a special dividend of \$13.00 per share and a \$0.50 per share dividend for the quarter ended June 30, 2005 for which \$294,138 was paid. A \$0.50 per share dividend was paid for the quarters ended September 30, 2005 and December 31, 2005 for which \$10,823 and \$10,916 was paid in cash, respectively.

In connection with the payment of the special and initial quarterly dividend, the exercise price and number of all outstanding options were adjusted such that each option had the same value to the holder after the dividend as it had before the dividend. The conversion rate on our outstanding 3.25% convertible notes due 2023 was also adjusted to reflect all of the dividends based on the terms of the convertible notes. At the conversion price in effect at December 31, 2005, our convertible debt is convertible into 7,285,200 shares of our common stock.

Non-cash compensation, in the form of dividend equivalent units, of \$2,662 related to vested, deferred restricted stock units, vested, deferred Executive Stock Purchase Plan ("ESPP") share units and unvested 401(k) shares was recorded in 2005, in connection with the dividends. The dividends, in the form of dividend equivalent units, on unvested restricted stock and unvested ESPP share units of \$6,052 were recorded as deferred compensation in 2005 and will be recognized as compensation cost over the remaining vesting periods. For the year ended December 31, 2005, \$1,493 of this deferred compensation was recognized.

## Schedule I

**COMMONWEALTH TELEPHONE ENTERPRISES, INC.**  
**CONDENSED FINANCIAL INFORMATION OF THE REGISTRANT**  
**STATEMENTS OF OPERATIONS**

	For the Years Ended December 31,		
	2005	2004	2003
	(Thousands of Dollars, Except Per Share Amounts)		
<b>Income:</b>			
Sales .....	\$ —	\$ 7,522	\$ 15,371
Interest income-other .....	—	(1)	15
Other .....	—	692	9,923
<b>Total income</b> .....	<u>—</u>	<u>8,213</u>	<u>25,309</u>
<b>Expenses:</b>			
Cost of goods sold .....	—	5,027	8,890
Interest expense on long-term debt, net .....	12,154	12,626	8,223
Interest expense, net on notes payable to subsidiaries .....	3,902	4,956	5,861
General and administrative expenses .....	1,380	3,003	4,756
Depreciation and amortization .....	—	106	294
<b>Total expenses</b> .....	<u>17,436</u>	<u>25,718</u>	<u>28,024</u>
Loss before income taxes and equity in net income of subsidiaries .....	(17,436)	(17,505)	(2,715)
Benefit for income taxes .....	(4,391)	(5,571)	(687)
Loss before equity in net income of subsidiaries .....	(13,045)	(11,934)	(2,028)
Net income of subsidiaries .....	83,153	71,964	72,195
Equity in income of unconsolidated entities .....	—	2,001	2,698
Net income .....	\$ 70,108	\$ 62,031	\$ 72,865
Unrealized gain on derivative instruments, net of tax .....	703	1,660	1,632
Minimum pension liability adjustment, net of tax .....	(2,288)	—	2,839
Comprehensive net income .....	<u>\$ 68,523</u>	<u>\$ 63,691</u>	<u>\$ 77,336</u>
<b>Basic earnings per share:</b>			
Net income .....	\$ 3.24	\$ 2.91	\$ 3.10
Weighted average shares outstanding .....	21,617,630	21,325,907	23,515,367

## Schedule I

**COMMONWEALTH TELEPHONE ENTERPRISES, INC.**  
**CONDENSED FINANCIAL INFORMATION OF THE REGISTRANT**  
**BALANCE SHEETS**

	<u>December 31,</u>	
	<u>2005</u>	<u>2004</u>
	(Thousands of Dollars)	
<b>ASSETS</b>		
Current assets:		
Cash .....	\$ 2,134	\$ 3,029
Notes receivable affiliates .....	44,816	25,068
Interest receivable .....	352	175
Accounts receivable affiliates .....	24,885	15,038
Accounts receivable other .....	819	843
Prepayments .....	302	8
Materials and supply inventory .....	35	53
Deferred tax assets .....	654	—
Total current assets .....	<u>73,997</u>	<u>44,214</u>
Investment in subsidiaries (stated at equity) .....	443,948	674,945
Deferred tax assets and other .....	8,275	12,980
Total assets .....	<u>\$526,220</u>	<u>\$ 732,139</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Note payable to affiliates .....	\$138,194	\$ 145,639
Accounts payable to affiliates .....	4,570	1,795
Accrued liabilities and other .....	7,974	8,692
Deferred income taxes—current .....	—	6,988
Total current liabilities .....	<u>150,738</u>	<u>163,114</u>
Long-term debt .....	300,000	300,000
Deferred income taxes and other deferred credits .....	12,563	3,095
Other liabilities .....	7,054	—
Common shareholders' equity:		
Common Stock, par value \$1, authorized 85,000,000 shares, issued 24,226,482 shares in 2005 and 24,172,376 shares in 2004 .....	24,226	24,172
Additional paid-in capital .....	118,723	284,358
Deferred compensation .....	(16,861)	(10,093)
Accumulated other comprehensive loss .....	(2,415)	(830)
Retained earnings .....	26,327	86,931
Treasury stock at cost, 2,383,564 shares in 2005 and 3,049,114 shares in 2004 .....	(94,135)	(118,608)
Total common shareholders' equity .....	<u>55,865</u>	<u>265,930</u>
Total liabilities and common shareholders' equity .....	<u>\$526,220</u>	<u>\$ 732,139</u>

## Schedule I

**COMMONWEALTH TELEPHONE ENTERPRISES, INC.**  
**CONDENSED FINANCIAL INFORMATION OF THE REGISTRANT**  
**STATEMENTS OF CASH FLOWS**

	<u>For the Years Ended December 31,</u>		
	<u>2005</u>	<u>2004</u>	<u>2003</u>
	(Thousands of Dollars)		
<b>Cash flows from operating activities:</b>			
Net income	\$ 70,108	\$ 62,031	\$ 72,865
Depreciation and amortization	—	106	294
Deferred income taxes, net	6,501	6,350	8,283
Net change in certain assets and liabilities	(8,219)	4,911	(11,513)
Equity in income of subsidiaries	(83,153)	(71,964)	(72,195)
Equity in income of unconsolidated entities	—	(2,001)	(2,698)
Other	19,420	6,442	6,646
Net cash flow provided by operating activities	<u>4,657</u>	<u>5,875</u>	<u>1,682</u>
<b>Cash flows from investing activities:</b>			
Additions to property, plant and equipment	—	(59)	(141)
Dividends from subsidiaries	102,000	—	27,000
Capital contributions to subsidiaries	212,000	(205,758)	(470)
Other	—	1,983	(1)
Net cash provided by (used in) investing activities	<u>314,000</u>	<u>(203,834)</u>	<u>26,388</u>
<b>Cash flows from financing activities:</b>			
Redemption of long-term debt	—	—	(30,000)
Borrowings of long-term debt	—	—	300,000
Proceeds from the exercise of stock options	23,678	9,136	3,881
Increase in notes payable to affiliates	(7,445)	11,457	14,900
Decrease (increase) in notes receivable from affiliates	(19,748)	(24,122)	(721)
Stock repurchases	—	(75,177)	(43,367)
Dividends paid	(315,877)	—	—
Payment made for debt issuance costs	(160)	(76)	(8,674)
Net cash (used in) provided by financing activities	<u>(319,552)</u>	<u>(78,782)</u>	<u>236,019</u>
Net increase (decrease) in cash and temporary cash investments	<u>\$ (895)</u>	<u>\$ (276,741)</u>	<u>\$ 264,089</u>
Cash and temporary cash investments at beginning of year	<u>\$ 3,029</u>	<u>\$ 279,770</u>	<u>\$ 15,681</u>
Cash and temporary cash investments at end of year	<u>\$ 2,134</u>	<u>\$ 3,029</u>	<u>\$ 279,770</u>
<b>Components of net change in certain assets and liabilities:</b>			
Accounts receivable	\$ (10,000)	\$ 11,250	\$ (16,871)
Materials and supply inventory	18	2,372	267
Accounts payable	2,740	(4,448)	(960)
Prepayments	(294)	78	(1)
Accrued expenses	(683)	(4,341)	6,052
Net change in certain assets and liabilities	<u>\$ (8,219)</u>	<u>\$ 4,911</u>	<u>\$ (11,513)</u>
<b>Supplemental disclosures of non-cash information:</b>			
Non-cash contribution of assets to subsidiaries	\$ —	\$ (4,340)	\$ —

Schedule II

COMMONWEALTH TELEPHONE ENTERPRISES, INC.  
 VALUATION AND QUALIFYING ACCOUNTS AND RESERVES

For the Years Ended December 31, 2005, 2004 and 2003  
 (Thousands of Dollars)

DESCRIPTION	BALANCE AT BEGINNING OF PERIOD	ADDITIONS		DEDUCTIONS/ REVERSALS	BALANCE AT END OF PERIOD
		CHARGED TO COSTS AND EXPENSE	CHARGED TO OTHER ACCOUNTS		
<b>ALLOWANCE FOR DOUBTFUL</b>					
<b>ACCOUNTS—DEDUCTED FROM</b>					
<b>ACCOUNTS RECEIVABLE IN THE</b>					
<b>CONSOLIDATED BALANCE SHEETS.</b>					
2005 .....	\$2,185	\$ 712	\$513	\$2,048	\$1,362
2004 .....	\$2,329	\$ 736	\$578	\$1,458	\$2,185
2003 .....	\$5,520	\$1,230	\$ 60	\$4,481	\$2,329
<b>ALLOWANCE FOR DEFERRED TAX</b>					
<b>ASSETS—DEDUCTED FROM DEFERRED</b>					
<b>TAX ASSETS IN THE CONSOLIDATED</b>					
<b>BALANCE SHEETS.</b>					
2005 .....	\$1,728	\$ 736	\$—	\$ —	\$2,464
2004 .....	\$2,320	\$ 210	\$—	\$ 802	\$1,728
2003 .....	\$2,088	\$ 232	\$—	\$ —	\$2,320

Form 10-K Certification

I, Michael J. Mahoney, certify that:

1. I have reviewed the annual report on Form 10-K for the year ended December 31, 2005 of Commonwealth Telephone Enterprises, Inc.;

2. Based on my knowledge, this report does 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 this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal controls over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 10, 2006

/s/ Michael J. Mahoney

President and Chief Executive Officer

## Form 10-K Certification

I, Donald P. Cawley, certify that:

1. I have reviewed the annual report on Form 10-K for the year ended December 31, 2005 of Commonwealth Telephone Enterprises, Inc.;

2. Based on my knowledge, this report does 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 this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal controls over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 10, 2006

/s/ Donald P. Cawley

Executive Vice President and  
Chief Accounting Officer

March 10, 2006

Securities and Exchange Commission  
100 F Street, N.E.  
Washington, D.C. 20549

Ladies and Gentlemen:

The certification set forth below is being submitted in connection with the Annual Report on Form 10-K for the period ended December 31, 2005 (the "Report") of Commonwealth Telephone Enterprises, Inc., for the purpose of complying with Rule 13a-14(b) under the Securities Exchange Act of 1934 and Section 1350 of Chapter 63 of Title 18 of the United States Code.

Michael J. Mahoney, the Chief Executive Officer and Donald P. Cawley, the Chief Accounting Officer of Commonwealth Telephone Enterprises, Inc., each certifies that, to the best of his knowledge:

1. such Report fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934; and
2. the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of Commonwealth Telephone Enterprises, Inc.

/s/ Michael J. Mahoney

Michael J. Mahoney  
Chief Executive Officer  
(Principal Executive Officer)

/s/ Donald P. Cawley

Donald P. Cawley  
Chief Accounting Officer  
(Principal Financial Officer and  
Principal Accounting Officer)

A signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signatures that appear in typed form within the electronic version of this written statement required by Section 906, has been provided to Commonwealth Telephone Enterprises, Inc. and will be retained by Commonwealth Telephone Enterprises, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.

## CORPORATE INFORMATION

### Corporate Headquarters

Commonwealth Telephone Enterprises, Inc.  
100 CTE Drive  
Dallas, PA 18612-9774  
(570) 631-2700  
www.ct-enterprises.com

### Transfer Agent and Registrar

Computershare Investor Services, LLC  
Shareholder Services  
2 North LaSalle Street  
Chicago, IL 60602  
(800) 697-7998 or (312) 360-5495  
www.computershare.com

### Shareholder Account Assistance

Questions about stock certificates, address changes, registration changes or other shareholder matters should be directed to the transfer agent and registrar listed above.

### Independent Public Accountants

PricewaterhouseCoopers LLP  
Two Commerce Square, Suite 1700  
2001 Market Street  
Philadelphia, PA 19103-7042  
(267) 330-3000

### Investor Information

Institutional investors, security analysts and other members of the financial community requesting information about CTE should contact:

#### David G. Weselcouch

Senior Vice President —  
Investor Relations and Corporate Communications  
Commonwealth Telephone Enterprises, Inc.  
100 CTE Drive  
Dallas, PA 18612-9774  
Phone: (570) 631-2807  
Fax: (570) 631-8114  
e-mail: [dwes@epix.net](mailto:dwes@epix.net)

### Requests for Additional Financial Information

Documents such as Forms 10-K and 10-Q, which are filed with the U.S. Securities and Exchange Commission ("SEC"), are available through our web site, [www.ct-enterprises.com](http://www.ct-enterprises.com), as well as at the SEC web site, [www.sec.gov](http://www.sec.gov).

Printed copies of these documents can also be obtained by writing to the corporate headquarters, attention David G. Weselcouch, Senior Vice President — Investor Relations and Corporate Communications, at the contact address listed at left.

### Common Stock

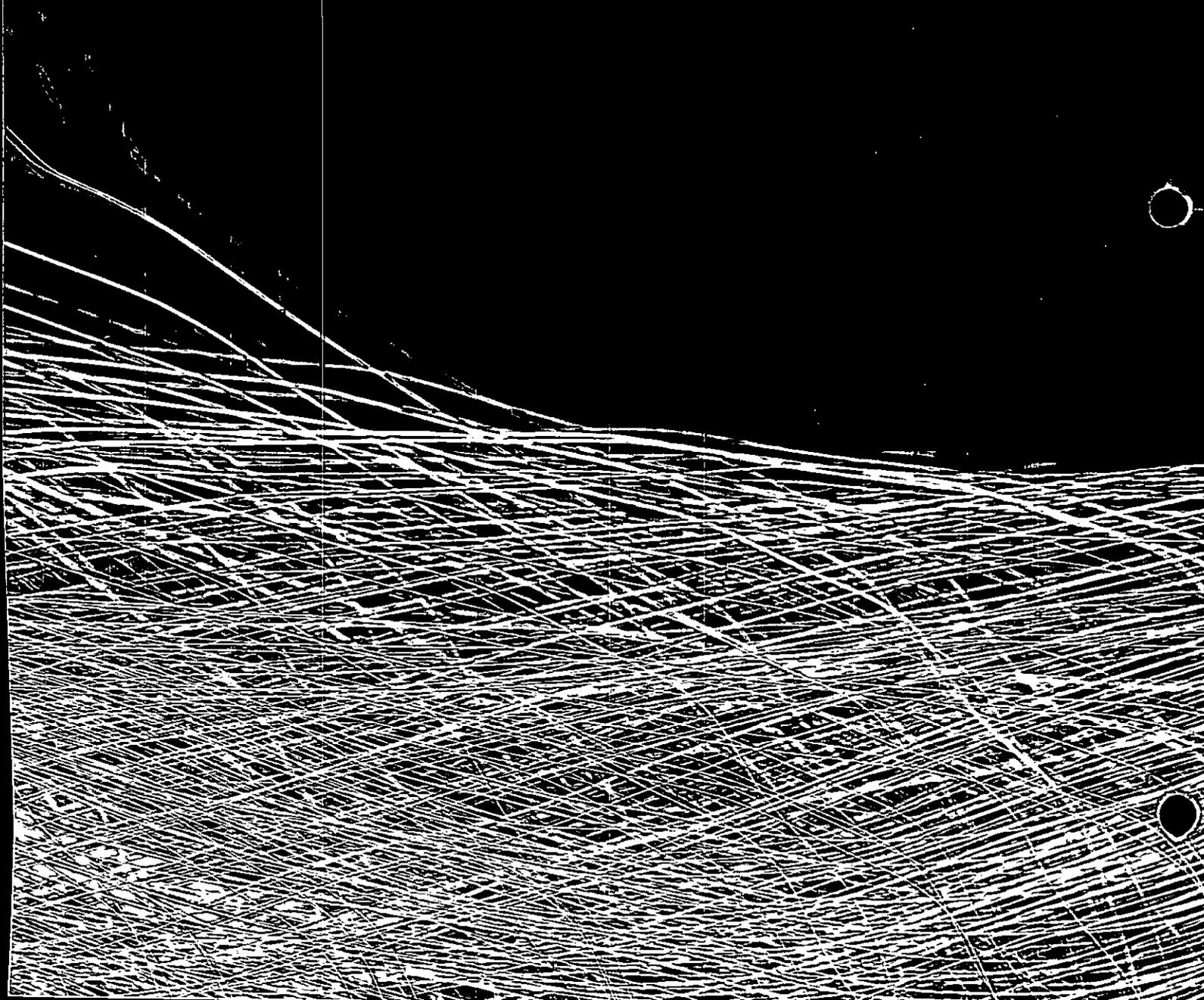
The Nasdaq National Market  
Symbol: CTCO

### Media Relations Information

Media inquiries should be directed to the attention of David G. Weselcouch, Senior Vice President — Investor Relations and Corporate Communications, at the contact address listed at left.



100 CTE Drive, Dallas, PA 18612-9774  
(570) 631-2700  
[www.ct-enterprises.com](http://www.ct-enterprises.com)



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SECRETARY'S BUREAU

## Certification of Resolutions

### COMMONWEALTH TELEPHONE ENTERPRISES, INC.

I HEREBY CERTIFY, That at a meeting of the Board of Directors of Commonwealth Telephone Enterprises, Inc. (the "Company"), duly convened and held on the 17<sup>th</sup> day of September, 2006, at which a quorum for the transaction of business was present, the following resolutions, which have not been modified or rescinded and which are not contrary to or inconsistent with the Articles of Incorporation or By-Laws of the Company, were duly and regularly adopted:

"WHEREAS, the Board has determined that it is advisable and in the best interests of the Company and its shareholders to enter into the Agreement and Plan of Merger (the "**Merger Agreement**") among the Company, Citizens Communications Company, a Delaware corporation ("**Parent**"), and CF Merger Corp., a Delaware corporation ("**Merger Subsidiary**"), substantially in the form submitted to this meeting; and

WHEREAS, the Board has determined that it is advisable and in the best interests of the Company and its shareholders to consummate the transactions contemplated by the Merger Agreement.

NOW, THEREFORE, IT IS:

RESOLVED, that the form of the Merger Agreement submitted to this meeting is approved and adopted, and the President, each Executive Vice President and each Senior Vice President of the Company (the "**Authorized Officers**") be, and each of them hereby is, authorized in the name and on behalf of the Company to execute and deliver the Merger Agreement substantially in the form approved and adopted, with such changes as the officer executing the same may approve, such approval to be conclusively evidenced by the execution and delivery thereof;

RESOLVED, that the Merger (as defined in the Merger Agreement) and the other transactions contemplated by the Merger Agreement be, and each of them hereby is, authorized and approved;

RESOLVED, that the Board hereby determines that the Merger Agreement and the transactions contemplated thereby are advisable and in the best interests of the shareholders of the Company;

RESOLVED, that in furtherance of the transactions contemplated by the Merger Agreement, the Authorized Officers be, and each of them hereby is, authorized in the name and on behalf of the Company to prepare or cause to be prepared, to execute and to file or cause to be filed with any federal, state, local or other regulatory agencies any reports, filings, applications or other documents, and to seek all governmental or regulatory consents or approvals, required with respect to the Merger and the other transactions contemplated by the Merger Agreement (including, without limitation, those required by the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended, the Federal Communications Commission and the Pennsylvania Public Utility Commission);

RESOLVED, that in furtherance of the Merger, the Authorized Officers be, and each of them hereby is, authorized in the name and on behalf of the Company to execute and to file or cause to be

filed articles of merger with the Department of State of the Commonwealth of Pennsylvania and a certificate of merger with the Secretary of State of the State of Delaware pursuant to the provisions of the Pennsylvania Business Corporation Law and the Delaware General Corporation Law, such articles of merger and certificate of merger, in each case, to be in the form approved by the officer executing the same, such approval to be conclusively evidenced by the execution and filing thereof, and, if appropriate, to execute and to file or cause to be filed any and all amendments thereto and any and all documents and information required to be filed by the Company with the Department of State of the Commonwealth of Pennsylvania and/or the Secretary of State of the State of Delaware, in each case, in the form approved by such officer, such approval to be conclusively evidenced by the execution and filing thereof; .

RESOLVED, that the Board directs that the Merger Agreement and the Merger be submitted to the shareholders of the Company for their approval and adoption, and the Board recommends that the shareholders of the Company approve and adopt the Merger Agreement and the Merger;

RESOLVED, that the Chairman of the Board is hereby authorized in the name and on behalf of the Company to convene a meeting of shareholders of the Company in accordance with the provisions of the Merger Agreement, on such date and at such place as may be selected by the Chairman of the Board, for purpose of soliciting the vote of shareholders of the Company for approval and adoption of the Merger Agreement and the Merger;

RESOLVED, the Authorized Officers be, and each of them hereby is, authorized in the name and on behalf of the Company to prepare or cause to be prepared and to execute a proxy statement (the "Proxy Statement") for purpose of soliciting the vote of shareholders of the Company for approval and adoption of the Merger Agreement and the Merger, on such form or schedule as appropriate under the Securities Exchange Act of 1934, as amended, together with the rules and regulations thereunder, and thereafter to file or cause to be filed with the Securities and Exchange Commission such Proxy Statement and any necessary amendments or supplements thereto from time to time, in each case in such form as the officer executing the same may approve, such approval to be conclusively evidenced by the execution and delivery thereof;

RESOLVED, the Authorized Officers be, and each of them hereby is, authorized in the name and on behalf of the Company to prepare or cause to be prepared, to execute and to file or cause to be filed with the Securities and Exchange Commission any and all statements, schedules, forms, reports and documents concerning the Merger, the Merger Agreement or the transactions contemplated thereby or incidental thereto as shall be necessary or advisable, in each case in such form as the officer executing the same may approve, such approval to be conclusively evidenced by the execution and delivery thereof;

RESOLVED, that any and all actions heretofore taken by any of the Authorized Officers in connection with the retention of legal, financial, accounting or other advisors with respect to the Merger are hereby approved, ratified and confirmed in all respects as fully as if such actions had been presented to the Board for its approval prior to such actions being taken;

RESOLVED, that the Authorized Officers be, and each of them hereby is, authorized in the name and on behalf of the Company to retain such legal, financial, accounting or other advisors, including, without limitation, proxy solicitors, with respect to the Merger as such officers shall deem necessary, advisable or appropriate, and that the Company is authorized to pay any and all expenses and fees arising in connection therewith;

General Authorization

FURTHER RESOLVED, that the Authorized Officers be, and each of them hereby is, authorized in the name and on behalf of the Company to take or cause to be taken any and all actions, to execute and deliver or cause to be delivered any and all documents, agreements and instruments and to take or cause to be taken any and all steps deemed by any such Authorized Officer to be necessary, appropriate or desirable to carry out the purpose and intent of each of the foregoing resolutions, and all actions heretofore taken by any of them in furtherance thereof are hereby ratified and confirmed in all respects.”

IN WITNESS WHEREOF, I have hereunto set my hand and affixed the seal of Commonwealth Telephone Enterprises, Inc. this 20th day of September, 2006.



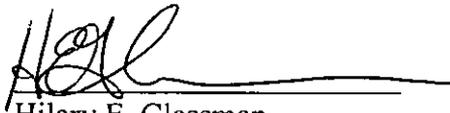
**Raymond B. Ostroski,  
Senior Vice President, General  
Counsel & Corporate Secretary**

(CORPORATE SEAL)

CITIZENS COMMUNICATIONS COMPANY  
SECRETARY'S CERTIFICATE

I, Hilary E. Glassman, the duly elected Senior Vice President, General Counsel and Secretary of Citizens Communications Company, a Delaware corporation (the "Company"), do hereby certify that attached hereto as Exhibit A is a true and correct copy of the resolutions of the Board of Directors of the Company adopted at a meeting of the Board of Directors held on September 16, 2006, which resolutions are in full force and effect and have not been revoked.

IN WITNESS WHEREOF, I have hereunto signed my name this 27<sup>th</sup> day of September, 2006.

A handwritten signature in black ink, appearing to read 'H. Glassman', with a long horizontal line extending to the right.

Hilary E. Glassman,  
Senior Vice President, General  
Counsel and Secretary

RESOLUTIONS OF THE  
BOARD OF DIRECTORS  
OF  
CITIZENS COMMUNICATIONS COMPANY

Dated September 16, 2006

Agreement and Plan of Merger

**RESOLVED**, that the Board of Directors of the Company (the "Board of Directors") adopts, and deems it advisable and in the best interests of the Company that the Company enter into, the Agreement and Plan of Merger (as such agreement may be amended or modified as contemplated hereby, the "Merger Agreement") among the Company, CF Merger Corp., a Delaware corporation and a wholly-owned subsidiary of the Company ("Merger Sub"), and the company referred to as Reggie, a Pennsylvania corporation ("Reggie"), pursuant to which, among other things, Merger Sub will be merged with and into Reggie (the "Merger"), with Reggie continuing as the surviving corporation and a wholly-owned subsidiary of the Company; and be it further

**RESOLVED**, that the form, terms and conditions of the Merger Agreement, copies of which have been provided to the Board of Directors, be, and the same hereby are, in all respects, approved, authorized and adopted by the Board of Directors, and the Merger, the other transactions contemplated by the Merger Agreement, and all other actions or matters necessary or appropriate to give effect to the foregoing be, and the same hereby are, in all respects approved, authorized and adopted by the Board of Directors; and be it further

**RESOLVED**, that the Chief Executive Officer, the Chief Financial Officer and/or such other officers of the Company as they may designate (together with the Chief Executive Officer and the Chief Financial Officer, the "Authorized Officers") be, and each of them with full power to act without the others hereby is, authorized to execute and deliver, in the name and on behalf of the Company, the Merger Agreement, including any amendments thereto, in such form and with, to the extent permitted by law, such changes as the Authorized Officer executing the same may approve, such approval to be conclusively evidenced by such Authorized Officer's execution and delivery of such agreement; and be it further

**RESOLVED**, that the issuance of shares of common stock, par value \$0.25 per share, of the Company contemplated by the Merger Agreement be, and hereby is, in all respects approved and authorized by the Board of Directors.

## Financing

**RESOLVED**, that the Board of Directors adopts, and deems it advisable and in the best interests of the Company to enter into, the commitment letter, term sheets, fee letter and engagement letter (as such documents may be amended or modified as contemplated hereby, the "Debt Documents") received by the Company from Citigroup Global Markets, Inc. ("CGMI") in connection with the Merger, pursuant to which, among other things, CGMI will commit to provide certain debt financing to the Company in connection with the Merger; and be it further

**RESOLVED**, that the terms and conditions of the Debt Documents, as previously discussed with the Board of Directors, be, and the same hereby are, in all respects approved, authorized and adopted by the Board of Directors, and the incurrance of indebtedness and consummation of the transactions contemplated by the Debt Documents, and all other matters necessary or appropriate to give effect to the foregoing be, and the same hereby are, in all respects approved, authorized and adopted by the Board of Directors; and be it further

**RESOLVED**, that the Authorized Officers be, and each of them with full power to act without the others hereby is, authorized to execute and deliver, in the name and on behalf of the Company, the Debt Documents, including any amendments thereto, in such form and with, to the extent permitted by law, such changes as the Authorized Officer executing the same may approve, such approval to be conclusively evidenced by such Authorized Officer's execution and delivery of such agreements, and such other documents, agreements, instruments and certificates with respect to any financing required or advisable in connection with the Merger, whether pursuant to the Debt Documents or otherwise (the "Financing"), including, but not limited to, documentation relating to an amendment or amendment and restatement of the Company's existing credit facilities.

## General Authorization and Ratification

**RESOLVED** that the Authorized Officers be, and each of them with full power to act without the others hereby is, authorized and empowered to:

- (i) prepare or cause to be prepared with the assistance of counsel, execute and file or cause to be filed, in the name and on behalf of the Company or any of its subsidiaries, all registrations, reports, statements, documents and information necessary or appropriate to be filed, printed or mailed under all applicable laws (including the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended, the Federal securities laws, the Federal Communications Commission and the Pennsylvania Public Utility Commission) or applicable requirements and regulations of Federal, state, local and foreign administrative or governmental agencies or associations (including all applicable foreign merger control, antitrust or similar authorities and the New York Stock Exchange) in connection with the

Merger or the Financing, including the filing of a Registration Statement on Form S-4;

- (ii) cause the Company to consummate the Merger and to effect the other transactions contemplated by the Merger Agreement in accordance with the terms of the Merger Agreement and to do all actions and things necessary or appropriate to give effect to the foregoing;
- (iii) cause the Company to consummate the Financing and to do all actions and things necessary or appropriate to give effect to the foregoing;
- (iv) do any and all acts and things and prepare, sign, seal, execute, acknowledge, file, deliver and record all papers, instruments, documents, agreements and certificates and to pay all charges, fees, taxes and other expenses from time to time necessary or appropriate to be done, prepared, signed, sealed, executed, acknowledged, filed, delivered, recorded or paid, under any applicable law, under the Merger Agreement, the Debt Documents or otherwise, in the name and on behalf of the Company or any of its subsidiaries;
- (v) certify as having been adopted by the Board of Directors any form of resolution required by any law, regulation or agency necessary or appropriate to effectuate the purpose and intent of these resolutions or any of them and the agreements referred to above and the transactions contemplated thereby and any actions necessary or appropriate to give effect to the foregoing and such other agreements and documents as may be executed by any Authorized Officer pursuant to authorization granted in these resolutions or to carry out the transactions contemplated thereby; and
- (vi) retain, in the name and on behalf of the Company, such financial advisors, legal counsel and such other advisors, consultants or experts necessary or appropriate to carry out the actions contemplated in these resolutions, and to secure any appropriate advice and opinions from such advisors, consultants and experts, and to pay all fees and expenses incurred by the Company in connection with the transactions contemplated by the agreements referred to above and any actions or matters necessary or appropriate to give effect to the foregoing, including, but not limited to, all fees and expenses necessary or appropriate to effectuate the purpose and intent of the foregoing resolutions or any of them and the agreements referred to above and the transactions contemplated thereby and such other agreements and documents as may be executed by any Authorized Officer pursuant to authorization granted in these resolutions or to carry out the transactions contemplated thereby; and be it further

**RESOLVED**, that each Authorized Officer may authorize any other officer, employee or agent of, or counsel to, the Company or any of its subsidiaries to take any

and all actions and to execute and deliver any and all certificates, documents, agreements and instruments referred to in these resolutions in place of or on behalf of such Authorized Officer, with full power as if such Authorized Officer were taking such action himself or herself; and be it further

**RESOLVED**, that any or all actions heretofore taken by any officer or officers of the Company or any of its subsidiaries with respect to any matter referred to or contemplated by any of the foregoing resolutions be, and hereby are, ratified and confirmed as the act and deed of the Company or such subsidiary.

COMMONWEALTH OF PENNSYLVANIA  
PENNSYLVANIA PUBLIC UTILITY COMMISSION  
P. O. BOX 3265, HARRISBURG PA 17105-3265

IN REPLY PLEASE  
REFER TO OUR FILE  
Secretary  
717-772-7777

October 3, 2006

A-310800F0010  
A-311095F0005  
A-311225F0003

Norman J Kennard, Esquire  
Hawke McKeon Sniscak and Kennard, LLP  
100 North Tenth Street  
P. O. Box 1778  
Harrisburg, PA 17105

DOCUMENT  
FOLDER

Dear Mr. Kennard:

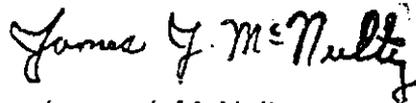
Receipt is acknowledged of the Joint Application of Commonwealth Telephone Company, CTSI, LLC and CTE Telecom, LLC d/b/a Commonwealth Long Distance Company for approval of the Acquisition by Citizens Communications Company of all of the Stock of the Joint Applicants' Corporate Parent, Commonwealth Telephone Enterprises, Inc., which has been captioned and docketed to the above numbers.

Publication in a local newspaper is not required.

Enclosed is a copy of the Publication Notice that will appear in the Saturday, October 14, 2006 edition of the Pennsylvania Bulletin. This notice is being sent to you for informational purposes only.

This matter will receive the attention of the Commission and you will be advised of any further necessary procedure.

Sincerely,



James J. McNulty  
Secretary

JJM:ddt

Enclosure

DOCKETED

OCT 03 2006

**DATE:** October 3, 2006

**SUBJECT:** A-310800F0010; A-311095F0005  
A-311225F0003

**TO:** Bureau of Fixed Utility Services

**FROM:** James J. McNulty, Secretary *ddt*

DOCUMENT  
FOLDER

**JOINT APPLICATION OF COMMONWEALTH TELEPHONE  
COMPANY, CTSI, LLC, AND CTE TELECOM LLC D/B/A  
COMMONWEALTH LONG DISTANCE COMPANY**

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We attach hereto a copy of the Joint Application of Commonwealth Telephone Company, CTSI, LLC and CTE Telecom, LLC d/b/a Commonwealth Long Distance Company, for approval of the Acquisition by Citizens Communications Company of all of the Stock of the Joint Applicants' Corporate Parent, Commonwealth Telephone Enterprises, Inc, which has been captioned and docketed to the above numbers.

Notice will be published in the Saturday, October 14, 2006 edition of the Pennsylvania Bulletin.

If no protests are received by October 30, 2006, will your Bureau please prepare a report for the attention of the Commission or instruct the Secretary's Bureau to re-assign this matter to the Office of Administrative Law Judge for hearing.

Attachment

cc: Law Bureau

*ddt*

**DOCKETED**  
OCT 03 2006

PENNSYLVANIA PUBLIC UTILITY COMMISSION

NOTICE TO BE PUBLISHED

Joint Application of Commonwealth Telephone Company, CTSI LLC, and CTE Telecom, LLC d/b/a Commonwealth Long Distance Company, for all approvals under the Public Utility Code for the Acquisition by Citizens Communications Company of all of the Stock of the Joint Applicants' Corporate Parent, Commonwealth Telephone Enterprises, Inc. Docket Numbers: A-310800F0010; A-311095F0005; and A-311225F0003.

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Formal protests and petitions to intervene must be filed in accordance with Title 52 of the Pennsylvania Code. All filings must be made with the Secretary of the Pennsylvania Public Utility Commission, P. O. Box 3265, Harrisburg, PA 17105-3265, with a copy served on the Applicant, on or before October 30, 2006. The documents filed in support of the Application are available for inspection and copying at the Office of the Secretary between the hours of 8:00 a.m. and 4:30 p.m., Monday through Friday, and at the Applicant's business address.

Joint Applicants:

Commonwealth Telephone Company  
CTSI, LLC  
CTE Telecom, LLC, d/b/a Commonwealth Long Distance Co.

Through and By Counsel:

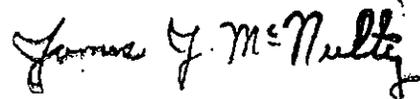
Norman J. Kennard, Esquire  
Hawke McKeon Sniscak and Kennard, LLP  
100 North Tenth Street  
P. O. Box 1778  
Harrisburg, PA 17105

**DOCKETED**

OCT 03 2006

DOCUMENT  
FOLDER

BY THE COMMISSION



James J. McNulty  
Secretary

PA. CODE & BULLETIN

06 OCT -3 PM 2:36

RECEIVED  
LEGISLATIVE REFERENCE  
BUREAU

PENNSYLVANIA PUBLIC UTILITY COMMISSION

RECEIPT

*The addressee named here has paid the PA P.U.C. for the following bill:*

DATE: 10/4/2006  
RECEIPT NO: 205015

NORMAN J. KENNARD  
HAWKE MCKEON SNISCAK & KENNARD LLP  
100 NORTH TENTH STREET, P.O. BOX 1778  
HARRISBURG PA 17105

**DOCUMENT  
FOLDER**

IN RE: Application fees for COMMONWEALTH TELEPHONE COMPANY CTSI, LLC & CTE  
TELECOM, LLC

Docket Number A-310800F0010 AND A-311095F0005.....\$350.00  
A-311225F0003

REVENUE ACCOUNT: 001780-017601-102

CHECK NUMBER: 19405  
CHECK AMOUNT: \$350.00

Michael Sobolesky  
(for Department of Revenue)

**DOCKETED**  
OCT 06 2006

KJR