# CITIZENS COMMUNICATIONS COMPANY

## FORM 10-K

## ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)

## OF THE SECURITIES EXCHANGE ACT OF 1934

## FOR THE YEAR ENDED DECEMBER 31, 2006

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-K

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

For the fiscal year ended December 31, 2006

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 | 06-0619596 |
|---|---|
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |

| 3 High Ridge Park Stamford, Connecticut | 06905 |
|---|---|
| (Address of principal executive offices) | (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 |
|---|---|
| Common Stock, par value $.25 per share | New York Stock Exch |
| Guarantee of Convertible Preferred Securities of Citizens Utilities Trust | New York Stock Exch |
| Series A Participating Preferred Stock Purchase Rights | New York Stock Exch |

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 X 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 X

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 X 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. [X]

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 [X]   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 X

The aggregate market value of common stock held by non-affiliates of the registrant on June 30, 2006 was approximately $4,166,069,000 based on the closing price of $13.05 per share.

The number of shares outstanding of the registrant's Common Stock as of January 31, 2007 was 322,538,000.

DOCUMENT INCORPORATED BY REFERENCE

Portions of the Proxy Statement for the Company's 2007 Annual Meeting of Stockholders to be held on May 18, 2007 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 (Citizens) and its subsidiaries 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. Revenue from our Frontier operations was $2.025 billion in 2006. Among the highlights for 2006:

* Proposed Acquisition
  On September 17, 2006, we entered into a definitive agreement to acquire Commonwealth Telephone Enterprises, Inc. (Commonwealth). Total consideration (cash and stock) to be paid is approximately $1.2 billion. We expect to close this transaction in the first half of 2007.

* 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. In 2006, we sold our competitive local exchange carrier (CLEC), Electric Lightwave, LLC, or ELI (including the sale of associated real estate), for approximately $255 million in cash. We also received approximately $65 million from the dissolution of the Rural Telephone Bank.

* Stockholder Value
  During 2006, we repurchased $135.2 million of our common stock and we continued to pay an annual dividend of $1.00 per common share.

* Growth
  During 2006, we added approximately 75,100 new high-speed internet customers and almost 88,200 customers began buying a bundle or package of our services. At December 31, 2006, we had approximately 393,200 high-speed data customers and almost 517,700 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 2006 we had approximately 62,900 customers.

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, 2006, we operated as an incumbent local exchange carrier in

23 states.

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.

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 and Analysis of Financial Condition and Results of Operations (MD&A), we operate in an increasingly challenging environment and, accordingly, our Frontier revenues have been growing only slightly.

Our business, under the Frontier name, is primarily with residential customers and, to a lesser extent, non-residential customers. Our Frontier services include:

* access services,



* local services,
* long distance services,
* data and internet,
* directory services, and
* television services.

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. Access charges are based on access rates filed with the Federal Communications Commission (FCC) for interstate services and with the respective state regulatory agency for intrastate services. 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.

Local services. We provide basic telephone wireline 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. All of these local services are billed monthly 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. We also 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 IXCs. Our long distance services are billed either as unlimited/fixed number of minutes in advance or on a per minute of use basis, in which case it is billed in arrears.

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 services. We offer other data transmission services to other carriers and high-volume commercial customers with dedicated high-capacity circuits like DS-1's and DS-3's. Such services are generally offered on a contract basis and the service is billed on a fixed monthly recurring charge basis. Data and internet services are typically billed monthly in advance.

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. We offer a television product in partnership with Echostar's DISH Network (DISH). We provide access to all-digital television channels featuring movies, sports, news, music, and high-definition TV programming. We offer packages that include 100, 200 or 250 channels, high-definition channels, family channels and ethnic channels. We are in an "agency" relationship with DISH. We bill the customer for the monthly services and remit those billings to DISH without recognizing any revenue. We in-turn receive from DISH and recognize as revenue activation fees and a nominal billing and collection fee.



Wireless services. During 2006, we began offering wireless data services in certain markets. Our wireless data 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. During 2007, we expect to begin offering differentiated wireless voice and data packages in certain markets. Our success in offering wireless voice services will, to a great extent, be determined by the relationships we are developing with both wireless carriers and switching equipment vendors, and is also dependent on their capabilities.

In the fourth quarter of 2006, the Company revised its reporting of certain operating metrics to be consistent with those used by management to run the business. The data reported below is consistent with that used by management internally on a daily basis.

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, 2006 and 2005.

| State | Frontier RGUs at December 31, 2006 | 2005 |
|---|---|---|
| New York............ | 952,500 | 1,001,500 |
| Minnesota........... | 296,900 | 296,400 |
| Arizona............. | 198,700 | 196,000 |
| California.......... | 190,200 | 188,400 |
| West Virginia....... | 178,100 | 171,000 |
| Illinois............ | 129,100 | 130,800 |
| Tennessee........... | 111,000 | 110,300 |
| Wisconsin........... | 77,600 | 77,100 |
| Iowa................ | 57,600 | 59,200 |
| Nebraska............ | 54,100 | 55,700 |
| All other states (13)... | 274,000 | 269,200 |
| Total | 2,519,800 | 2,555,600 |

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 or cable modem service. We lost approximately 111,000 access lines during the year ended December 31, 2006, but added over 75,100 high-speed internet subscribers during this same period. We lost 98,800 residential customer lines and 12,200 non-residential customer lines in 2006. 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 2007. 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 2007.

Regulatory Environment

General

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

Our 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 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. In a small number of states (California, Alabama, Iowa, Indiana, Michigan, Nebraska), we have been successful in reducing or eliminating price regulation on services under state commission jurisdiction. 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 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 2007 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 99% of our exchanges are LNP capable. We will upgrade the remaining exchanges in response to bona fide requests as required by FCC regulations.

In 1994, Congress passed the Communications Assistance for Law Enforcement Act (CALEA) to ensure that telecommunication networks can meet law enforcement wiretapping needs. Our company was fully compliant, for all TDM voice services, by June 2006. In June 2006, the FCC issued an order addressing the assistance capabilities required, pursuant to section 103 of the CALEA law, for facilities-based broadband Internet access providers and providers of interconnected VOIP. Frontier expects to be fully compliant in 2007 as required by the order.

The FCC and Congress may address issues involving inter-carrier compensation, the universal service fund and internet telephony in 2007. 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 FCC requested additional comments on intercarrier compensation proposals in late 2006. 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. In addition the Joint Board requested comments, on August 8, 2006, on the merits of using reverse auctions to determine the distribution of high-cost Universal Service support. 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 our access revenues declined in 2006 compared to 2005. Our access and subsidy revenues are both likely to decline in 2007.

The development and growth of internet telephony (also known as VOIP) by cable and other companies have 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 models as traditional telephony. The FCC has concluded that certain VOIP services are jurisdictionally interstate in nature and are thereby exempt from state telecommunications regulations. The FCC has not addressed other related issues, such as: whether or under what terms VOIP traffic may be subject to intercarrier compensation; and whether VOIP services are subject to general state requirements relating to taxation and general commercial business requirements. The FCC has stated its intent to address these open questions in subsequent orders in its ongoing "IP-Enabled Services Proceeding," which opened in February 2004. 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. On June 27, 2006, the FCC issued an order stating that revenues from certain VOIP services are subject to contributing to the universal service fund. Both the VOIP E-911 order and the CALEA order have been fully litigated in the FCC's reconsideration petition and appealed before federal courts; the result is that VOIP will be required to comply with both of these regulatory mandates.

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.

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 2007 across all products and in all of our markets. Our Frontier business experienced erosion in access lines and switched access minutes of use in 2006 as a result of competition. Competition in our markets may result in reduced revenues in 2007.

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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.

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.

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. Our last public utility operation (Vermont Electric) was sold in April of 2004.

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 No. 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, 2008 and remained in default for the duration of the contract (another 7 years), we estimate that our undiscounted purchase obligation for 2008 through 2015 would be approximately $1.1 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.

Divestiture of Electric Lightwave LLC

In 2006, we sold our CLEC business, Electric Lightwave LLC (ELI) for $255.3 million (including the sale of associated real estate) in cash plus the assumption of approximately $4.0 million in capital lease obligations. We recognized a pre-tax gain on the sale of ELI of approximately $116.7 million. Our after-tax gain on the sale was $71.6 million. Our cash liability for taxes as a result of the sale is expected to be approximately $5.0 million due to the utilization of existing tax net operating losses on both the federal and state level.



Segment Information

With the 2006 sale of our CLEC (ELI), we currently operate in only one reportable segment.

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, 2006, we had 5,446 employees. 2,996 of our employees are affiliated with a union. The number of union employees covered by agreements set to expire during 2007 is 1,526. We consider our relations with our employees to be good.

Available Information

We are subject to the informational requirements of the Securities Exchange Act of 1934. Accordingly, we file periodic reports, proxy statements and other information with the Securities and Exchange Commission (SEC). Such reports, proxy statements and other information may be obtained by visiting the Public Reference Room of the SEC at 100 F Street, NE, Washington, D.C. 20549 or by calling the SEC at 1-800-SEC-0330. In addition, the SEC maintains an Internet site (www.sec.gov) that contains reports, proxy and information statements and other information regarding the Company and other issuers that file electronically. Material filed by us can also be inspected at the offices of the New York Stock Exchange, Inc. (NYSE), 20 Broad Street, New York, NY 10005, on which our common stock is listed. On June 26, 2006, our Chief Executive Officer submitted the annual certification required by Section 303A.12(a) of the NYSE Listed Company Manual. In addition, the certifications of our Chief Executive Officer and Chief Financial Officer required under Section 302 of the Sarbanes-Oxley Act of 2002 are included as exhibits to this Form 10-K.

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 www.czn.net.

## Item 1A. Risk Factors

Before you make an investment decision with respect to 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, 2006 we had 111,000 fewer access lines than we had at December 31, 2005 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.

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.

## 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 expect that our cash taxes will increase substantially in 2007 as we begin to have lower amounts of tax operating losses. We have implemented several growth initiatives, including increasing our marketing promotion/expenditures and launching new products and services with a focus on areas that are growing or demonstrate meaningful demand such as wireline and wireless high-speed internet. There is no assurance that these initiatives will result in an improvement in our financial position or our results of operations.

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 all of the above.

From time to time we evaluate potential acquisitions and other arrangements, such as the Commonwealth acquisition, 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 all of the above. 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, capital expenditures and dividends 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, the effects of increased competition, lower subsidy and 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 ($263.0 million or 13% in 2006) 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. The FCC has an open proceeding to address reform to access charges and other intercarrier compensation. A material reduction in the access revenues we receive would adversely affect our financial results.

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

We receive a portion of our revenue ($165.0 million or 8% in 2006) from federal and state subsidies, including the federal high cost fund, federal local switching support fund, federal USF surcharge and various state funds. 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 revenue.

The federal high cost fund is our largest source of subsidy revenue (approximately $59.0 million in 2006). We currently expect that as a result of both an increase in the national average cost per loop and a decrease in our cost structure, there is likely to be a decrease in the subsidy revenue earned in 2007 through the federal high cost support fund and such decrease may be significant in relation to the total amount of our subsidy revenue.

In addition, approximately $37.1 million or 2% of our revenue represents a surcharge to customers (local, long distance and IXC) which is remitted to the FCC and recorded as an expense in "other operating expenses". The FCC revised the calculation for this surcharge by eliminating high speed internet connections from the calculation effective August 15, 2006. As a result, we expect this surcharge revenue (and its associated expense) to decrease in 2007 and such decrease may be significant in relation to the total amount of our subsidy revenue.

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.

Customers are now permitted 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 the Acquisition of Commonwealth

There is no assurance that the acquisition of Commonwealth will occur.

While we have received the requisite Hart-Scott Rodino and FCC approvals, the acquisition of Commonwealth is still subject to a number of conditions, including the approval of the Pennsylvania Public Utilities Commission, or Pennsylvania PUC.

The integration of Commonwealth following the acquisition may present significant challenges.



We may face significant challenges in combining Commonwealth's operations into our operations in a timely and efficient manner and in retaining key Commonwealth personnel. The failure to integrate successfully and to manage successfully the challenges presented by the integration process may result in us not achieving the anticipated benefits of the acquisition. In addition, we and Commonwealth expect to incur costs associated with transaction fees and other costs related to the acquisition. We will also incur integration and restructuring costs following the completion of the acquisition as we integrate the businesses of Commonwealth with those of ours. Although we expect that the realization of efficiencies related to the integration of the business will offset incremental transaction, integration and restructuring costs over time, we cannot give any assurance that this net benefit will be achieved.

## 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.

## Item 2. Properties

Our principal corporate offices are located in leased premises at 3 High Ridge Park, Stamford, Connecticut 06905.

An operations support office is currently located in leased premises at 180 South Clinton Avenue, Rochester, New York 14646. In addition, we lease and own space in our operating markets throughout the United States.

Our telephone properties 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 initially 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 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.

On June 27, 2006, the court issued Findings of Fact and Conclusions of Law in the first phase of the case. The court found contamination in only a small section of the River and determined that Citizens and the City should share cleanup costs 60% and 40%, respectively. The precise nature of the remedy in this case remains to be determined by subsequent proceedings. However, based upon the Court's ruling, we believed that we would be responsible for only a portion of the cost to clean up and the final resolution of this matter would not be material to the operating results nor the financial condition of the Company.



Subsequent to the June 27, 2006 judgment, we began settlement discussions with the City, with participation from the State of Maine. In January 2007, we reached an agreement in principle to settle the matter for a payment by us of $7,625,000. The Bangor City Council has approved the settlement terms, and a settlement agreement has been executed by the City and Citizens. Completion of settlement remains contingent upon entry of a Consent Decree with the State that is reasonably acceptable to us. We are in negotiations with the State over the terms of the Consent Decree. If the settlement of this matter does not become effective, we intend to (i) seek relief from the Court in connection with the adverse aspects of the Court's opinion and (ii) continue pursuing our right to obtain contribution from the third parties against whom we have commenced litigation in connection with this case. In addition, 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. We cannot at this time determine what amount we may recover from third parties or insurance carriers.

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 2006.



Executive Officers of the Registrant

Our Executive Officers as of February 1, 2007 were:

| Name | Age | Current Position and Officer |
|---|---|---|
| Mary Agnes Wilderotter | 52 | Chairman of the Board and Chief Executive Officer |

| | | |
|---|---|---|
| Donald R. Shassian | 51 | Chief Financial Officer |
| John H. Casey, III | 50 | Executive Vice President |
| Hilary E. Glassman | 44 | Senior Vice President, General Counsel and Secretary |
| Peter B. Hayes | 49 | Executive Vice President Sales, Marketing and Business Dev |
| Robert J. Larson | 47 | Senior Vice President and Chief Accounting Officer |
| Daniel J. McCarthy | 42 | Executive Vice President and Chief Operating Officer |
| Cecilia K. McKenney | 44 | 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 with Citizens since November 2004. She was elected Chairman of the Board and Chief Executive Officer in December 2005. Previously, Mrs. Wilderotter 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.

DONALD R. SHASSIAN has been with Citizens since April 2006. Prior to joining Citizens, Mr. Shassian had been an independent consultant since 2001 primarily providing M&A advisory services to several organizations in the communications industry. In his role as independent consultant, Mr. Shassian also served as Interim Chief Financial Officer of the Northeast region of Health Net, Inc. for a short period of time, and assisted in the evaluation of acquisition, disposition and capital raising opportunities for several companies in the communications industry including ATT, Consolidated Communications and smaller companies in the rural local exchange business. Mr. Shassian is a certified public accountant, and served for 5 years as the Senior Vice President and Chief Financial Officer of Southern New England Telecommunications Corporation and for more than 16 years at Arthur Andersen.

JOHN H. CASEY, III has been 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.

HILARY E. GLASSMAN has been 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 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 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 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 with Citizens since February 2006. Prior to joining Citizens, she was the Group Vice President, of Headquarters of 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.

| | 2006 | | 2005 | |
|---|---|---|---|---|
| | High | Low | High | Low |
| First Quarter | $13.72 | $11.97 | $14.05 | $12.25 |
| Second Quarter | $13.76 | $12.25 | $13.74 | $12.16 |
| Third Quarter | $14.31 | $12.38 | $13.98 | $13.05 |
| Fourth Quarter | $14.95 | $13.68 | $13.57 | $12.08 |

As of January 31, 2007, the approximate number of security holders of record of our common stock was 25,053. This information was obtained from our transfer agent, Illinois Stock Transfer Company.

### 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 $323.7 million, $338.4

million and $832.8 million in 2006, 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.

| | 2006 | 2005 | 2004 |
|---|---|---|---|
| First Quarter | $ 0.25 | $ 0.25 | $ - |
| Second Quarter | $ 0.25 | $ 0.25 | $ - |
| Third Quarter | $ 0.25 | $ 0.25 | $ 2.25 |
| Fourth Quarter | $ 0.25 | $ 0.25 | $ 0.25 |

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STOCKHOLDER RETURN PERFORMANCE GRAPH

The following performance graph compares the cumulative total return of our common stock to the S&P 500 Stock Index and to the S&P Telecommunications Services Index for the five-year period commencing December 31, 2001. The graph assumes $100 was invested in our common stock as of December 31, 2001. It also assumes reinvestment of dividends, if applicable.

Cumulative Total Return

| | 12/01 | 12/02 | 12/03 | 12/04 | 12/05 | 1 |
|---|---|---|---|---|---|---|
| Citizens Communications Company | $100.00 | $98.97 | $116.51 | $155.79 | $149.07 | $18 |
| S & P 500 | 100.00 | 77.90 | 100.24 | 111.15 | 116.61 | 13 |
| S & P Telecommunication Services | 100.00 | 65.89 | 70.56 | 84.57 | 79.81 | 10 |

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

None.

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ISSUER PURCHASES OF EQUITY SECURITIES

| | (a) Total Number of | (b) Average | (c) Total Number of Shares Purchased as Part of Publicly | (d) Maxim Approxi Dollar Va Shares May Ye Purcha |
|---|---|---|---|---|

| Period | Shares Purchased | Price Paid per Share | Announced Plans or Programs | Under th or Prog |
|---|---|---|---|---|
| October 1, 2006 to October 31, 2006 | | | | |
| Share Repurchase Program (1) | - | $ - | - | |
| Employee Transactions (2) | 722 | $ 14.36 | N/A | N/A |
| November 1, 2006 to November 30, 2006 | | | | |
| Share Repurchase Program (1) | - | $ - | - | |
| Employee Transactions (2) | 12,435 | $ 14.66 | N/A | N/A |
| December 1, 2006 to December 31, 2006 | | | | |
| Share Repurchase Program (1) | - | $ - | - | |
| Employee Transactions (2) | - | $ - | N/A | N/A |
| Totals October 1, 2006 to December 31, 2006 | | | | |
| Share Repurchase Program (1) | - | $ - | - | |
| Employee Transactions (2) | 13,157 | $ 14.64 | N/A | N/A |

(1) In February 2006, our Board of Directors authorized the Company to repurchase up to $300.0 million of the Company's common stock, in public or private transactions, over the following twelve month period. This share repurchase program commenced on March 6, 2006. No shares were repurchased during the fourth quarter of 2006.

(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.

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Item 6. Selected Financial Data

| ($ in thousands, except per share amounts) | Year Ended December 31, | | | |
|---|---|---|---|---|
| | 2006 | 2005 | 2004 | 2003 |
| Revenue (4) | $2,025,367 | $2,017,041 | $2,022,378 | $2,268, |
| Income (loss) from continuing operations before cumulative effect of change in accounting principle(1) | $ 254,008 | $ 187,942 | $ 57,064 | $ 71, |
| Net income (loss) | $ 344,555 | $ 202,375 | $ 72,150 | $ 187, |
| Basic income (loss) per share of common stock from continuing operations before cumulative effect of change in accounting principle (1) | $ 0.79 | $ 0.56 | $ 0.19 | $ 0 |
| Earnings (loss) available for common shareholders per basic share | $ 1.07 | $ 0.60 | $ 0.24 | $ 0 |
| Earnings (loss) available for common shareholders per diluted share | $ 1.06 | $ 0.60 | $ 0.23 | $ 0 |
| Cash dividends declared (and paid) per common | | | | |

| | | | | |
|---|---|---|---|---|
| share | $ 1.00 | $ 1.00 | $ 2.50 | $ |

| | As of December 31, | | | |
|---|---|---|---|---|
| | 2006 | 2005 | 2004 | 2003 |
| Total assets | $6,791,205 | $6,427,567 | $6,679,899 | $7,457,9 |
| Long-term debt | $4,460,755 | $3,995,130 | $4,262,658 | $4,179,5 |
| Equity units (2) | $ - | $ - | $ - | $ 460,0 |
| Company Obligated Mandatorily Redeemable Convertible Preferred Securities (3) | $ - | $ - | $ - | $ 201,2 |
| Shareholders' equity | $1,058,032 | $1,041,809 | $1,362,240 | $1,415,1 |

(1) The cumulative effect of change 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.
(2) On August 17, 2004, we issued common stock to equity unit holders in settlement of the equity purchase contract.
(3) The consolidation of this item changed effective January 1, 2004 as a result of the adoption of FIN No. 46R, "Consolidation of Variable Interest Entities."
(4) Operating results include activities from our Vermont Electric segment for three months of 2004 and the years ended 2003 and 2002.



## 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:

* Our ability to complete the acquisition of Commonwealth, to successfully integrate their operations and to realize the synergies from the acquisition;

* Our ability to refinance the bridge loan that will be used to finance any remaining cash portion of the merger consideration with long-term debt;

* 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 VOIP or otherwise), high-speed cable modems and cable

telephony;

* 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 general and local economic and employment conditions on our revenues;

* Our ability to effectively manage 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, switched access services and subsidies;

* 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 operations, operating expenses and capital expenditures, to pay dividends and to 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 bankruptcies in the telecommunications industry, which could result in 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;

* 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 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 1,526 employees that are scheduled to expire

during 2007;

* 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 2007) 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 full-service communications provider and one of the largest exchange telephone carriers in the country. We offer our incumbent local exchange carrier (ILEC) services under the "Frontier" name. On July 31, 2006 we sold our competitive local exchange carrier (CLEC), Electric Lightwave, LLC (ELI). We are accounting for ELI as a discontinued operation in our consolidated statements of operations. In September 2006, we entered into a definitive agreement to acquire Commonwealth. This acquisition, if successfully completed, will expand our presence in Pennsylvania and strengthen our position as a market-leading full-service communications provider to rural markets. The acquisition is subject to approval by the Pennsylvania PUC. All other regulatory approvals have been received.

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 2007 across all of our products and in all of our markets. Our Frontier business experienced erosion in access lines and switched access minutes in 2006 as a result of competition. Competition in our markets may result in reduced revenues in 2007.

The communications industry is undergoing significant changes. The market is extremely competitive, resulting in lower prices. 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 the potential for increasing operating costs, could cause our profitability and our cash generated by operations to decrease.

(a) Liquidity and Capital Resources

## Cash Flow from Operating Activities

As of December 31, 2006, we had cash and cash equivalents aggregating $1.04 billion. Our primary source of funds continued to be cash generated from operations. Our cash balance increased significantly in December 2006 when we borrowed $550.0 million. For the year ended December 31, 2006, we used cash flow from continuing operations, proceeds from the Rural Telephone Bank (RTB), proceeds from the sale of ELI and cash and cash equivalents to fund capital expenditures, dividends, interest payments, debt repayments and stock repurchases.

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 stockholders in accordance with our dividend policy and support our short-term and long-term operating strategies. We have approximately $39.3 million and $497.7 million of debt maturing in 2007 and 2008, respectively.

A number of factors, including but not limited to, losses of access lines, increases in competition and lower subsidy and access revenues are expected to reduce our cash generated by operations and may require us to increase capital expenditures. Our below investment grade credit ratings 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 in 2007 our cash taxes will increase substantially.

## Cash Flow from Investing Activities

### Commonwealth Acquisition

On September 17, 2006, we entered into a definitive agreement to acquire Commonwealth for $41.72 per share, in a cash-and-stock taxable transaction, for a total consideration of $1.16 billion, based on the closing price of Citizens' common stock on September 15, 2006. Each Commonwealth share will receive $31.31 in cash and 0.768 shares of Citizens' common stock.

The acquisition has been approved by the Boards of Directors of both Citizens and Commonwealth and by Commonwealth's shareholders. The transaction has received the requisite Hart-Scott Rodino and FCC approvals, but is still subject to Pennsylvania PUC regulatory approval. We expect the transaction to be consummated in the first half of 2007.

We intend to finance the cash portion of the transaction with a combination of cash on hand and debt. We obtained a commitment letter for a $990.0 million senior unsecured term loan, the proceeds of which may be used to pay the cash portion of the acquisition consideration (including cash payable upon the assumed conversion of $300.0 million of the Commonwealth convertible notes in connection with the acquisition), to cash out restricted shares, options and other equity awards of Commonwealth, to repay all of Commonwealth's outstanding indebtedness (which was $35.0 million as of December 31, 2006) and to pay fees and expenses related to the acquisition. We expect to refinance this term loan, which matures within one year, with long-tem debt prior to the maturity thereof. On December 22, 2006 this commitment was reduced by $400.0 million as the result of our issuance of 7.875% senior notes due 2027 in the amount of $400.0 million (see "Cash Flow from Financing Activities - Issuance of Debt Securities" below). In December 2006, we also borrowed $150.0 million from CoBank under a 6-year unsecured term loan. These proceeds can be used to repurchase existing indebtedness or to essentially reduce the amount of additional borrowings needed in connection with the Commonwealth transaction. We expect the need to borrow $200.0 million - $300.0 million under the remaining commitment to close the Commonwealth transaction, pay all closing transaction costs and implementation costs.

Rural Telephone Bank Proceeds

In August 2005, the Board of Directors of the RTB voted to dissolve the bank. In November 2005, the liquidation and dissolution of the RTB was initiated with the signing of the 2006 Agricultural Appropriation bill by President Bush. We received approximately $64.6 million in cash from the dissolution of the RTB in April 2006, which resulted in the recognition of a pre-tax gain of approximately $61.4 million during the second quarter of 2006. Our cash liability for taxes as a result of the cash distribution is expected to be approximately $2.0 million due to the utilization of existing tax net operating losses on both the federal and state level.

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Sale of Non-Core Operations and Investments

During 2006, we sold ELI, our CLEC business (including its associated real estate), for $255.3 million in cash plus the assumption of approximately $4.0 million in capital lease obligations.

During 2005, we executed a strategy of divesting non-core assets, which resulted in the following transactions:

On February 1, 2005, we sold 20,672 shares of Prudential Financial, Inc. for approximately $1.1 million in cash.

On March 15, 2005, we completed the sale of Conference Call USA, LLC for $43.6 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 gain of approximately $457,000 that is included in investment and other income.

During 2005, we sold 79,828 shares of Global Crossing Limited for $1.1 million in cash.

Capital Expenditures

For the year ended December 31, 2006, our capital expenditures were $268.8 million. 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. We anticipate capital expenditures of approximately $270.0 million - $280.0 million for 2007.

Increasing competition and improving the capabilities or reducing the maintenance costs of our plant may cause our capital expenditures to increase in the future. Our capital expenditures planned for new services such as wireless and VOIP in 2007 are not material. However, based on the success of our planned roll-out of these products that began in late 2006, our capital expenditures for these products may increase in the future.

## Cash Flow from Financing Activities

### Debt Reduction and Debt Exchanges

For the year ended December 31, 2006, we retired an aggregate principal amount of $251.0 million of debt, including $15.9 million of 5% Company Obligated Mandatorily Redeemable Convertible Preferred Securities (EPPICS) that were converted into our common stock.

During the first quarter of 2006, we entered into two debt-for-debt exchanges of our debt securities. As a result, $47.5 million of our 7.625% notes due 2008 were exchanged for approximately $47.4 million of our 9.00% notes due 2031. During the fourth quarter of 2006, we entered into four debt-for-debt exchanges and exchanged $157.3 million of our 7.625% notes due 2008 for $149.9 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, with respect to the first quarter debt exchanges, a non-cash pre-tax loss of approximately $2.4 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.

On June 1, 2006, we retired at par our entire $175.0 million principal amount of 7.60% Debentures due June 1, 2006.

On June 14, 2006, we repurchased $22.7 million of our 6.75% Senior Notes due August 17, 2006 at a price of 100.181% of par.

On August 17, 2006, we retired at par the $29.1 million remaining balance of the 6.75% Senior Notes.

In February 2006, our Board of Directors authorized us to repurchase up to $150.0 million of our outstanding debt over the following twelve-month period. Through December 31, 2006, we had not made any purchases pursuant to this authorization.



For the year ended December 31, 2005, we retired an aggregate principal amount of $36.4 million of debt, including $30.0 million of 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.

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, exchanges of debt securities, by exercising rights to call or privately negotiated transactions. We may also exchange existing debt for newly issued debt obligations.

Issuance of Debt Securities
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On December 22, 2006, we issued in a private placement, $400.0 million principal amount of 7.875% Senior Notes due January 15, 2027. Proceeds from the sale are expected to be used to partially finance our acquisition of Commonwealth or if the acquisition is not completed, to purchase, redeem or otherwise retire a portion of our outstanding debt. We have agreed to file with the SEC a registration statement for the purpose of exchanging these notes for registered notes.

In December 2006, we borrowed $150.0 million under a senior unsecured term loan agreement. The loan matures in 2012 and bears interest based on an average prime rate or London Interbank Offered Rate or LIBOR, at our election plus a margin which varies depending on our debt leverage ratio. We intend to use the proceeds to repurchase a portion of our outstanding debt or to partially finance our acquisition of Commonwealth.

EPPICS
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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 share of our common stock. 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 of common stock special, non-recurring dividend. The proceeds from the issuance of the Trust Convertible Preferred Securities and a Company capital contribution were used to purchase $207.5 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 relating 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 2006, 2005 and 2004. 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, 2006, EPPICS representing a total principal amount of $193.9 million have been converted into 15.6 million shares of our common stock, and a total of $7.4 million remains outstanding to third parties. Our long-term debt footnote indicates $17.9 million of EPPICS outstanding at December 31, 2006, of which $10.5 million is debt of related parties for which we have an offsetting receivable.

## Interest Rate Management

In order to manage our interest expense, we have entered into interest rate swap agreements. Under the terms of these agreements, 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 either in advance or in arrears.

The notional amounts of fixed-rate indebtedness hedged as of December 31, 2006 and December 31, 2005 were $550.0 million and $500.0 million, respectively. Such contracts require us to pay variable rates of interest (estimated average pay rates of approximately 9.02% as of December 31, 2006 and approximately 8.60% as of December 31, 2005) and receive fixed rates of interest (average receive rate of 8.26% as of December 31, 2006 and 8.46% as of December 31, 2005). All swaps are accounted for under SFAS No. 133 (as amended) as fair value hedges. For the year ended December 31, 2006, the interest expense resulting from these interest rate swaps totaled approximately $4.2 million. For the years ended December 31, 2005, and 2004 our interest expense was reduced by $2.5 million and $9.4 million, respectively, as a result of our swaps.

## Credit Facilities

As of December 31, 2006, we had an available line of credit with financial institutions in the aggregate amount of $249.6 million. Outstanding standby letters of credit issued under the facility were $0.4 million. Associated facility fees vary, depending on our debt leverage ratio, and are 0.375% per annum as of December 31, 2006. 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.

## Covenants

The terms and conditions contained in our indentures and credit facilities agreements 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 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 agreement) over the last four quarters no greater than 4.00 to 1.

Our $250.0 million credit facility and our $150.0 million senior unsecured term loan contain 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 no greater than 4.50 to 1. Although both facilities are unsecured, they 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.

Certain indentures for our senior unsecured debt obligations limit our ability to create liens or merge or consolidate with other companies and our subsidiaries' ability to borrow funds, subject to important exceptions and qualifications.

We are in compliance with all of our debt and credit facility covenants.

Proceeds from the Sale of Equity Securities

We receive proceeds from the issuance of our common stock pursuant to our stock-based compensation plans. For the periods ended December 31, 2006 and 2005, we received approximately $27.2 million and $47.6 million, respectively, upon the exercise of outstanding stock options.

On August 17, 2004, we issued 32,074,000 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.



Share Repurchase Programs

In February 2007, our Board of Directors authorized us to repurchase up to $250 million of our common stock in public or private transactions over the following twelve month period.

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. This share repurchase program commenced on March 6, 2006. As of December 31, 2006, we had repurchased 10,199,900 shares of our common stock at an aggregate cost of approximately $135.2 million. No more shares can be repurchased under this authorization.

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 shares of our common stock at an aggregate cost of $250.0 million.

Dividends

Our ongoing annual dividends of $1.00 per share of common stock under our current policy utilize a significant portion of our cash generated by operations and therefore could limit 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.

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, 2006 is as follows:

| Contractual Obligations: | | | Payment due by period | |
|---|---|---|---|---|
| ($ in thousands) | Total | Less than 1 year | 1-3 years | 3-5 years |
| Long-term debt obligations, excluding interest (see Note 11) (1) | $4,532,904 | $39,271 | $500,195 | $1,258,40 |
| Operating lease obligations (see Note 25) | 69,393 | 15,794 | 19,510 | 15,90 |
| Purchase obligations (see Note 25) | 70,165 | 26,449 | 35,509 | 7,54 |
| Total | $4,672,462 | $81,514 | $555,214 | $1,281,85 |

(1) Includes interest rate swaps (($10.3) million).

At December 31, 2006, we have outstanding performance letters of credit totaling $22.8 million.

## 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.

## 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.

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## Discontinued Operations

On July 31, 2006, we sold our CLEC business Electric Lightwave LLC (ELI) for $255.3 million (including a later sale of associated real estate) in cash plus the assumption of approximately $4.0 million in capital lease obligations. We recognized a pre-tax gain on the sale of ELI of approximately $116.7 million. Our after-tax gain on the sale was $71.6 million. Our cash liability for taxes as a result of the sale is expected to be approximately $5.0 million due to the utilization of existing tax net operating losses on both the federal and state level.

On March 15, 2005, we completed the sale of Conference Call USA, LLC (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.

## 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.

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.

### 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 2006 and 2005, we had no "critical estimates" related to telecommunications bankruptcies.

### Asset Impairment

In 2006 and 2005, we had no "critical estimates" related to asset impairments.

### 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 and updated in 2006. We adopted the lives proposed in the study effective October 1, 2005 and as revised on October 1, 2006.

### 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, we aggregate our reporting units into one ILEC segment. In determining fair value of goodwill during 2006 we compared the net book value of the reporting units to current trading multiples of ILEC properties as well as 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 current and former 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 pension plan for the majority of our current employees is frozen. 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 our independent 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 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 and the changes in those rates from one period to the next. This rate can change from year-to-year based on market conditions that impact corporate bond yields. Our discount rate increased from 5.625% at year-end 2005 to 6.00% at year-end 2006.

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 35% to 55% in fixed income securities, 35% 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 2006, we did not change our expected long-term rate of return from the 8.25% used in 2005. Our pension plan assets are valued at actual market value as of the measurement date.

Accounting standards in effect prior to December 31, 2006 required that we record an additional minimum pension liability when the plan's "accumulated benefit obligation" exceeded 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 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.

We expect that our pension and other postretirement benefit expenses for 2007 will be $11.0 million to $14.0 million (they were $11.3 million in 2006) and that no contribution will be required to be made by us to the pension plan in

2007. No contribution was made to our pension plan during 2006.

Income Taxes

Our effective tax rates in 2005 and 2004 were below statutory rate levels (2006 was close to statutory) as a result of the completion of audits with federal and state taxing authorities and changes in the structure of certain of our subsidiaries.

## New Accounting Pronouncements

### Accounting for Defined Benefit Pension and Other Postretirement Plans

In October 2006, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans," which completes the first phase of a FASB project that will comprehensively reconsider accounting for pensions and other postretirement benefit plans and amends the following FASB Statements:

* SFAS No. 87, "Employers' Accounting for Pensions;"

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* SFAS No. 88, "Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits;"
* SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions;" and
* SFAS No. 132(R), "Employers' Disclosures about Pensions and Other Postretirement Benefits."

SFAS No. 158 requires (1) recognition of the funded status of a benefit plan in the balance sheet, (2) recognition in other comprehensive income of gains or losses and prior service costs or credits arising during the period but which are not included as components of periodic benefit cost, (3) measurement of defined benefit plan assets and obligations as of the balance sheet date, and (4) disclosure of additional information about the effects on periodic benefit cost for the following fiscal year arising from delayed recognition in the current period. In addition, SFAS No. 158 amends SFAS No. 87 and SFAS No. 106 to include guidance regarding selection of assumed discount rates for use in measuring the benefit obligation.

For public companies, the requirements to recognize the funded status of a plan and to comply with the disclosure provisions of SFAS No. 158 are effective as of the end of the fiscal year that ends after December 15, 2006. The requirement to measure plan assets and benefit obligations as of the balance sheet date is effective for fiscal years ending after December 15, 2008. Adoption of SFAS No. 158 on December 31, 2006 did not have a material impact on the Company's financial position at December 31, 2006. See Note 24.

### Consideration of Prior Years' Errors in Quantifying Current Year Misstatements

In September 2006, the SEC issued Staff Accounting Bulletin (SAB) No. 108, "Consideration of Prior Years' Errors in Quantifying Current Year Misstatements." SAB No. 108 provides guidance concerning the process to be applied in considering the impact of prior years' errors in quantifying misstatements in the current year. SAB No. 108 is effective for periods ending after November 15, 2006. We adopted SAB No. 108 in the fourth quarter of 2006. See Note 5.

Accounting for Uncertainty in Income Taxes

In July 2006, the FASB issued FASB Interpretation No. (FIN) 48, "Accounting for Uncertainty in Income Taxes." Among other things, FIN No. 48 requires applying a "more likely than not" threshold to the recognition and derecognition of uncertain tax positions. FIN No. 48 is effective for fiscal years beginning after December 15, 2006. We do not expect the adoption of FIN No. 48 to have a material impact on our financial position, results of operations or cash flows.

How Taxes Collected from Customers and Remitted to Governmental Authorities
Should be Presented in the Income Statement

In June 2006, the FASB issued EITF Issue No. 06-3, "How Taxes Collected from Customers and Remitted to Governmental Authorities Should be Presented in the Income Statement" (EITF No. 06-3), which requires disclosure of the accounting policy for any tax assessed by a governmental authority that is directly imposed on a revenue-producing transaction, that is Gross versus Net presentation. EITF No. 06-3 is effective for periods beginning after December 15, 2006. We will adopt the disclosure requirements of EITF No. 06-3 commencing January 1, 2007.

Exchanges of Productive Assets

In December 2004, the FASB issued SFAS No. 153, "Exchanges of Nonmonetary Assets," an amendment of Accounting Principles Board (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 have not had any "exchanges of nonmonetary" assets.

Accounting for Conditional Asset Retirement Obligations

In March 2005, the FASB issued FIN No. 47, "Accounting for Conditional Asset Retirement Obligations," an interpretation of FASB No. 143. FIN No. 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 No. 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 asbestos, sufficient information is not available currently to estimate the amount of our liability, as the range of time over which we may settle theses obligations is unknown or cannot be reasonably estimated. The adoption of FIN No. 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. The adoption of SFAS

No. 154 during the first quarter of 2006 had no impact on our financial position or results of operations.

Partnerships
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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 are the managing partner and have a 33% ownership position in a wireless voice business, Mohave Cellular Limited Partnership (Mohave).

The Company has applied the provisions of EITF No. 04-5 retrospectively and consolidated Mohave for all periods presented.

Stock-Based Compensation
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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 SEC required adoption of SFAS No. 123R for annual periods beginning after June 15, 2005. Accordingly, we have adopted SFAS No. 123R commencing January 1, 2006 using a modified prospective application, as permitted by SFAS No. 123R. Accordingly, prior period amounts have not been restated. Under this application, we are required to record compensation expense for all awards granted after the date of adoption and for the unvested portion of previously granted awards that remain outstanding at the date of adoption.

Prior to the adoption of SFAS No. 123R, we applied APB No. 25 and related interpretations to account for our stock plans resulting in the use of the intrinsic value to value the stock. Under APB No. 25, we were not required to recognize compensation expense for the cost of stock options. In accordance with the adoption of SFAS No. 123R, we recorded stock-based compensation expense for the cost of stock options, restricted shares and stock units issued under our stock plans (together, Stock-Based Awards). Stock-based compensation expense for the year ended December 31, 2006 was $10.3 million ($6.7 million after tax or $0.02 per basic and diluted share of common stock).

Accounting for Endorsement Spli