

Consolidated Communications Holdings, Inc.
Form 10-K
March 05, 2012
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

[Mark One]

Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

for the fiscal year ended December 31, 2011

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 000-51466

CONSOLIDATED COMMUNICATIONS HOLDINGS, INC.

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(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

02-0636095
(IRS Employer Identification No.)

121 South 17th Street
Mattoon, Illinois
(Address of principal executive offices)

61938
(Zip Code)

(217) 235-3311

(Registrant's Telephone Number, including Area Code)

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

Title of each class:
Common Stock, \$0.01 par value

Name of exchange on which registered:
NASDAQ Global Select Market

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 o NO x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. YES o 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 o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES x NO o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of the 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. o

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Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer
Non-accelerated filer Smaller reporting company
(Do not check if a smaller reporting company)

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant as of June 30, 2011 was approximately \$509,792,519 based upon the closing price of the Common Stock reported for such date on the NASDAQ Global Select Market.

Indicate the number of shares outstanding of each class of Common Stock, as of the latest practicable date:

Class	Outstanding as of March 1, 2012
Common Stock, \$0.01 par value	29,869,510 Shares

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive proxy statement for the 2012 annual meeting of stockholders are incorporated by reference into Part III.

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YEAR ENDED DECEMBER 31, 2011

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Acronyms Used in this Annual Report on Form 10-K

CLEC	Competitive local exchange carrier
DSL	Digital subscriber line
EBITDA	Earnings before interest, taxes, depreciation and amortization
ETFL	East Texas Fiber Line, Inc.
FASB	Financial Accounting Standards Board
FCC	Federal Communications Commission
GAAP	Generally accepted accounting principles
ICC	Illinois Commerce Commission
ICTC	Illinois Consolidated Telephone Company
ILEC	Incumbent local exchange carrier
IP	Internet protocol
IPTV	Internet protocol digital television
ISP	Internet service provider
IXC	Inter exchange carrier
LIBOR	London interbank offer rate
NECA	National Exchange Carrier Association
NOL	Net operating loss
PAPUC	Pennsylvania Public Utility Commission
PAUSF	Pennsylvania Universal Service Fund
PUCT	Public Utility Commission of Texas
PURA	Texas Public Utilities Regulatory Act
RLEC	Rural local exchange carrier
SFAS	Statement of Financial Accounting Standards
SONET	Synchronous Optical Network
TXUCV	TXU Communications Ventures Company
UNE	Unbundled network element
UNE-P	Unbundled network element platform
VOIP	Voice over Internet Protocol

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Terminology Used in this Annual Report on Form 10-K

Access line equivalents represent a combination of voice services and data circuits. The calculations represent a conversion of data circuits to an access line basis. Equivalents are calculated by converting data circuits (basic rate interface (BRI), primary rate interface (PRI), DSL, DS-1, DS-3, and Ethernet) and SONET-based (optical) services (OC-3 and OC-48) to the equivalent of an access line.

Bill and keep is a pricing arrangement for the interconnection of two telecommunications networks under which the reciprocal call termination charge is zero. That is, each network agrees to terminate calls from the other network at no charge. Typically the traffic terminating to each party is in parity or balance.

Competitive local exchange carriers (CLECs) are telecommunications providers formed after enactment of the Telecommunications Act of 1996 to provide local exchange service that competes with ILECs and other established carriers.

Digital telephone or VOIP service involves the routing of voice calls, at least in part, over the Internet through packets of data instead of transmitting the calls over the telephone system.

An **exchange** is a geographic area established for administration and pricing of telecommunications services.

Hosted VOIP is our broadband phone product that utilizes our soft switch to provide an Internet Protocol based voice service to business and residential customers. The product provides the flexibility of utilizing new telephone technology and features provided by our hosted soft switch but does not require an investment in a new telephone system to use the advanced features.

Incumbent local exchange telephone companies (ILECs) are the local telephone companies that provided local telephone exchange service on the effective date of the Telecommunications Act of 1996, or their predecessors. This designation is important because ILECs have statutory obligations that other telephone companies do not have. For example, ILECs are required to give other carriers access to certain equipment (known as unbundled network elements) or to house equipment for other carriers (known as collocation), on reasonable and nondiscriminatory terms. For more information, see Part I Item 1 Business Regulatory Environment.

Metro Ethernet is the use of carrier Ethernet technology in metropolitan area networks. Metro Ethernet services are provided over a standard, widely used Ethernet interface and can connect business local area networks to wide area networks or to the Internet. Metro Ethernet offers cost-effectiveness, reliability, scalability and bandwidth management superior to most proprietary networks.

MPLS or Multiprotocol Label Switching refers to a highly scalable data-carrying mechanism in which data packets are assigned labels. Packet-forwarding decisions are made solely on the contents of this label, without the need to examine the packet itself. This allows for

end-to-end circuits across any type of transport medium, using any protocol.

Rural telephone companies or rural local exchange carriers (RLECs) provide communications services to geographic areas that are not heavily populated. This designation is important because rural telephone companies historically have been eligible to receive government subsidies to compensate for the disproportionate cost of providing service in low density areas. In addition, ILECs that are statutory rural telephone companies, as defined in the Telecommunications Act of 1996, are exempt from some obligations to provide access to competitors.

Unified messaging is the integration of multiple messaging technologies into a single system. With this application, voice mail, fax, cellular and other messages are sent to the email inbox. From the email system, the messages can be heard, read or forwarded to others.

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FORWARD-LOOKING STATEMENTS

Any statements contained in this report that are not statements of historical fact, including statements about our beliefs and expectations, are forward-looking statements. We use words like anticipate, believe, expect, intend, plan, estimate, target, project, should, may, identify forward-looking statements throughout this report.

Forward-looking statements reflect, among other things, our current expectations, plans, strategies, and anticipated financial results. There are a number of risks, uncertainties, and conditions that may cause our actual results to differ materially from those expressed or implied by these forward-looking statements. Many of these circumstances are beyond our ability to control or predict. Moreover, forward-looking statements necessarily involve assumptions on our part.

All forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by the cautionary statements that appear throughout this report. Furthermore, forward-looking statements speak only as of the date they are made. Except as required under the federal securities laws or the rules and regulations of the Securities and Exchange Commission, we are not under any obligation to update any forward-looking information whether as a result of new information, future events, or otherwise. You should not place undue reliance on forward-looking statements.

Please see Part I Item 1A Risk Factors of this report, as well as this report generally and the other documents that we file with the SEC from time to time, for important factors that could cause our actual results to differ from current expectations and from the forward-looking statements discussed in this report.

MARKET AND INDUSTRY DATA

Market and industry data and other information used throughout this report are based on independent industry publications, government publications, publicly available information, reports by market research firms or other published independent sources. Although we believe these sources are reliable, we have not verified the information. Some data is also based on estimates that members of management derive from their industry knowledge and review of internal surveys.

We cannot know, or reasonably determine, our market share in each of our markets or for our services because there is significant overlap in the telecommunications industry; it is difficult to isolate information regarding individual services. For example, wireless providers both compete with and complement our local telephone services.

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PART I

Item 1. Business

General

Consolidated Communications Holdings, Inc. and its subsidiaries, (Consolidated , the Company , we , our or us) operates its businesses under name Consolidated Communications. We are an established rural local exchange carrier (RLEC) offering a wide range of telecommunications services to residential and business customers in Illinois, Texas and Pennsylvania including: local and long-distance service; high-speed broadband Internet access (DSL); standard and high-definition digital television (IPTV); digital telephone service (VOIP); custom calling features; private line services; carrier access services; network capacity services over our regional fiber optic network; directory publishing and Competitive Local Exchange Carrier (CLEC) services. At December 31, 2011, we had 227,992 local access lines, 110,913 DSL lines, 34,356 IPTV subscribers and an estimated 89,774 CLEC access line equivalents.

We also operate two non-core complementary businesses: telephone services to correctional facilities and business equipment sales.

Founded in 1894 as the Mattoon Telephone Company by the great-grandfather of our current Chairman, Richard A. Lumpkin, we began as one of the nation's first independent telephone companies. After several acquisitions, the Mattoon Telephone Company was incorporated as the Illinois Consolidated Telephone Company (ICTC) on April 10, 1924.

In 1997, McLeodUSA acquired ICTC and all related businesses from the Lumpkin family. In 2002, ICTC and several related businesses were reacquired from McLeodUSA by a group of investors led by Mr. Lumpkin.

In 2004, we acquired the rural telephone operations in Lufkin, Conroe and Katy, Texas of TXU Communications Ventures Company (TXUCV) from TXU Corporation, which had been operating in those markets for over 90 years. This acquisition approximately tripled the size of the Company.

On December 31, 2007, we acquired all of the capital stock of North Pittsburgh Systems, Inc. (North Pittsburgh). North Pittsburgh provides services to residential and business customers in several counties in western Pennsylvania and also operates a CLEC in the Pittsburgh metropolitan area.

On February 5, 2012, we entered into a definitive agreement to acquire all the outstanding shares of SureWest Communications (SureWest) for \$23.00 per share in a cash and stock transaction with a total consideration valued at approximately \$340.9 million, exclusive of debt, based on our February 3, 2012 closing price. SureWest's shareholders may elect to exchange each share of SureWest common stock for either \$23 in cash

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or shares of Consolidated common stock having an equivalent value based on average trading prices for the 20-day period ending two days before the closing of the acquisition, subject to a collar so that there will be a maximum exchange ratio of 1.40565 shares of Consolidated common stock for each share of SureWest common stock and a minimum of 1.03896 shares of Consolidated common stock for each share of SureWest common stock. Overall elections are also subject to proration so that 50% of the SureWest shares will be exchanged for cash and 50% for stock. The results of applying the collar and proration provisions are subject to adjustment to ensure the transaction will be treated as a tax-free reorganization for federal income tax purposes. The stock portion of the transaction will be tax free. The definitive agreement is not subject to any financing contingency. We intend to finance the cash portion of the acquisition price with debt and cash on hand. We have obtained a commitment for the

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financing necessary to complete the transaction from Morgan Stanley Senior Funding, Inc. The transaction is subject to approval by our and SureWest's stockholders and is subject to federal and state regulatory approvals, as well as other customary closing conditions. We and SureWest have made customary representations, warranties and covenants in the definitive agreement, including SureWest agreeing not to solicit alternative transactions or, subject to certain exceptions, to enter into discussions concerning, or provide confidential information in connection with, an alternative transaction. The definitive agreement also contains certain termination rights for both us and SureWest, and further provides that, upon termination of the agreement under certain circumstances, SureWest may be obligated to pay us a termination fee of \$14,675,000. The transaction will be accretive to Consolidated's free cash flow per share in the first full year following closing, excluding integration costs, and the transaction is deleveraging to Consolidated. The consideration represents a 47% premium to SureWest's stock price as of the close on February 3, 2012. The transaction is expected to close in the third or fourth quarter of 2012. The agreement contains a termination date of November 5, 2012.

On a standalone basis, SureWest reported in their 2011 earnings release dated February 29, 2012, that they serve 268,400 residential and 15,700 business revenue generating units in the greater Kansas City, Kansas and Missouri and Sacramento, California regions, which contain over 327,700 residential marketable homes to SureWest. SureWest reported revenues of \$248.1 million for 2011.

We are a Delaware corporation organized in 2002, and are the successor to businesses engaged in providing telecommunications services since 1894.

Available Information

Our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to those reports are available on our website, at no charge, at www.consolidated.com, as soon as reasonably practicable after electronic filing or furnishing such information to the U.S. Securities and Exchange Commission (SEC). Also available on our website, or in print upon written request at no charge, are our corporate governance guidelines, the charters of our audit, compensation and corporate governance committees, and a copy of our code of business conduct and ethics that applies to our directors, officers and employees, including our chief executive officer, principal financial officer, principal accounting officer, controller or other persons performing similar functions. Information on our website should not be considered to be part of this Annual Report on Form 10-K.

Business Overview

We derive our revenue principally from the sale of telecommunication services, including local and long-distance telephone (both traditional telephone service and VOIP), high-speed broadband Internet, and standard and high-definition digital IPTV services to residential and business customers in Illinois, Texas and Pennsylvania. We also derive revenues from two complementary non-core businesses: telephone services to correctional facilities and equipment sales. Prior to December 2010, we also derived revenues from our Operator Services business which we sold as of November 30, 2010. Prior to March 2010, we derived revenues from our telemarketing and order fulfillment business which we sold as of February 28, 2010. We operate in two reportable segments: Telephone Operations and Other Operations. Our Telephone Operations segment generates the substantial majority of our revenue and operating income and substantially all of our cash flow from operations.

Sources of Revenue

The following chart summarizes our sources of revenue for the last three years:

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(in millions, except for percentages)	2011		2010		2009	
	\$	% of Revenues	\$	% of Revenues	\$	% of Revenues
Telephone operations:						
Local calling services	86.9	23.2	91.9	24.0	97.2	23.9
Network access services	80.5	21.5	81.7	21.3	86.3	21.3
Subsidies	45.4	12.1	48.7	12.7	56.0	13.8
Long-distance services	15.9	4.2	18.0	4.7	20.4	5.0
Data, Internet and video services	80.3	21.5	75.2	19.6	68.1	16.8
Other services	33.6	9.0	34.1	8.9	36.6	9.0
Total telephone operations	342.6	91.5	349.6	91.2	364.6	89.8
Other operations	31.7	8.5	33.8	8.8	41.6	10.2
Total operating revenue	374.3	100.0	383.4	100.0	406.2	100.0

Telephone Operations

Our Telephone Operations segment consists of local and long-distance calling services, network access services and subsidies, all of which are related to our traditional wireline business. Our telephone operations segment also consists of data, Internet and video services (including DSL, IPTV and VOIP telephone service) and other services. Our Telephone Operations segment had the following service lines as of December 31:

	2011	December 31, 2010	2009
Residential access lines in service	137,179	140,660	146,766
Business access lines in service	90,813	96,481	100,469
Total local access lines in service	227,992	237,141	247,235
VOIP telephone subscribers	9,199	8,640	8,665
IPTV subscribers	34,356	29,236	23,127
ILEC DSL subscribers	110,913	106,387	100,122
Total broadband connections	154,468	144,263	131,914
CLEC access line equivalents (1)	89,774	81,090	72,681
Total connections	472,234	462,494	451,830
Long-distance lines (2)	177,610	172,856	165,714

(1) CLEC access line equivalents represent a combination of voice services and data circuits. The calculations represent a conversion of data circuits to an access line basis. Equivalents are calculated by converting data circuits (basic rate interface, primary rate interface, DSL, DS-1, DS-3 and Ethernet) and SONET-based (optical) services (OC-3 and OC-48) to the equivalent of an access line.

(2) Reflects the inclusion of long-distance service provided as part of our VOIP offering while excluding CLEC long-distance subscribers.

Our Telephone Operations segment generated approximately \$130.0 million and \$115.4 million of cash flows from operating activities for the years ended December 31, 2011 and 2010, respectively. As of December 31, 2011, our Telephone Operations had total assets of approximately \$1.2 billion.

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Local calling services

These services include dial tone and other basic services. We generally charge residential and business customers a fixed monthly rate for access to the network and for originating and receiving telephone calls within their local calling area.

Custom calling features include caller name and number identification, call forwarding and call waiting. Value-added services include usage-based services and voice mail. We usually charge a flat monthly fee for custom calling features and value-added services. Otherwise, we bundle the selected services with local calling services at a discounted rate.

We offer private lines that provide direct connections between two or more local locations primarily to business customers at flat monthly rates. In all of our markets, we offer small- and medium-sized businesses a hosted VOIP package, which utilizes a soft switch and allows the customer the flexibility of utilizing new telephone technology and features without investing in a new telephone system. The package bundles local service, calling features, Internet protocol (IP) business telephones and unified messaging, which integrates multiple messaging technologies into a single system, such as allowing the customer to receive and listen to voice messages through email. We offer similar products to our residential customers in Texas, Pennsylvania and Illinois.

Network access services

A significant portion of our revenue comes from network access charges paid by long-distance and other carriers for originating or terminating calls within our service areas. These services allow customers to make or receive calls in our service area. Our long-distance customers typically pay a monthly fee for this service. In addition, other carriers pay network access charges for originating or terminating calls within our service areas. These charges, which are regulated, also apply to private lines that connect a customer in one of our service areas to a location outside of our service areas. Network access charges include subscriber line charges (a fee for being connected to the telephone network), local number portability fees (whereby consumers can keep their telephone number when changing carriers) and universal services surcharges, as well as the costs of originating and terminating calls from/to our local exchanges. The amount of network access revenues we receive is based on rates set or approved by federal and state regulatory commissions or as directed by law that are subject to change at any time.

We capture the details of long-distance and switched access calls through our carrier access billing system and bill the applicable carriers on a monthly basis. The network access rates for intrastate long-distance calls and private lines within Texas and Pennsylvania are regulated and approved by the Public Utility Commission of Texas (PUCT) and the Pennsylvania Public Utility Commission (PAPUC), respectively. Access rates for interstate long-distance calls and private lines are regulated and approved by the Federal Communications Commission (FCC). Illinois passed a statute in 2010 requiring intrastate access rates in Illinois to be no higher than interstate access rates. There is no effective regulation of the intrastate access rates by the Illinois Commerce Commission (ICC). See Regulatory Environment Federal Regulation and Regulatory Environment Access Charges .

Subsidies

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Subsidies consist of federal and state subsidies designed to promote widely available, quality telephone service at affordable prices in rural areas. Subsidies come from pools to which we and other telecommunications providers, including local, long-distance and wireless carriers, contribute on a monthly basis. Subsidies are allocated and distributed to rural carriers monthly based upon their respective costs for providing local service. Like access charges, subsidies are regulated by federal and

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state regulatory commissions. In Illinois, we receive federal but not state subsidies. In Texas and Pennsylvania, we receive both federal and state subsidies. See Regulatory Environment and Part I Item 1A Risk Factors Regulatory Risks .

Long-distance services

Long-distance services enable customers to make calls that terminate outside their local calling area. We offer a variety of long-distance plans, including an unlimited calling plan, and offer a combination of subscription and usage fees.

Data, Internet and video services

Data, Internet and video services include revenues from providing access to the Internet and IPTV services along with providing non-local private lines (typically inter-city). We also offer a variety of data connectivity services, including Metro Ethernet services (both copper and fiber-based), Asynchronous Transfer Mode and frame relay networks. In select markets, we also provide virtual hosting services and collocation services.

Although we expect our revenues from data, Internet and video services to grow substantially, these products typically generate lower margins than our traditional wireline business (primarily due to a lack of subsidies for this revenue stream). As a result, as we replace traditional wireline revenue with revenue from data, Internet and video services, our margins may decline. See Part II Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations Trends and Factors that May Affect Future Operating Results .

Other services

Other services include revenues from telephone directory publishing, wholesale transport services on our fiber-optic network in Texas, billing and collection services, inside wiring service and maintenance.

Other Operations

Prior to 2010, our Other Operations segment consisted of Prison Services, Business Systems, Market Response (telemarketing and order fulfillment) (CMR) and Operator Services. During 2010, we sold both our CMR and Operator Services businesses. Our on-going Other Operations segment consists of two complementary non-core businesses:

- *Prison Services* provides local and long-distance service and automated calling service for correctional facilities.

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- *Business Systems* sells and supports telecommunications equipment, such as key, private branch exchange (PBX) and IP-based telephone systems, to business customers in Texas and Illinois. We are an Avaya and ShoreTel distributor.

Our Other Operations segment generated approximately \$0.2 million of cash flows for operating activities for the year ended December 31, 2011 and used approximately \$0.4 million in cash flow from operations for the year ended December 31, 2010. As of December 31, 2011, Other Operations had total assets of approximately \$6.4 million.

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See Part I Item 1A Risk Factors Risks Relating To Our Business The State of Illinois is a significant customer, and our contracts with the state are favorable to the government.

Wireless partnerships

Wireless partnership investment income is included as a component of other income. Our wireless partnership investment consisted of five cellular partnerships: GTE Mobilnet of South Texas, GTE Mobilnet of Texas RSA #17, Pittsburgh SMSA, Pennsylvania RSA 6(I) and Pennsylvania RSA 6(II).

We own 2.34% of GTE Mobilnet of South Texas Limited Partnership (Mobilnet South Partnership). The principal activity of the Mobilnet South Partnership is providing cellular service in the Houston, Galveston and Beaumont, Texas metropolitan areas. Because we have a minor ownership interest and cannot influence operations, we account for this investment using the cost basis. Income is recognized only upon cash distributions of our proportionate earnings in the partnership. We recognized income on cash distributions of \$3.7 million from this partnership for the year ended December 31, 2011, and \$5.3 million for the year ended December 31, 2010.

We own 17.02% of GTE Mobilnet of Texas RSA #17, which serves areas in and around Conroe, Texas. Because we have some influence over the operating and financial policies of this partnership, we account for the investment under the equity method, recognizing income on our proportionate share of earnings. Cash distributions are recorded as a reduction in our investment. For the years ended December 31, 2011 and 2010, we recognized income from this partnership of \$6.3 million and \$4.9 million, respectively and received cash distributions of \$6.1 million and \$4.8 million, respectively.

San Antonio MTA, L.P., a wholly owned partnership of Cellco Partnership (doing business as Verizon Wireless), is the general partner for both GTE Mobilnet of South Texas and GTE Mobilnet of Texas RSA #17.

We own 3.6% of Pittsburgh SMSA, 16.6725% of Pennsylvania RSA 6(I) and 23.67% of Pennsylvania RSA 6(II) wireless partnerships, all of which are majority owned and operated by Verizon Wireless. These partnerships cover territories that almost entirely overlap the markets served by our Pennsylvania ILEC and CLEC operations. Because of our limited influence over Pittsburgh SMSA, we account for the investment using the cost basis. For the years ended December 31, 2011 and 2010, we recognized income on cash distributions from Pittsburgh SMSA of \$7.4 million and \$6.5 million, respectively. The Pennsylvania RSA 6(I) and RSA 6(II) partnerships are accounted for under the equity method. For the years ended December 31, 2011 and 2010, we recognized income of \$9.7 million and \$10.7 million, respectively, and received cash distributions of \$11.0 million and \$10.9 million, respectively, from these partnerships.

Customers and Markets

Our Illinois local telephone markets consist of 35 geographically contiguous exchanges serving predominantly small towns and rural areas. We cover an area of 2,681 square miles, primarily in five central Illinois counties: Coles, Christian, Montgomery, Effingham and Shelby. We provide basic telephone services in this territory with 59,121 local access lines (averaging 22.1 lines per square mile) as of December 31, 2011.

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Approximately 59.3% of our Illinois local access lines serve residential customers, with the remainder serving business customers. Our Illinois business customers are predominantly small retail, commercial, light manufacturing and service industry accounts, as well as universities and hospitals.

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Our 21 exchanges in Texas serve three principal geographic markets Lufkin, Conroe and Katy in a 2,054 square mile area. We provide basic telephone services in this territory with 119,889 local access lines (averaging 58.4 lines per square mile) as of December 31, 2011. Approximately 65.4% of our Texas local access lines serve residential customers, with the remainder serving business customers. Our Texas business customers are predominately manufacturing and retail industries; our largest business customers are hospitals, local governments and school districts.

The Lufkin market is centered primarily in Angelina County in east Texas, approximately 120 miles northeast of Houston, and extends into three neighboring counties. The area is a center for the lumber industry and includes other significant industries such as education, healthcare, manufacturing, retail and social services.

The Conroe market is located primarily in Montgomery County and is centered approximately 40 miles north of Houston. Parts of the Conroe operating territory extend south to within 28 miles of downtown Houston, including parts of the affluent suburb of The Woodlands. Major industries in this market include education, healthcare, manufacturing, retail and social services.

The Katy market is located in parts of Fort Bend, Harris, Waller and Brazoria Counties and is centered approximately 30 miles west of downtown Houston along the busy and expanding I-10 corridor. Most of the Katy market is considered part of metropolitan Houston, with major industries including administrative, education, healthcare, management, professional, retail, and scientific and waste management services.

The Pennsylvania ILEC territory consists of nine exchanges and covers 285 square miles, serving portions of Allegheny, Armstrong, Butler and Westmorland Counties in western Pennsylvania. The southernmost point of the ILEC territory is 12 miles north of the city of Pittsburgh. We provide basic telephone services in this territory, with 48,982 local access lines (averaging 171.9 lines per square mile) as of December 31, 2011. Approximately 48.4% of our Pennsylvania local access lines in this territory serve residential customers and the remainder service business customers. The CLEC operations expand south to serve the city of Pittsburgh and north to serve the city of Butler. The CLEC primarily targets small to mid-sized businesses, educational institutions, and healthcare facilities.

Sales and Marketing

Telephone Operations

The key components of our overall marketing strategy in the Telephone Operations segment include:

- Organizing our sales and marketing activities around our consumer, enterprise, and carrier customers;
- Positioning ourselves as a single point of contact for our customers communications needs;

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- Providing customers with a broad array of voice, data and video services and bundling these services whenever possible;
- Providing excellent customer service, including 24-hour, 7-days a week centralized customer support to coordinate installation of new services, repair and maintenance functions;
- Developing and delivering new services to meet evolving customer needs and market demands; and

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- Leveraging our history and involvement with local communities and expanding Consolidated Communications and Consolidated brand recognition across all market areas.

Our sales strategy is focused on increasing our penetration of broadband services (especially DSL and IPTV) in our service areas. We are also focused on cross-selling our services, developing additional services to maximize revenues and increase revenues per user, and increasing customer loyalty through superior service, local presence and compelling product offerings.

Our Telephone Operations segment currently has three sales channels: call centers, communication centers and commissioned sales people. Our customer service call centers serve as the primary sales channels for consumer and small business enterprise customers. We also have a group of commissioned sales people, called our Feet on the Street team, who focus on the consumer business. This team canvasses our territories offering residential customers our full suite of products, leading with our triple-play bundled offering of voice, DSL, and IPTV services. In addition to being a strong sales point of contact, this sales effort also helps us to identify and address customer service issues, if any, on a proactive, face-to-face basis. This team of individuals can be scaled up or down to match our business needs, including, for example, if we launch a new product.

In both the ILEC and CLEC markets, we have sales teams led by a manager who has geographic market responsibility. Sales representatives/account managers support the existing base of larger business enterprises and new prospects. Individual sales representatives are responsible for the entire telecom product set and customize proposals to meet the customer needs (access lines, long-distance, Metro-Ethernet circuits, data connectivity, hosted VOIP and business systems). In most cases individual sales representatives are also charged with retaining and growing the telecom services within their account base.

Our customers can also visit one of our seven communications centers to address various communications needs, including paying bills or exploring and purchasing new services. We believe that customer availability to communication centers has helped decrease late payments and bad debt, and reinforces our local presence.

Our Telephone Operations sales efforts are supported by direct mail, bill inserts, newspaper advertising, public relations activities, sponsorship of community events and website promotions.

Our Carrier Services sales effort is led by a dedicated team and addresses the growing wireless backhaul business, as well as, dedicated and switched access services and large institutional and governmental opportunities within and near our geographic markets. The Carrier Services team also focuses on the legacy competitive industry participants such as IXCs, CAPs, LECs and CLECs. The Carrier Services sales effort is supported by sales engineers and provisioning resources which leverage the common infrastructure which supports the rest of the Company. Our carrier networks include our local exchange carrier and regional long haul fiber-based ringed networks in Texas, Illinois and Pennsylvania with Texas having a transport business unit to support our large regional fiber network.

Our Directory Publishing business is supported by a dedicated sales force, which is focused on each of the directory markets in order to maximize sales with both traditional print and online advertising products. We believe the directory business has been an efficient tool for marketing our telecom services and for promoting brand development and awareness.

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Other Operations

Each of our Other Operations businesses executes our sales and marketing strategy primarily through an independent sales and marketing team comprised of dedicated field sales account managers, management and service representatives. Our executives enhance these efforts by attending industry trade shows and assuming leadership roles in industry groups including the U.S. Telecom Association, the Associated Communications Companies of America, and the Independent Telephone and Telecommunications Alliance.

Information Technology and Support Systems

Our information technology and support systems staff is a seasoned organization that supports day-to-day operations and develops system enhancements. The technology supporting our Telephone Operations segment is centered on a core of commercially available and internally maintained systems.

We have successfully migrated most of the key business processes from previous acquisitions into a single Company-wide system and platform, which includes common network provisioning, network management, workforce management systems and financial systems. Our core systems and hardware platforms are expandable.

Network Architecture and Technology

All of our local networks are based on Carrier Serving Area (CSA) architecture. CSA architecture allows access equipment to be placed closer to customer premises, which means customers can be connected to the equipment over shorter copper loops than would be possible if all customers were connected directly to the carrier's main switch. The access equipment is connected back to the main switch on a high capacity fiber circuit, resulting in extensive fiber deployment throughout our network, enabling us to provide broadband services in excess of 20 megabits per second (mbps) to customers.

A single engineering team is responsible for the overall architecture and inter-operability of the various elements within our network in support of our consumer, enterprise and carrier groups. Our network operations center (NOC) in Mattoon, Illinois monitors the performance of our enterprise-wide communications network around the clock and deals with customer-specific issues. We believe our NOC allows us to maintain superior network performance standards using common network systems and platforms, allowing us to quickly and efficiently provide weekend and after-hours coverage in all of our markets while allocating personnel to manage fluctuations in our workload volumes in a more efficient manner.

Our network is supported by advanced 100% digital switches, with a fiber network connecting 64 of our 65 exchanges. These switches provide all of our local telephone customers with access to custom calling features, value-added services and dial-up Internet access. We have four additional switches: one that supports feature-rich VOIP, two dedicated to long-distance service and one that supports our Prison Services business.

We have developed a high-quality 100% digital switching network, comprising 65 central offices and 487 CSAs. The CSA architecture has enabled us to provide DSL service, with speeds up to 6 mbps, to over 96% of our DSL lines. In addition, we have deployed fiber-optic cable extensively throughout our network, resulting in a 100% fiber backbone network that supports all of the inter-office and host-remote links, as well as the majority of business parks within our ILEC service areas.

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As a result of our advanced network, we introduced IPTV service in selected Illinois markets in 2005, Texas markets in 2006 and Pennsylvania markets in 2008. We leverage our high definition head-end equipment in Illinois and distribute content across our three state backbone network allowing the Company to better manage costs of future channel additions and upgrades. As of December 31, 2011, IPTV was available to approximately 212,000 homes in our markets. Our IPTV subscriber base continues to grow and now totals 34,356 subscribers as of December 31, 2011. We do not anticipate having to make any material capital upgrades to our network infrastructure in connection with the continued growth of our IPTV product except for providing set-top boxes to future subscribers and adding head-end equipment and capacity as we further increase our high-definition channel offerings.

We also operate a 2,000 mile fiber network in the State of Texas. Approximately 52% of this network consists of cable sheath that we own, either directly or through our majority-owned subsidiary East Texas Fiber Line, Inc. (ETFL).

For the remaining route-miles of this network, we utilize strands on third-party fiber networks under contracts commonly known as indefeasible rights of use (IRU). An IRU conveys the right to use (including the right to lease to others) a number of fiber strands between two points along a specific route, with the grantee usually having the right to access the fibers at intermediate points along the route. The use of IRU s provides us with long-term availability of a fixed amount of capacity at a set price in order to meet our business needs without the cost of constructing our own network. Besides the initial cost to acquire the IRU, we are also typically required to pay an ongoing maintenance fee. The use of IRU s is a common practice among telecommunications companies.

We sell competitive wholesale capacity on our fiber network to other carriers, wireless providers, CLECs and large commercial customers. In addition, this fiber infrastructure provides the connectivity required to provide IPTV, Internet and long-distance services to all Consolidated residential and enterprise customers.

In Pennsylvania, we operate a CLEC with an extensive network consisting of over 575 route-miles of fiber-optic facilities in the Pittsburgh metropolitan area. The CLEC has placed equipment in 27 Verizon central offices and one CenturyLink central office, and serves its customers using UNE loops, VOIP and Metro Ethernet circuits (both copper and fiber-based). In the Pittsburgh market, the CLEC operates a carrier hotel that serves as the hub for its fiber-optic network. We offer space in this carrier hotel to ISPs, long-distance carriers, other CLECs, and other customers who need a carrier-class location to house voice and data equipment and access to a number of networks, including ours.

Employees

At December 31, 2011, we had 940 full-time and 23 part-time employees. Approximately 50% of our employees are covered by collective bargaining agreements as shown in the table below:

Location	# of Employees Covered	Union (1)	Contract Expiration Date
Illinois	198	IBEW	11/14/2012
Lufkin/Conroe, Texas	182	CWA	10/15/2013

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Pennsylvania (ILEC)	51	CWA	09/30/2011 (2)
Katy, Texas	38	CWA	02/28/2014
Pennsylvania (CLEC)	10	CWA	02/29/2012
Totals	479		

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(1) IBEW International Brotherhood of Electrical Workers

CWA Communication Workers of America

(2) The Company and the CWA are currently in negotiations on a new collective bargaining agreement. Since the contract has expired the employees have continued to work without a bargaining agreement.

As a whole, we believe our relations with our employees are good; however, we have been in contract negotiations with our Pennsylvania (ILEC) CWA since September 2011 and since the contract has expired the employees have continued to work without a bargaining agreement. Any protracted labor disputes or labor disruptions by any of our employees could have a negative effect on our financial results.

During 2010, we reduced the number of employees by 66 full-time and 48 part-time positions as a result of the sale of our CMR and Operator Services businesses.

See Part I Item 1A Risk Factors Risks Relating To Our Business We have employees who are covered by collective bargaining agreements and could be adversely affected by labor disputes .

Our Strengths

Technologically advanced network

We have made significant investments building our technologically advanced telecommunications network. As a result, we are able to deliver high-quality, reliable video, data and voice services in all markets we serve. Our wide-ranging network and extensive use of fiber provide an easy reach into existing and new areas. By bringing the fiber network closer to the customer premises, we can increase our service offerings, quality and bandwidth services.

Our IP backbone network provides a high-quality, flexible platform that allows us to deliver broadband applications to our customers at competitive prices. Approximately 95% of our total local access lines were DSL-capable as of December 31, 2011, and approximately 96% of these DSL-capable lines are capable of speeds of 6 mbps or greater. Metro-Ethernet, VOIP services, and other additional IP services leverage the extensive MPLS (Multi-Protocol Label Switching) core network, making it more efficient and scalable. Our existing network can support increased IPTV subscribers with limited additional network preparation thereby driving additional revenue growth.

Attractive markets

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The geographic areas we serve are characterized by a balanced mix of growing suburban areas and stable, rural territories.

Our Lufkin, Texas and central Illinois markets have experienced only nominal population growth over the past decade. As of December 31, 2011, 92,154, or 40.4%, of our local access lines were located in these markets. These low growth, low customer density markets, along with the predominantly rural residential character of these areas, have limited the number of, and product offerings, from potential competitors in these areas.

Our Conroe and Katy, Texas markets are suburbs of the Houston metropolitan area. As of December 31, 2011, 86,856, or 38.1%, of our local access lines were located in these markets. Conroe and Katy have experienced above-average population and business employment growth over the past decade as compared to the remainder of Texas and the United States as a whole.

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Our Pennsylvania ILEC operates in a territory that has experienced population growth as the suburban communities in its territory have been expanding (the southernmost point of this territory is only 12 miles from Pittsburgh). For similar reasons, the ILEC has benefited from growth in business activity and favorable market demographics. As of December 31, 2011, 48,982, or 21.5%, of our local access lines are located in our Pennsylvania ILEC territory.

Our Pennsylvania CLEC assets provide telecommunications and broadband services south of our ILEC territory to customers in the metropolitan Pittsburgh area, and to the north of the ILECs territory in the City of Butler and surrounding areas.

Broad product offerings and bundling of services

We are able to leverage our long-standing relationship with our customers by offering them a broad suite of telecommunications and information services that enables us to pursue increased revenue per access line by selling additional services through a bundling strategy, which includes our triple play offering of voice, DSL and IPTV services. Our consumer and enterprise customers have access to a broad array of competitively priced advanced television programming, data and voice service choices with a single point of contact. In addition to providing local and long-distance telephone service, customers can choose multiple speeds of DSL service and IPTV programming with over 230 all-digital channels, 60 high-definition (HD) offerings, video on demand programming and digital video recorder (DVR) services. We also offer custom calling services, carrier access services, VOIP service to residential and business customers and directory publishing.

By bundling our service offerings, we are able to offer and sell a more complete package of services, which we believe simultaneously increases our average revenue per user (ARPU) and adds value for the consumer. We also believe that bundling leads to increased customer loyalty and retention. As of December 31, 2011, we had 48,417 customers who subscribed to service bundles that included local service and a selection of other services including custom calling features, DSL and IPTV.

Experienced management team with proven track record

With an average of over 25 years of experience in both regulated and non-regulated telecommunications businesses, our management team has demonstrated that it can deliver profitable growth while providing high levels of customer satisfaction. Specifically, our management team has a proven track record of:

- Providing superior quality services to rural customers in a regulated environment;
- Implementing successful business acquisitions and integrations;
- Launching and growing new services, such as DSL and IPTV; and
- Managing CLEC and complementary businesses, such as transport, business systems and directory publishing.

Business Strategies

Increase revenues per customer

We continue to focus on increasing our revenue per customer, primarily by improving our DSL and IPTV market penetration, by increasing the sale of other value-added services and by encouraging customers to subscribe to our service bundles.

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We provide IPTV service in all of the markets we serve. We offer HD programming, video on demand and DVR service in all markets, which further increases our ARPU. As of December 31, 2011, over 98% of our video customers have subscribed to our double or triple play offerings. At December 31, 2011, we had 34,356 video subscribers and the capability of offering the service to over 212,000 households in our service territories.

Improve operating efficiency

Over the years, we have made significant operational improvements in our business which has resulted in significant cost savings and reductions in headcount. As an example, in 2011 we used the departure of one of our senior executives as the occasion to conduct a company-wide reorganization that extracted significant cost savings and created a dedicated carrier sales team. As a result, we achieved annual cost savings of \$2.3 million. We started to recognize these benefits in the second quarter. We have also centralized most of the business and back office operations from our acquisitions into one functional organization with common work groups, processes and systems thereby removing redundant costs. All of our ILEC businesses use a common billing system platform. We have consolidated most of our principal accounting functions to our Mattoon, Illinois corporate office. We also have consolidated all network operations into a single NOC. We have reduced the number of customer care centers from six to two. We now operate one residential customer care center in Texas and one business customer care center in Illinois. Because of these efficiencies, we are better able to deliver a consistent customer experience, service our customers in a more cost-effective manner and lower our cost structure. We have identified and continue to look for additional projects which will allow us to reduce our cost structure while launching new products and improving the customer experience.

Maintain capital expenditure discipline

Across all of our service territories, we have successfully managed capital expenditures to optimize returns through disciplined planning and targeted investment of capital. For example, specific investments in our IP core and access networks allow us to continue to have significant flexibility to expand our new service offerings, such as IPTV and Metro Ethernet services in a very cost-efficient manner while maintaining our reputation as a high-quality service provider.

Pursue selective acquisitions

We have in the past taken, and expect to continue to take in the future, a disciplined approach in pursuing the acquisition of access lines or operating companies. When we evaluate potential transactions, important considerations include whether or not:

- The market is attractive;
- The network is of appropriate quality;
- We can integrate the acquired company efficiently;
- There are significant potential operating synergies; and

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- The transaction is cash flow accretive from day one.

We believe all of the above criteria were met in connection with our agreement to acquire SureWest Communications announced on February 6, 2012. See Part I - Item 1- Business - General . We will initially be focused on integrating SureWest into our existing operations and continuing to deliver solid results and returns for shareholders. However, in the longer term, we believe that this

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transaction gives us additional scale and better positions us financially, strategically and competitively to pursue additional acquisitions.

Competition

Competition for telecommunications and information services is intense. Technological advances have expanded the types and uses of services and products available. In addition, the lack of or a reduced level of regulation applicable to comparable alternatives (e.g., cable, wireless and VOIP providers) has lowered costs for these alternative communications providers. As a result, we face heightened competition as well as some new opportunities in significant portions of our business. We expect competition to remain a significant factor affecting our operating results in 2012 and beyond. See Part I - Item 1A Risk Factors Risks Relating to Our Business The Telecommunications Industry is Constantly Changing and Competition is Intense .

Local telephone market

In general, telecommunications service in rural areas is more costly to provide than service in urban areas as a lower customer density necessitates higher capital expenditures on a per-customer basis. As a result, it generally is not economically viable for new entrants to overlap existing networks in rural territories.

Despite the barriers to entry, rural telephone companies face significant competition for voice services from wireless providers, cable providers and, to a lesser extent, competitive telephone companies. Cable providers have upgraded their networks with fiber optics and are able to provide fully interactive broadband voice, data and video communications. Competitive telephone companies have been granted permission by federal law and state regulators to offer local telephone service in areas already served by a local telephone company.

Industry participants are increasingly embracing VOIP service, which essentially involves the routing of voice calls, at least in part, over the Internet through packets of data instead of transmitting the calls over the telephone system. While current VOIP applications typically complete calls using ILEC infrastructure and networks, as VOIP services become more widespread and technology advances, more calls may be placed without using the telephone system. On March 10, 2004, the FCC issued a Notice of Proposed Rulemaking with respect to IP-enabled services. Among other things, the FCC is considering whether VOIP services are regulated telecommunications services or unregulated information services. As of December 31, 2011, this proceeding is still active; however the FCC has yet to issue a decision. We cannot predict the outcome of the FCC's rulemaking or how it will affect the revenues of our rural telephone companies. The proliferation of VOIP, particularly to the extent such communications do not utilize our networks, may reduce our customer base and cause us to lose access fees and other funding.

Mediacom, which serves portions of our Illinois territories, offers a VOIP service that competes with our basic voice services. NewWave Communications offers a competing voice product in the portions of our Illinois territory not served by Mediacom. In addition, both Suddenlink and Comcast, cable competitors in Texas, offer a competing voice product. In our Pennsylvania territory, each of the two incumbent cable providers, Armstrong and Comcast, offer a competitive VOIP service. All of these companies also compete with us for video and high speed Internet customers. In all markets, our competitors offer aggressive triple play packages of voice, video and Internet services. In general, cable companies have modern networks and the capacity to serve a substantial number of customers. We estimate that cable companies now cover 85% of our territory.

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Wireless service

Rural telephone companies have historically faced less wireless competition than non-rural providers of traditional wireline services because wireless networks in rural areas had generally been less developed. Our service areas in Conroe and Katy, Texas and in Pennsylvania are exceptions to this general rule because they are close to major metropolitan areas. As a result, we continue to see increasing competition from wireless service providers in these markets. We have experienced a decline in local access lines by customers choosing to eliminate their wireline service altogether in favor of a wireless provider. We believe that wireless substitution will continue to be a competitive threat in the years to come.

Internet service

The Internet services market is highly competitive and there are few barriers to entry. Internet services meaning wired and wireless Internet access and online content services are provided by cable providers, ISP s, long-distance carriers and satellite-based companies. Many of these companies provide direct access to the Internet and a variety of supporting services. In addition, many companies offer access to closed, proprietary information networks.

Cable providers have substantial transmission capabilities, can carry large amounts of data to large numbers of customers with increasing speeds and have a billing system infrastructure that permits them to add new services. Industry sources expect, and we agree, that competition for Internet services will continue to be very competitive.

Long-distance service

The long-distance telecommunications market is highly competitive and faces intense competition from cable and wireless providers who generally provide unlimited long-distance with their service packages. As a result, the number of minutes of long-distance traffic we handle has declined as our customers have relied on and increased their use of wireless and other unlimited long-distance service packages.

Other competition

Our other lines of business are subject to substantial competition from local, regional and national competitors. In particular, our directory publishing and transport businesses operate in competitive markets. We expect that competition in all of our businesses will continue to intensify as new technologies and new services are offered. Customers in these businesses can and do change vendors frequently. Long-term contracts are unusual, and those that do exist have cancellation clauses that allow quick termination. Where long-term contracts are in place, customers are renewing them for shorter terms.

Regulatory Environment

The following summary does not describe all existing and proposed legislation and regulations affecting the telecommunications industry. Regulation can change rapidly, and ongoing proceedings and hearings could alter the manner in which the telecommunications industry operates. We cannot predict the outcome of any of these developments, nor their potential impact on us. See Part I Item 1A Risk Factors Regulatory Risks .

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Overview

The telecommunications industry is subject to extensive federal, state and local regulation. Under the Telecommunications Act of 1996 (Telecommunications Act), federal and state regulators share responsibility for implementing and enforcing statutes and regulations designed to encourage competition and to preserve and advance widely available, quality telephone service at affordable prices.

At the federal level, the FCC generally exercises jurisdiction over facilities and services of local exchange carriers, such as our rural telephone companies, to the extent they are used to provide, originate, or terminate interstate or international communications. The FCC has the authority to condition, modify, cancel, terminate, or revoke our operating authority for failure to comply with applicable federal laws or FCC rules, regulations and policies. Fines or penalties also may be imposed for any of these violations.

State regulatory commissions, such as the ICC in Illinois, PAPUC in Pennsylvania, and the PUCT in Texas, generally exercise jurisdiction over carriers facilities and services to the extent they are used to provide, originate, or terminate intrastate communications. In particular, state regulatory agencies have substantial oversight over interconnection and network access by competitors of our rural telephone companies. In addition, municipalities and other local government agencies regulate the public rights-of-way necessary to install and operate networks. State regulators can sanction our rural telephone companies or revoke our certifications if we violate relevant laws or regulations.

Federal regulation

Our rural telephone companies and competitive local exchange companies must comply with the Communications Act of 1934, which requires, among other things, that telecommunications carriers offer services at just and reasonable rates and on non-discriminatory terms and conditions. The 1996 amendments to the Communications Act (contained in the Telecommunications Act discussed below) dramatically changed, and likely will continue to change, the landscape of the industry.

Removal of entry barriers

The central aim of the Telecommunications Act is to open local telecommunications markets to competition while enhancing universal service. Before the Telecommunications Act was enacted, many states limited the services that could be offered by a company competing with an incumbent telephone company. The Telecommunications Act preempts these state and local laws.

The Telecommunications Act imposes a number of interconnection and other requirements on all local communications providers. All telecommunications carriers have a duty to interconnect directly or indirectly with the facilities and equipment of other telecommunications carriers. Local exchange carriers, including our rural telephone companies, are required to:

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- Allow other carriers to resell their services;
- Provide number portability where feasible;
- Ensure dialing parity, meaning that consumers can choose their default local or long-distance telephone company without having to dial additional digits;
- Ensure that competitors' customers receive non-discriminatory access to telephone numbers, operator service, directory assistance and directory listings;
- Afford competitors access to telephone poles, ducts, conduits, and rights-of-way; and
- Establish reciprocal compensation arrangements with other carriers for the transport and termination of telecommunications traffic.

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Furthermore, the Telecommunications Act imposes on incumbent telephone companies (other than rural telephone companies that maintain their so-called rural exemption as our subsidiaries do) additional obligations to:

- Negotiate interconnection agreements with other carriers in good faith;
- Interconnect their facilities and equipment with any requesting telecommunications carrier, at any technically feasible point, at non-discriminatory rates and on non-discriminatory terms and conditions;
- Offer their retail services to other carriers for resale at discounted wholesale rates;
- Provide reasonable notice of changes in the information necessary for transmission and routing of services over the incumbent telephone company's facilities or in the information necessary for interoperability; and
- Provide, at rates, terms, and conditions that are just, reasonable, and non-discriminatory, for the physical collocation of other carriers equipment necessary for interconnection or access to UNEs at the premises of the incumbent telephone company.

Access charges

On November 18, 2011 the FCC released its comprehensive order on intercarrier compensation and universal service reform. See Part I - Item 1- Business Regulatory Environment FCC Access Charge and Universal Service Reform Order .

A significant portion of our rural telephone companies' revenues come from network access charges paid by long-distance and other carriers for using our companies' local telephone facilities for originating or terminating calls within our service areas. The amount of network access revenues our rural telephone companies receive is based on rates set or approved by federal and state regulatory commissions, and these rates are subject to change at any time.

Intrastate network access charges are regulated by state commissions. Network access charges in our Illinois market currently mirror interstate charges for everything but local switching. Illinois law requires that our intrastate access charges may not exceed our interstate access charges established by the ICC. Interstate and intrastate network access charges in our Pennsylvania market also are very similar. In contrast, as required by Texas regulators, our Texas rural telephone companies impose significantly higher network access charges for intrastate calls than for interstate calls.

The FCC regulates the prices we may charge for the use of our local telephone facilities to originate or terminate interstate and international calls. The FCC has structured these prices as a combination of flat monthly charges paid by customers and both usage-sensitive (per-minute) charges and flat monthly charges paid by long-distance or other carriers.

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The FCC regulates interstate network access charges by imposing price caps on Regional Bell Operating Companies, referred to as RBOCs, and other large incumbent telephone companies. These price caps can be adjusted based on various formulas, such as inflation and productivity, and otherwise through regulatory proceedings. Incumbent telephone companies, such as our local telephone companies, may elect to base network access charges on price caps, but are not required to do so.

Historically, all of our rural telephone companies had elected not to apply federal price caps. Instead, they employed a rate-of-return regulation for their network interstate access charges, whereby they earned a fixed return on their investment over and above operating costs. In December 2007, we

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filed a petition with the FCC seeking to permit our Illinois and Texas companies to convert to price cap regulation. Our petition was approved on May 6, 2008, and became effective on July 1, 2008. This conversion gives us greater pricing flexibility for interstate services, especially the increasingly competitive special access segment. It also provides us with the potential to increase our net earnings by becoming more productive and introducing new services. On the other hand, we were required to reduce our interstate access charges in Illinois significantly, and because our Illinois intrastate access charges generally mirror interstate rates, this conversion also resulted in lower intrastate revenues in Illinois. In addition, we now receive somewhat reduced subsidies from the interstate Universal Service Fund program.

Our Pennsylvania rural telephone company is an average schedule rate-of-return company, which means its interstate access revenues are based upon a statistical formula developed by the National Exchange Carrier Association (NECA) and approved by the FCC, rather than upon its actual costs. In its 2006 and 2007 annual revisions of the average schedule formulas, NECA proposed and the FCC approved structural changes that were fully phased-in during 2008, reducing our Pennsylvania rural telephone company's annual interstate revenues by approximately \$3.7 million compared to periods prior to the phase-in of the structural changes. The NECA and the FCC may make further changes to the formulas in future years, which could have an additional impact on our revenues. Our Pennsylvania rural telephone company has the option to become a cost company, meaning its rates would be subject to its own individual cost and demand data studies, but this option would be irrevocable if exercised. We cannot predict whether or when it would be advantageous to make this conversion.

Traditionally, regulators have allowed network access rates for rural areas to be set higher than the actual cost of terminating or originating long-distance calls as an implicit means of subsidizing the high cost of providing local service in rural areas. Following a series of federal court decisions ruling that subsidies must be explicit rather than implicit, the FCC adopted reforms in 2001 that reduced per-minute network access charges and shifted a portion of cost recovery, which historically was imposed on long-distance carriers, to flat-rate, monthly subscriber line charges imposed on end-user customers. While the FCC also increased explicit subsidies to rural telephone companies through the Universal Service Fund, the aggregate amount of interstate network access charges paid by long-distance carriers to access providers, such as our rural telephone companies, has decreased and may continue to decrease.

Unlike the federal system, Illinois does not provide an explicit subsidy in the form of a universal service fund. Therefore, while subsidies from the Federal Universal Service Fund offset the decrease in revenues resulting from the reduction in interstate network access rates in Illinois, there was no corresponding offset for the decrease in revenues from the reduction in intrastate network access rates. In Pennsylvania and Texas, the intrastate network access rate regime applicable to our rural telephone companies does not mirror the FCC regime, so the impact of the reforms was revenue neutral.

In recent years, carriers have become more aggressive in disputing the FCC's interstate access charge rates and the application of access charges to their telecommunications traffic. We believe these disputes have increased in part because advances in technology have made it more difficult to determine the identity and jurisdiction of traffic, giving carriers an increased opportunity to challenge access costs for their traffic. For example, in September 2003, Vonage Holdings Corporation filed a petition with the FCC to preempt an order of the Minnesota Public Utilities Commission asserting jurisdiction over Vonage. The FCC determined that it was impossible to divide Vonage's VOIP service into interstate and intrastate components without negating federal rules and policies. Accordingly, the FCC found it was an interstate service not subject to traditional state telephone regulation. While the FCC order did not specifically address whether intrastate access charges were applicable to Vonage's VOIP service, the fact that the service was found to be solely interstate raises that concern. We cannot predict what other actions other long-distance carriers may take before the FCC or with their local exchange carriers,

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including our rural telephone companies, to challenge the applicability of access charges. Due to the increasing deployment of VOIP services and other technological changes, we believe these types of disputes and claims are likely to increase.

Unbundled network element rules

The unbundling requirements have been some of the most controversial provisions of the Telecommunications Act. In its initial implementation of the law, the FCC generally required incumbent telephone companies to lease a wide range of UNE s to CLECs. Those rules were designed to enable competitors to deliver services to their customers in combination with their existing networks or as recombined service offerings on an unbundled network element platform, commonly known as UNE-P, which allowed competitors with no facilities of their own to purchase all the elements of local telephone service from the incumbent and resell them to customers. These unbundling requirements, and the duty to offer UNEs to competitors, imposed substantial costs on the incumbent telephone companies and made it easier for customers to shift their business to other carriers. After a court challenge and a decision vacating portions of the UNE rules, the FCC issued revised rules in February 2005 that reinstated some unbundling requirements for incumbent telephone companies that are not protected by the rural exemption, but eliminated the UNE-P option and certain other unbundling requirements.

Each of the subsidiaries through which we operate our local telephone businesses is an incumbent telephone company and provides service in rural areas. As discussed above, the Telecommunications Act exempts rural telephone companies from certain of the more burdensome interconnection requirements. However, the Telecommunications Act provides that the rural exemption will cease to apply as to competing cable companies if and when the rural carrier introduces video services in a service area. In that event, a competing cable operator providing video programming and seeking to provide telecommunications services in the area may interconnect. Since each of our subsidiaries now provides video services in their major service areas, the rural exemption no longer applies to cable company competitors in those service areas. Additionally, in Texas, the PUCT has removed the rural exemption for our Texas subsidiaries with respect to telecommunications services furnished by Sprint Communications, L.P. on behalf of cable companies. We believe the benefits of providing video services outweigh the loss of the rural exemptions to cable operators.

Under its current rules, the FCC has eliminated unbundling requirements for ILECs providing broadband services over fiber facilities, but continues to require unbundled access to mass-market narrowband loops. ILECs are no longer required to unbundle packet switching services. In addition, the FCC found that CLECs generally are not at a disadvantage at certain wire center locations in regard to high bandwidth (DS-1 and DS-3) loops, dark fiber loops and dedicated interoffice transport facilities. However, where a disadvantage persists, ILECs continue to be required to unbundle loops and transport facilities.

The FCC rules regarding the unbundling of network elements did not have an impact on our Illinois and Pennsylvania ILEC operations because these ILECs have rural exemptions. Our Pennsylvania CLEC operations were not significantly affected by the 2005 changes to the UNE rules because they use their own switching for business customers that are served by high capacity loops. In July 2011, our Pennsylvania CLEC renewed, for a three-year term, a commercial agreement with Verizon that sets the terms of the pricing and provisioning of lines previously served utilizing UNE-P, including Verizon switching service. Less than 5% of our Pennsylvania CLEC access lines are provisioned utilizing this commercial arrangement. Although the costs for this arrangement will increase over time pursuant to the terms of the agreement, our relatively low use of Verizon s switching and our ability to migrate some of the lines to alternative provisioning sources will limit the overall impact on our current cost structure. The CLEC has experienced moderate increases in the overall cost to provision high-

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capacity loops, interoffice transport facilities and dark fiber as a result of the FCC's changes to unbundling requirements for those facilities.

In 2006, Verizon filed a petition requesting that the FCC refrain from applying a number of regulations to the Verizon operations in six major metropolitan markets, including the Pittsburgh market area. Among other things, Verizon urged the FCC to forbear from applying loop and transport unbundling regulations, claiming there was sufficient competition in the Pittsburgh market to mitigate the need for these rules. The FCC denied Verizon's petition in December 2007, but a federal court of appeals remanded this decision to the FCC for further analysis in 2009. If the FCC grants this remanded petition or any similar forbearance petitions in markets in which our CLEC operates, our cost to obtain access to loop and transport facilities would increase substantially for the 5%, or less, of the lines provisioned under the commercial agreement discussed above.

Promotion of universal service

In general, telecommunications service in rural areas is more costly to provide than service in urban areas. The lower customer density means that switching and other facilities serve fewer customers and loops are typically longer, requiring greater expenditures per customer to build and maintain. By supporting the high cost of operations in rural markets, Federal Universal Service Fund subsidies promote widely available, quality telephone service at affordable prices in rural areas. In 2011, we received \$45.4 million in aggregate payments from the Federal Universal Service Fund, the Pennsylvania Universal Service Fund and the Texas Universal Service Fund. In 2010, we received \$48.7 million from the Federal Universal Service Fund, the Pennsylvania Universal Service Fund and the Texas Universal Service Fund.

Federal Universal Service Fund subsidies are paid only to carriers that are designated eligible telecommunications carriers, or ETCs, by a state commission. Each of our rural telephone companies have been designated an ETC. However, under FCC rules prior to 2008, competitors could obtain the same level of Federal Universal Service Fund subsidies as we do, per line served, if the applicable state regulator determined that granting such Federal Universal Service Fund subsidies to competitors would be in the public interest and the competitors offered and advertised certain services as required by the Telecommunications Act and the FCC. The ICC has granted several petitions for ETC designations, but to date no other ETCs are operating in our Illinois service area. We are not aware that any carriers have filed petitions to be designated an ETC in our Pennsylvania or Texas service areas. In May 2008, the FCC adopted an interim cap on payments to ETCs that are not incumbent telephone companies, based on the payments received by such companies in March 2008, which reduces (but does not eliminate) the incentive for ETCs to seek to compete against our rural telephone companies.

FCC Access Charge and Universal Service Reform Order

On November 18, 2011 the FCC released its comprehensive order on Access Charge and Universal Service Reform. The access charge portion of the order systematically reduces minute of use based interstate access, intrastate access and reciprocal compensation rates over a six to nine year period to an end state of Bill and Keep, in which each carrier recovers the costs of its network through charges to its own subscribers, not through intercarrier compensation. The reductions apply to terminating access rates and usage, while originating access will be addressed by the FCC in a later proceeding. To help with the transition to Bill and Keep, the FCC created two mechanisms. The first is an Access Recovery Mechanism (ARM) which is funded from the Connect America Fund, and the second is an Access Recovery Charge (ARC) which is recovered from the end users. The universal service portion of the order shifts the national policy goal from voice service to broadband and is now called the Connect America Fund (CAF). In order to receive CAF funding, carriers must agree to provide broadband capability to 100% of their customer base at a minimum speed of 4 Mbps downstream and 1Mbps

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upstream. The current high cost funding program is frozen at 2011 levels and will be eliminated upon development and implementation of a CAF census block model.

The order has already been appealed by state commissions and carriers including Consolidated. We filed our petition for review on January 18, 2012 and raised issues with the order pertaining to access rates, universal service and transition provisions. In addition, several other carriers and associations have filed petitions for reconsideration at the FCC. The timeframe and results of these appeals and petitions for reconsideration are not known at this time.

In the FCC order, holding companies with price cap study areas and rate of return study areas are mandated to move all their interstate rate of return study areas to price cap for universal service purposes only. The intercarrier compensation rules will keep rate of return study areas under the rate of return ICC transitions plan and the price cap study areas under the price cap ICC transition.

State regulation of CCI Illinois

Our Illinois Telephone Operations long-distance and payphone services subsidiary holds the necessary certifications in Illinois (and the other states in which it operates). This subsidiary is required to file tariffs with the ICC, but generally can change the prices, terms, and conditions stated in its tariffs on one day's notice, with prior notice of price increases to affected customers. Our Illinois Telephone Operations other services are not subject to any significant state regulations in Illinois, and our Other Illinois Operations are not subject to any significant state regulation outside of any specific contractually imposed obligations.

Our Illinois rural telephone company is certified by the ICC to provide local telephone services. This entity operates as a distinct company from a regulatory standpoint and is regulated under a rate of return system for intrastate revenues. Although, as explained above, the FCC has preempted certain state regulations pursuant to the Telecommunications Act, Illinois retains the authority to impose requirements on our Illinois rural telephone company to preserve universal service, protect public safety and welfare, ensure quality of service and protect consumers. For instance, our Illinois rural telephone company must file tariffs setting forth the terms, conditions, and prices for its intrastate services; these tariffs may be challenged by third parties. Our Illinois rural telephone company has not had a general rate proceeding before the ICC since 1983.

The ICC has broad authority to impose service quality and service offering requirements on our Illinois rural telephone company, including credit and collection policies and practices, and can require our Illinois rural telephone company to take actions to ensure that it meets its statutory obligation to provide reliable local exchange service. For example, as part of its approval of the reorganization we implemented in connection with our 2005 initial public offering, the ICC imposed various conditions, including (1) prohibitions on payment of dividends or other cash transfers from ICTC to us if ICTC fails to meet or exceed agreed benchmarks for a majority of seven service quality metrics, and (2) the requirement that ICTC have access to \$5.0 million or its currently approved capital expenditure budget (whichever is higher) for each calendar year through a combination of available cash and credit facilities. During 2011, we satisfied each of the applicable Illinois regulatory requirements necessary to permit ICTC to pay dividends to us.

The Illinois General Assembly has made major revisions and added significant new provisions to the portions of the Illinois Public Utilities Act governing the regulation and obligations of telecommunications carriers on a number of occasions since 1985. In 2007, the Illinois legislature

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addressed competition for cable and video services and authorized statewide licensing by the ICC to replace the existing system of individual town franchises. This legislation also imposed substantial state-

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mandated consumer service and consumer protection requirements on providers of cable and video services. The requirements generally became applicable to us on January 1, 2008, and we are operating in compliance with the new law. Although we have franchise agreements for cable and video services in all the towns we serve, this statewide franchising authority will simplify the process in the future. In 2010, the Illinois General Assembly passed Public Act 96-0927, which updates the telecommunications statute, allowing ILECs, beginning January 1, 2011, to elect deregulation of local services. To date, ICTC has not made an election to deregulate its local services. Under this option, an ILECs rates for local services would become competitive and no longer subject to rate of return regulation, and certain other service quality obligations would be reduced. The electing ILECs would have obligations to make certain basic local exchange service packages available to customers. Public Act 96-0927 also specified that local exchange carriers may not charge intrastate access rates at levels higher than their interstate access rates. The Governor of Illinois signed the bill into law on June 15, 2010. The Illinois telecommunications statute is scheduled to sunset in 2013. In the past, such sunset dates in telecommunication legislation have led to further amendments to reflect changing industry technological and competitive conditions.

State regulation of CCI Texas

Our Texas rural telephone companies are each certified by the PUCT to provide local telephone services in their respective territories. In addition, our Texas long-distance and transport subsidiaries are registered with the PUCT as interexchange carriers. The transport subsidiary also has obtained a service provider certificate of operating authority (SPCOA) to better assist the transport subsidiary with its operations in municipal areas. Recently, to assist with expanding services offerings, Consolidated Communications Enterprise Services, Inc. also obtained a SPCOA from the PUCT. While our Texas rural telephone company services are extensively regulated, our other services, such as long-distance and transport services, are not subject to any significant state regulation.

Our Texas rural telephone companies operate as distinct companies from a regulatory standpoint. Each is separately regulated by the PUCT in order to preserve universal service, protect public safety and welfare, ensure quality of service and protect consumers. Each Texas rural telephone company must file and maintain tariffs setting forth the terms, conditions and prices for its intrastate services.

Currently, both of our Texas rural telephone companies have immunity from adjustments to their rates, including their intrastate network access rates, because they elected incentive regulation under the Texas Public Utilities Regulatory Act, or PURA. In order to qualify for incentive regulation, our rural telephone companies agreed to fulfill certain infrastructure requirements. In exchange, they are not subject to challenge by the PUCT regarding their rates, overall revenues, return on invested capital, or net income.

PURA prescribes two different forms of incentive regulation in Chapter 58 and Chapter 59. Under either election, the rates, including network access rates, an incumbent telephone company may charge for basic local services generally cannot be increased from the amount(s) on the date of election without PUCT approval. Even with PUCT approval, increases can only occur in very specific situations. Pricing flexibility under Chapter 59 is extremely limited. In contrast, Chapter 58 allows greater pricing flexibility on non-basic network services, customer-specific contracts and new services.

Initially, both of our Texas rural telephone companies elected incentive regulation under Chapter 59 and fulfilled the applicable infrastructure requirements, but they changed their election status to Chapter 58 in 2003, which gives them some pricing flexibility for basic services, subject to PUCT approval. The PUCT could impose additional infrastructure requirements or other restrictions in the future. Any requirements or restrictions could limit the amount of cash that is available to be transferred

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from our rural telephone companies to the parent entities, and could adversely affect our ability to meet our debt service requirements and repayment obligations.

In September 2005, the Texas legislature adopted significant additional telecommunications legislation. Among other things, this legislation created a statewide video franchise for telecommunications carriers, established a framework to deregulate the retail telecommunications services offered by incumbent local telecommunications carriers, imposed concurrent requirements to reduce intrastate access charges and directed the PUCT to initiate a study of the Texas Universal Service Fund. The PUCT study submitted to the legislature in 2007 recommended that the Small Company Area High-Cost Program, which covers our Texas telephone companies, should be reviewed by the PUCT from a policy perspective regarding basic local telephone service rates and lines eligible for support. The PUCT has only addressed the large company fund and has no immediate plans to conduct a small company review.

Texas universal service

The Texas Universal Service Fund is administered by NECA. PURA, the governing law, directs the PUCT to adopt and enforce rules requiring local exchange carriers to contribute to a state universal service fund that helps telecommunications providers offer basic local telecommunications service at reasonable rates in high cost rural areas. The Texas Universal Service Fund is also used to reimburse telecommunications providers for revenues lost by providing Tel-Assistance and to reimburse carriers for providing lifeline service. Our Texas rural telephone companies receive disbursements from this fund.

In 2011, the Texas legislature passed Senate Bill 985 which requires the PUCT to review the large and small company Texas Universal Service Funds in 2012 and report back to the legislature by January 2013. The PUCT began the large company fund proceeding in January 2012 and has announced that it will begin the small company fund proceeding in March 2012. We expect that the impact of these proceedings, if any, would occur in 2013.

State regulation of CCI Pennsylvania

The PAPUC regulates the rates, the system of financial accounts for reporting purposes, and certain aspects of service quality, billing procedures and universal service funding, among other things, related to our rural telephone company and CLEC's provision of intrastate services. In addition, the PAPUC sets the rates and terms for interconnection between carriers within the guidelines ordered by the FCC.

Price regulation in Pennsylvania

Pennsylvania intrastate rates are regulated under a statutory framework referred to as Act 183. Under this statute, rates for non-competitive intrastate services are allowed to increase based on an index that measures economy-wide price increases. In return, we committed to continue to upgrade our network to ensure that all our customers would have access to broadband services, and to deploy a ubiquitous broadband (defined as 1.544 mbps) network throughout our entire service area by December 31, 2008, which we did.

Pennsylvania universal service and access charges

On September 30, 1999, as part of a proceeding that resolved a number of pending issues, the PAPUC ordered ILECs, including our Pennsylvania property, to rebalance and reduce intrastate toll and switched access rates. In that same order, the PAPUC also created a Pennsylvania Universal Service

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Fund (PAUSF) to help offset the resulting loss of ILEC revenues. In 2003, the PAPUC ordered ILECs to further rebalance and reduce intrastate access charges and left the PAUSF in place pending further review. In 2008, our Pennsylvania ILECs annual receipts from and contributions to the PAUSF total \$5.2 million and \$0.3 million, respectively. Our Pennsylvania CLEC receives no funding from the PAUSF but currently contributes \$0.2 million annually. Since Act 183 was adopted in 2004, the PAPUC may not require a local exchange carrier to reduce intrastate access rates except on a revenue neutral basis.

In 2011, the PAPUC issued an intrastate access reform order reducing intrastate access rates to interstate levels over a three step process beginning in March 2012. With the release of the FCC order in October, 2011 the PAPUC has temporarily issued a stay and will address in the first quarter of 2012 whether it will permanently stay the order, modify the implementation to coincide with the FCC order or implement as originally ordered. The PAPUC will address state universal funding in 2012 pending the implementation of its access reform order.

Local government authorizations

In Illinois, we historically have been required to obtain franchises from each incorporated municipality in which our rural telephone company operates. An Illinois state statute prescribes the fees that a municipality may impose for the privilege of originating and terminating messages and placing facilities within the municipality. Our Illinois Telephone Operations may also be required to obtain permits for street opening and construction, or for operating franchises to install and expand fiber optic facilities. These permits or other licenses or agreements typically require the payment of fees.

Similarly, Texas incumbent telephone companies had historically been required to obtain franchises from each incorporated municipality in which they operated. Texas law now provides that incumbent telephone companies do not need to obtain franchises or other licenses to use municipal rights-of-way for delivering services. Instead, payments to municipalities for rights-of-way are administered through the PUCT and through a reporting process by each telecommunications provider. Incumbent telephone companies are still required to obtain permits from municipal authorities for street opening and construction, but most burdens of obtaining municipal authorizations for access to rights-of-way have been streamlined or removed.

Our Texas rural telephone companies still operate pursuant to the terms of municipal franchise agreements in some territories served by Consolidated Communications of Fort Bend Company. As the franchises expire, they are not being renewed.

Like Illinois, Pennsylvania operates under a structure in which each municipality may impose various fees.

Broadband and Internet regulatory obligations

To date, the FCC has treated ISPs as enhanced service providers rather than common carriers. As a result, ISPs are exempt from most federal and state regulation, including the requirement to pay access charges or contribute to the Federal Universal Service Fund. Currently, there is a relatively limited body of law and regulation that governs access to, or commerce on, the Internet, including such matters as protection of children from exposure to indecent content, and protection of private consumer data. As Internet usage increases, government at all levels may

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adopt new rules and regulations or apply existing laws and regulations to the Internet. The FCC is reviewing the appropriate regulatory framework governing high speed access to the Internet through telephone and cable providers' communications networks. We cannot predict the outcome of these proceedings, and they may affect our regulatory obligations and the form of competition for these services.

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In 2005, the FCC adopted a comprehensive regulatory framework for facilities-based providers of wireline broadband Internet access service after determining that such service is an information service. This decision places the federal regulatory treatment of DSL service in parity with the federal regulatory treatment of cable modem service. Facilities-based wireline carriers are permitted to offer broadband Internet access transmission arrangements for wireline broadband Internet access services on a common carrier basis or a non-common carrier basis. Revenues from wireline non-common carrier broadband Internet access service are not subject to assessment for the Federal Universal Service Fund.

VOIP can be used to carry voice communications over a broadband Internet connection. The FCC has ruled that some VOIP arrangements are not subject to regulation as telephone services. In particular, in 2004, the FCC ruled that certain VOIP services are jurisdictionally interstate, which means that states cannot regulate those applications or the service providers. A number of state regulators filed judicial challenges to that decision. Expanded use of VOIP technology could reduce the access revenues received by local exchange carriers like our ILECs and our CLEC. We cannot predict whether or when VOIP providers may be required to pay or be entitled to receive access charges, the extent to which users will substitute VOIP calls for traditional wireline communications, or the impact of the growth of VOIP on our revenues.

Video service over broadband is lightly regulated by the FCC and states. Such regulation is limited to company registration, broadcast signal call sign management, fee collection, service and billing requirements and administrative matters such as Equal Employment Opportunity reporting. IPTV rates are not regulated.

American Recovery and Reinvestment Act of 2009

The American Recovery and Reinvestment Act of 2009 (ARRA) allowed for two major telecommunications activities to occur. The first is to create \$4 billion in grants and loans to help build broadband infrastructure. This program will be administered by the Department of Agriculture's Rural Utilities Service (RUS) and the Commerce Department's National Telecommunications and Information Administration (NTIA). The second is to have the FCC develop a national broadband plan.

Broadband Stimulus (ARRA)

The ARRA program administered by NTIA is primarily a grant program, and the ARRA program administered by RUS is a grant and loan program. Both have specific target areas and directives and were required by Congress to complete the application and funding process by September 2010. Rounds one and two of these programs have been completed. Consolidated reviewed both program opportunities for rounds one and two and determined that neither made economic sense to pursue at this time. The outcomes of both rounds one and two resulted in very few applicants receiving money and those that did cover very little of our geographic areas.

National Broadband Plan

On April 8, 2009, the FCC began the process of developing a national broadband plan that will seek to ensure that every American has access to broadband capability. ARRA requires the plan to address four major areas of broadband deployment and use: (1) broadband access to all Americans effectively and efficiently, (2) affordability and utilization, (3) status of deployment and (4) broadband advancement on civic and

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public services. The plan, which was released on March 16, 2010, proposed changes to a number of FCC policies and regulations in an effort to promote these goals. The FCC issued

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the first of many notices of proposed rulemakings on the plan on February 8, 2011, addressing universal service, intercarrier compensation, VOIP calling and phantom traffic. On November 18, 2011 the FCC released its comprehensive order on intercarrier compensation and universal service reform. See Part I - Item 1- Business Regulatory Environment FCC Access Charge and Universal Service Reform Order .

Item 1A. Risk Factors

Our business is subject to certain risk factors that could have a material adverse effect our business, financial condition or results of operations in future periods. The risks described below are not the only risks our Company faces. Additional risks not presently known to us or that we currently consider immaterial may also materially adversely affect our business, financial condition, or results of operations in future periods.

Risks Relating to Current Economic Conditions

Unfavorable changes in financial markets could adversely affect pension plan investments resulting in material funding requirements to meet our pension obligations.

Our pension plans have investments in marketable securities, including marketable debt and equity securities, whose values are exposed to changes in the financial markets. We expect that we will continue to make future cash contributions to the plans, the amount and timing of which will depend on various factors including the finalization of funding regulations, future investment performance, changes in future discount rates and changes in demographics of the population participating in the Company's qualified pension plan. Returns generated on plan assets have historically funded a large portion of the benefits paid under these plans. Sustained returns below the estimated long-term rate of return could significantly increase our contribution requirements, which could adversely affect cash flows from operations.

Weak economic conditions in our service areas could cause us to lose subscriber connections and revenues.

Substantially all of our customers and operations are located in Illinois, Pennsylvania and Texas. Our customer base is small and geographically concentrated, particularly for residential customers. Because of our geographic focus, the successful operation and growth of our business depends primarily on economic conditions in the service areas of our rural telephone companies. The economies of these areas, in turn, are dependent upon many factors, including:

- Demographic trends;
- In Illinois, the strength of the agricultural markets and the light manufacturing and services industries, continued demand from universities and hospitals, and the level of government spending;
- In Pennsylvania, the strength of small- to medium-sized businesses, healthcare and education spending; and

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- In Texas, the strength of the manufacturing, healthcare, waste management, and retail industries and continued demand from schools and hospitals.

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Downturns in the economic conditions in the markets we serve could cause our existing customers to reduce their purchases of our services and make it difficult for us to obtain new customers which could negatively impact local access lines and revenues.

Risks Relating to Dividends

This section discusses reasons why we may be unable to pay dividends at our historic levels, or at all.

Our Board of Directors could, in its discretion, depart from or change our dividend policy at any time.

We are not required to pay dividends and our stockholders do not have contractual or other rights to receive them. Our Board of Directors may decide at any time, in its discretion, to decrease the amount of dividends, change or revoke the dividend policy, or discontinue paying dividends entirely. If we do not pay dividends, for whatever reason, shares of our common stock could become less liquid and the market price of our common stock could decline.

Our ability to pay dividends, and our Board of Directors' determination to maintain our dividend policy, will depend on numerous factors, including:

- The state of our business, the environment in which we operate, and the various risks we face, including competition, technological change, changes in our industry, and regulatory and other risks summarized in this Annual Report on Form 10-K;
- Changes in the factors, assumptions, and other considerations made by our Board of Directors in reviewing and adopting the dividend policy, as described under "Dividend Policy and Restrictions" in Part II - Item 5 of this Annual Report;
- Our results of operations, financial condition, liquidity needs and capital resources;
- Our expected cash needs, including for interest and any future principal payments on indebtedness, capital expenditures, taxes, and pension and other postretirement contributions; and
- Potential sources of liquidity, including borrowing under our revolving credit facility or possible asset sales.

We might not have sufficient cash to maintain current dividend levels.

While our estimated cash available to pay dividends for the year ended December 31, 2011 was sufficient to pay dividends in accordance with our dividend policy, if our future estimated cash available were to fall below our expectations, or if our assumptions as to estimated cash needs prove incorrect, we may need to:

- Reduce or eliminate dividends;
- Fund dividends by incurring additional debt (to the extent we are permitted to do so under the agreements governing our then-existing debt), which would increase our leverage, debt repayment obligations, and interest expense, decrease our interest coverage, and reduce our capacity to incur debt for other purposes, including to fund future dividend payments;
- Amend the terms of our credit agreement, if our lenders agree, to permit us to pay dividends or make other payments the agreement would otherwise restrict;
- Fund dividends by issuing equity securities, which could be dilutive to our stockholders and negatively affect the price of our common stock;

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- Fund dividends from other sources, such as by asset sales or working capital, which would leave us with less cash available for other purposes; and
- Reduce other expected uses of cash, such as capital expenditures.

Over time, our capital and other cash needs will invariably be subject to uncertainties, which could affect whether we pay dividends and at what level. In addition, if we seek to raise additional cash by incurring debt or issuing equity securities, we cannot assure that such financing will be available on reasonable terms or at all. Each of the possibilities listed above could negatively affect our results of operations, financial condition, liquidity and ability to maintain and expand our business.

Because we are a holding company with no operations, we can only pay dividends if our subsidiaries transfer funds to us.

As a holding company, we have no direct operations, and our principal assets are the equity interests we hold in our subsidiaries. However, our subsidiaries are legally distinct and have no obligation to transfer funds to us. As a result, we are dependent on our subsidiaries' results of operations, existing and future debt agreements, governing state law and regulatory requirements, and the ability to transfer funds to us to meet our obligations and to pay dividends.

Restrictions in our debt agreements or applicable state legal and regulatory requirements may prevent us from paying dividends.

Our ability to pay dividends will be restricted by current and future agreements governing our debt, including our credit agreement, as well as the corporate law and regulatory requirements in several states.

Based on the results of operations from October 1, 2005, through December 31, 2011, we would have been able to pay a dividend of \$183.4 million under the restricted payment covenants in our credit agreement. After giving effect to the dividend of \$11.6 million, which was declared in November 2011 and paid in February 2012, we could pay a dividend of \$171.8 million under the credit facility.

Under Delaware law, our Board of Directors may not authorize a dividend unless it is paid out of our surplus (calculated in accordance with the Delaware General Corporation law), or, if we do not have a surplus, it is paid out of our net profits for the fiscal year in which the dividend is declared and the preceding fiscal year. Statutes governing Illinois and Pennsylvania corporations impose similar limitations on the ability of our subsidiaries that are incorporated in those states to declare and pay dividends.

State regulators could require our rural telephone companies to make capital expenditures and could limit the amount of cash those entities may lawfully transfer to us. For example, the ICC imposed various conditions on its approval of the reorganization consummated in connection with our initial public offering. Those conditions prohibit our subsidiary, ICTC, from paying dividends or making other cash transfers to us if ICTC failed to meet or exceed agreed-upon benchmarks for a majority of seven service quality metrics for the prior reporting year. In addition, ICTC must have access to the higher of \$5.0 million or its currently approved capital expenditure budget for each calendar year through a combination

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of available cash and amounts available under credit facilities. In addition, the Illinois Public Utilities Act prohibits ICTC from paying dividends, except out of earnings and earned surplus, if ICTC's capital is or would become impaired by the payment, or if payment of the dividend would impair ICTC's ability to render reasonable and adequate service at reasonable rates, unless the ICC otherwise finds that the public interest requires payment of the dividend, subject to any conditions that regulator may impose.

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The PAPUC has placed debt and transaction cost recovery restrictions for a three-year period that could have an impact to the payment of dividends.

If our goodwill or other intangible assets become impaired, we may be required to record a significant charge to earnings.

We carry significant amounts of goodwill and other intangible assets on our books as a result of previous acquisitions. Under U.S. Generally Accepted Accounting Principles (GAAP), we review our goodwill and other intangible assets for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. Goodwill and other intangible assets are required to be tested for impairment at least annually. Factors that may be considered a change in circumstances indicating that the carrying value of our goodwill or other intangible assets that have infinite useful lives may not be recoverable include a decline in stock price and market capitalization, future cash flows and slower or declining growth rates. We may be required to record a significant charge to earnings in our financial statements during the period in which any impairment of our goodwill or other intangible assets is determined, resulting in an impact to our results of operations and stockholders' equity.

Our estimated tax payments related to our federal income tax liability will likely increase in 2012 and remain higher in the future as we have utilized the majority of our federal net operating losses and may not be allowed bonus depreciation in future years, which may reduce the amount of cash available to pay dividends.

Under the Internal Revenue Code (IRC), a corporation that incurs losses in excess of taxable income (known as a net operating loss, or NOL) generally may carry the loss back or forward and use it to offset taxable income in a different period. We have utilized the majority of our federal net operating losses (net of valuation allowances) and the \$2.7 million balance that we have remaining is restricted by IRC to a utilization of \$0.2 million a year through 2024. Since the majority of our NOLs have been used or have expired, we will be required to pay additional cash income taxes. Also, tax laws effect the cash payments for income taxes. The Internal Revenue Service has elected to allow accelerated or bonus depreciation of 100% in 2010 and 2011 and 50% bonus depreciation in 2012. With the reduction of bonus depreciation in 2012 and elimination of any bonus depreciation in future years we will be required to pay additional cash income taxes. The increase in our cash income tax liability may reduce the amount of cash available to pay dividends and could require us to reduce the amount of dividends we pay in the future.

Risks Relating to Our Common Stock

If we continue to pay dividends at the level currently anticipated under our dividend policy, our ability to pursue growth opportunities may be limited.

We believe that our dividend policy could limit, but not preclude, our ability to grow. If we continue paying dividends at the level currently anticipated, we may not retain a sufficient amount of cash to fund a material expansion of our business, including any acquisitions or growth opportunities requiring significant and unexpected capital expenditures. For that reason, our ability to pursue any material expansion of our business may depend on our ability to obtain third-party financing. We cannot guarantee that such financing will be available to us on reasonable terms or at all, particularly in the current economic environment.

Our organizational documents could limit or delay another party's ability to acquire us and, therefore, could deprive our investors of a possible takeover premium for their shares.

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A number of provisions in our amended and restated certificate of incorporation and bylaws will make it difficult for another company to acquire us. Among other things, these provisions:

- Divide our Board of Directors into three classes, which results in roughly one-third of our directors being elected each year;
- Provide that directors may only be removed for cause and then only upon the affirmative vote of holders of two-thirds or more of the voting power of our outstanding common stock;
- Require the affirmative vote of holders of two-thirds or more of the voting power of our outstanding common stock to amend, alter, change, or repeal specified provisions of our amended and restated certificate of incorporation and bylaws;
- Require stockholders to provide us with advance notice if they wish to nominate any candidates for election to our Board of Directors or if they intend to propose any matters for consideration at an annual stockholders meeting; and
- Authorize the issuance of so-called "blank check" preferred stock without stockholder approval upon such terms as the Board of Directors may determine.

We also are subject to laws that may have a similar effect. For example, federal, Illinois, and Pennsylvania telecommunications laws and regulations generally prohibit a direct or indirect transfer of control over our business without prior regulatory approval. Similarly, Section 203 of the Delaware General Corporation Law restricts our ability to engage in a business combination with an "interested stockholder". These laws and regulations make it difficult for another company to acquire us, and therefore could limit the price that investors might be willing to pay in the future for shares of our common stock. In addition, the rights of our common stockholders will be subject to, and may be adversely affected by, the rights of holders of any class or series of preferred stock that we may issue in the future.

Risks Relating to Our Indebtedness and Our Capital Structure

We have a substantial amount of debt outstanding and may incur additional indebtedness in the future, which could restrict our ability to pay dividends and fund working capital and planned capital expenditures.

As of December 31, 2011, we had \$880.0 million of long-term debt and \$4.7 million of capital leases outstanding along with \$47.8 million of stockholders' equity. This amount of leverage could have important consequences, including:

- We may be required to use a substantial portion of our cash flow from operations to make interest payments on our debt, which will reduce funds available for operations, future business opportunities and dividends;
- We may have limited flexibility to react to changes in our business and our industry;
- It may be more difficult for us to satisfy our other obligations;

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- We may have a limited ability to borrow additional funds or to sell assets to raise funds if needed for working capital, capital expenditures, acquisitions, or other purposes;
- We may become more vulnerable to general adverse economic and industry conditions, including changes in interest rates; and
- We may be at a disadvantage compared to our competitors that have less debt.

We currently expect our cash interest expense to be approximately \$44.0 million to \$46.0 million in 2012. We cannot guarantee that we will generate sufficient revenues to service our debt and have

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adequate funds left over to achieve or sustain profitability in our operations, meet our working capital and capital expenditure needs, compete successfully in our markets, or pay dividends to our stockholders.

If we cannot generate sufficient cash from our operations to meet our debt service obligations, we may need to reduce or delay capital expenditures, the development of our business generally and any acquisitions. If we became unable to meet our debt service and repayment obligations, we would be in default under the terms of our credit agreement, which would allow our lenders to declare all outstanding borrowings to be due and payable. If the amounts outstanding under our credit facilities were to be accelerated, we cannot assure you that our assets would be sufficient to repay in full the money owed.

As of December 31, 2011, our credit agreement would have permitted us to incur approximately \$133.2 million of additional debt. However, additional debt would exacerbate the risks described above.

Our credit agreement contains covenants that limit management's discretion in operating our business and could prevent us from capitalizing on opportunities and taking other corporate actions.

Among other things, our credit agreement limits or restricts our ability (and the ability of certain of our subsidiaries) to:

- Incur additional debt and issue preferred stock;
- Make restricted payments, including paying dividends on, redeeming, repurchasing, or retiring our capital stock;
- Make investments and prepay or redeem debt;
- Enter into agreements restricting our subsidiaries' ability to pay dividends, make loans, or transfer assets to us;
- Create liens;
- Sell or otherwise dispose of assets, including capital stock of subsidiaries;
- Engage in transactions with affiliates;
- Engage in sale and leaseback transactions;
- Make capital expenditures;
- Engage in a business other than telecommunications; and
- Consolidate or merge.

In addition, our credit agreement requires us to comply with specified financial ratios, including ratios regarding total leverage and interest coverage. Our ability to comply with these ratios may be affected by events beyond our control. These restrictions limit our ability to plan for or react to market conditions, meet capital needs, or otherwise constrain our activities or business plans. They also may adversely affect our ability to finance our operations, enter into acquisitions, or engage in other business activities that would be in our interest.

A breach of any of the covenants contained in our credit agreement, or in any future credit agreement, or our inability to comply with the financial ratios could result in an event of default, which would allow the lenders to declare all borrowings outstanding to be due and payable. If the amounts outstanding under our credit facilities were to be accelerated, we cannot assure that our assets would be sufficient to repay in full the money owed. In such a situation, the lenders could foreclose on the assets and capital stock pledged to them.

We may not be able to refinance our existing debt if necessary, or we may only be able to do so at a higher interest expense.

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In 2011 we amended and extended \$409.1 million or 46.5% of our credit facility. The new amended and extended balance of the credit facility matures in 2017. The remaining \$470.9 million or 53.5% of the original credit facility matures in 2014. We do not expect earnings to be sufficient by 2014 to allow repayment of the maturing facility, and we may not be able to refinance those loans. Alternatively, any renewal or refinancing may occur on less favorable terms. If we are unable to refinance or renew our credit facilities, our failure to repay all amounts due on the maturity dates would cause a default under the credit agreement. If we refinance our credit facilities on terms that are less favorable to us than the terms of our existing debt, our interest expense may increase significantly, which could impair our ability to use our funds for other purposes, such as to pay dividends.

Effective February 17, 2012 in connection with the acquisition financing for the SureWest transaction, we amended our credit facility. The amendment provides us with the ability to escrow proceeds from a high-yield note offering prior to closing the acquisition and, until closing, excludes the debt from current leverage calculations. The amendment also permits us additional flexibility for future high yield notes issuances with the same subsidiary guarantees as the current credit facility. All other terms, coverage, and leverage ratios were unchanged. See Part II Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources Credit Facilities .

Risks Relating to Our Business

The telecommunications industry is constantly changing and competition is intense.

The telecommunications industry has been, and we believe will continue to be, characterized by several trends, including:

- Intense competition within established markets from providers that may offer competing or alternative services;
- The blurring of traditional dividing lines between, and the bundling of, different services, such as local dial tone, long-distance, wireless, cable, and data, Internet and video services; and
- A continuation of the trend for mergers and strategic alliances that allow one telecommunications provider to offer increased services or access to wider geographic markets.

We expect competition to remain intense as a result of existing and new competitors and the development of new technologies, products and services. Consequently, we may need to spend significantly more in capital expenditures than we currently anticipate to keep existing customers and to attract new ones.

Many of our voice and data competitors, such as cable providers, Internet access providers, wireless service providers, and long-distance carriers, have substantially larger operational and financial resources, own larger and more diverse networks, are subject to less regulation and have superior brand recognition. In addition, due to consolidation and strategic alliances within the industry, we cannot predict the number of competitors we will face at any given time. Competition could adversely affect us in several ways including the loss of customers and resulting revenue and market share, the possibility of customers reducing their usage of our services or shifting to less profitable services, our need to

lower prices or increase marketing expenses to remain competitive and our inability to diversify by successfully offering new products or services.

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The use of new technologies by other companies may increase our costs and cause us to lose customers and revenues.

The telecommunications industry is subject to rapid and significant changes in technology, frequent new service introductions and evolving industry standards. Technological developments may make our services less competitive. We may need to respond by making unbudgeted upgrades or significant capital expenditures or by developing additional services, which could be expensive and time consuming. If we fail to respond successfully to technological changes or obsolescence, or fail to make use of important new technologies, we could lose customers and revenues and be limited in our ability to attract new customers. The successful development of new services, which is an element of our business strategy, is uncertain and dependent on many factors, and we may not generate anticipated revenues from such services, which would reduce our profitability. We cannot predict the effect of these changes on our competitive position, costs, or profitability.

In addition, we expect that an increasing amount of our revenues will come from providing DSL, VOIP and IPTV services. The market for high-speed Internet access is still developing, and we expect current competitors and new market entrants to introduce competing services and to develop new technologies. Likewise, the ability to deliver high-quality video service over traditional telephone lines is a recent advance that is still developing. The markets for these services could fail to develop, grow more slowly than anticipated, or become saturated with competitors with superior pricing or services. In addition, federal or state regulators may expand their control over DSL, VOIP service and IPTV offerings. We cannot predict the outcome of these regulatory developments or how they may affect our obligations or the form of competition for these services. As a result, we could have higher costs and capital expenditures, lower revenues, and greater competition than expected for DSL, VOIP and IPTV services.

A system failure could cause delays or interruptions of service, which could cause us to lose customers.

We have in the past experienced short, localized disruptions in our service due to factors such as cable damage, inclement weather and service failures by our third-party service providers. To be successful, we need to continue to provide our customers reliable service over our network. The principal risks to our network and infrastructure include physical damage to our central offices or local access lines, power surges or outages, software defects and other disruptions beyond our control.

Disruptions may cause interruptions in service or reduced capacity for customers, either of which could cause us to lose customers and incur unexpected expenses.

We are dependent on third-party vendors for our information, billing, and network systems, as well as IPTV service.

Sophisticated information and billing systems are vital to our ability to monitor and control costs, bill customers, process orders, provide customer service and achieve operating efficiencies. We currently rely on internal systems and third-party vendors to provide all of our information and processing systems, as well as applications that support our IP services, including IPTV. Some of our billing, customer service and management information systems have been developed for us by third parties and may not perform as anticipated. In addition, our plans for developing and implementing our information systems, billing systems, network systems and IPTV service rely primarily on the delivery of products and services by third-party vendors. Our right to use these systems is dependent upon license agreements, some of which can be cancelled by the vendor. If a vendor cancels or refuses to renew one of these agreements, our operations may be impaired. If we need to switch vendors, the transition could be costly and affect operating efficiencies.

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The State of Illinois is a significant customer, and our contracts with the state are favorable to the government.

In 2011, 2010 and 2009, 73.1%, 63.0% and 45.4%, respectively, of our Other Operations revenues were derived from our relationships with various agencies of the State of Illinois principally the Department of Corrections through our Prison Services business (the sharp increase in the percentage of revenue generated from our relationship with the State of Illinois for our Other Operation segment in 2010 and 2011 is the result of the loss of other revenue previously included in this operating segment due to the sale of our CMR and Operator Services business units in 2010).

Our relationship with the Illinois Department of Corrections accounted for 90.7%, 91.8% and 91.2% of our Prison Services revenues during 2011, 2010 and 2009, respectively. Our relationship (initially through our predecessor) with the Illinois Department of Corrections has continued uninterrupted since 1990, despite changes in government administrations. Nevertheless, obtaining contracts from government agencies is challenging, and government contracts often include provisions that are favorable to the government in ways that are not standard in private commercial transactions. Specifically, each of our contracts with the State of Illinois:

- Permits the applicable state agency to terminate the contract without cause and without penalty under some circumstances;
- Has renewal provisions that require decisions of state agencies that are subject to political influence;
- Gives the State of Illinois the right to renew the contract at its option but does not give us the same right; and
- Could be cancelled if state funding becomes unavailable.

The failure of the State of Illinois to perform under the existing agreements for any reason, or to renew the agreements when they expire, could have a material adverse effect on our revenues.

We have employees who are covered by collective bargaining agreements and could be adversely affected by labor disputes.

At December 31, 2011, approximately 50% of our employees were covered by collective bargaining agreements. These employees are hourly workers located in all of our service territories and are represented by various unions and locals. Our collective bargaining agreement with CWA for our Pennsylvania ILEC expired on September 30, 2011. Employees continue to work without a contract and we remain in negotiations with the CWA on a new collective bargaining agreement. All the other existing collective bargaining agreements expire between 2012 through 2014. While we believe our relations with the unions representing these employees are good, any protracted labor disputes or labor disruptions by any of our employees could have a significant negative effect on our financial results and operations.

If we cannot obtain and maintain necessary rights-of-way for our network, our operations may be interrupted and we would likely face increased costs.

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We need to obtain and maintain the necessary rights-of-way for our network from governmental and quasi-governmental entities and third parties, such as railroads, utilities, state highway authorities, local governments and transit authorities. We may not be successful in obtaining and maintaining these rights-of-way or obtaining them on acceptable terms. Some agreements relating to rights-of-way may be

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short-term or revocable at will, and we cannot be certain that we will continue to have access to existing rights-of-way after the governing agreements are terminated or expire. If any of our right-of-way agreements were terminated or could not be renewed, we may be forced to remove our network facilities from the affected areas, relocate or abandon our networks. This would interrupt our operations and force us to find alternative rights-of-way and make unexpected capital expenditures. In addition, our failure to maintain the necessary rights-of-way, franchises, easements, licenses and permits may result in an event of default under our credit agreement.

We depend on certain key management personnel, and need to continue to attract and retain highly qualified management and other personnel in the future.

Our success depends upon the talents and efforts of key management personnel, many of whom have been with our company and in our industry for decades. The loss of any of these individuals, due to retirement or otherwise, and the inability to attract and retain highly qualified technical and management personnel in the future, could have a material adverse effect on our business, financial condition and results of operations.

Future acquisitions could be expensive and may not be successful.

Our acquisition strategy entails numerous risks. The pursuit of acquisition candidates could be expensive and may not be successful. Our ability to complete future acquisitions will depend on whether we can identify suitable acquisition candidates, negotiate acceptable terms, and, if necessary, finance those acquisitions. We may be competing in these endeavors with other parties, some of which may have greater financial and other resources than we do. Whether any particular acquisition is closed successfully, the pursuit of an acquisition would likely require considerable time and effort from management, which would detract from their ability to run our current business. We may face unexpected challenges in receiving any required approvals from the applicable regulator(s), which could delay or prevent an acquisition.

If we are successful in closing an acquisition, we would face several risks in integrating the acquired business. For example, we may face unexpected difficulties entering markets in which we have little or no direct prior experience or generating expected revenue and cash flow from the acquired company or assets. We have in the past incurred significant integration and restructuring costs associated with acquisitions we have completed. Although we would expect to realize efficiencies from the integration of businesses that will offset the incremental transaction, integration and restructuring costs over time, there can be no assurances that we would achieve such efficiencies to offset any expenses.

Any of these potential problems could have a material adverse effect on our business and our ability to achieve sufficient cash flow, provide adequate working capital, service and repay our indebtedness, and pay dividends.

Risks Relating to Our Agreement to Acquire SureWest

The integration of the Company and SureWest following the merger may present significant challenges.

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We may face significant challenges in combining SureWest's operations into our operations in a timely and efficient manner and in retaining key SureWest personnel. The failure to integrate successfully the Company and SureWest and to manage successfully the challenges presented by the integration process may result in our not achieving the anticipated benefits of the merger, including operational and financial synergies.

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We will have a substantial additional amount of debt outstanding after completing the merger, and may incur additional indebtedness in the future, which could restrict our ability to pay dividends and have other consequences.

We have a significant amount of debt outstanding, and the amount will be higher after consummation of the merger. The amount of our indebtedness could have important consequences, including those identified in this Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2011 under the caption Risks Relating to Our Indebtedness and Our Capital Structure .

Obtaining required approvals and satisfying closing conditions may delay or prevent completion of the merger.

Obtaining required approvals and satisfying closing conditions may delay or prevent completion of the merger.

Completion of the merger is conditioned upon SureWest's shareholders approving, at a special meeting, the merger and our stockholders approving, at the annual meeting, the issuance of the common stock to SureWest shareholders in the merger. If the shareholders of SureWest or the stockholders of Consolidated do not approve these matters at their respective meetings to be held after the joint proxy statement/prospectus related to the merger is effective, the merger will not be consummated.

Completion of the merger is also conditioned upon the receipt of certain governmental consents and approvals, including approval by the Federal Communications Commission and the California Public Utilities Commission. These consents and approvals may impose conditions on us or SureWest. Such conditions may jeopardize or delay completion of the merger or may reduce the anticipated benefits of the merger. Further, no assurance can be given that the required consents and approvals will be obtained or that the required conditions to closing will be satisfied. Even if all such consents and approvals are obtained, no assurance can be given as to the terms, conditions and timing of the consents and approvals or that they will satisfy the terms of the Agreement and Plan of Merger.

Whether or not the merger is completed, we will incur transaction, integration and restructuring costs in connection with the proposed merger.

We have incurred and will continue to incur significant costs in connection with the proposed merger, including fees of our attorneys, accountants and financial advisors. If the merger is consummated, we and SureWest expect to incur additional costs associated with transaction fees and other costs related to the merger. We will incur integration and restructuring costs following the completion of the merger as we integrate the businesses of SureWest with those of the Company. Although we expect that the realization of efficiencies related to the integration of the businesses will offset incremental transaction, integration and restructuring costs over time, we cannot give any assurance that this net benefit will be achieved in the near term.

Whether or not the merger is completed, the pendency of the transaction could cause disruptions in our business, which could have an adverse effect on our business and financial results.

These disruptions could include the following:

- Current and prospective employees may experience uncertainty about their future roles with the combined company, which might adversely affect SureWest's and our ability to retain or attract key managers and other employees.

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- Current and prospective customers of SureWest or the Company may experience variations in levels of services as the companies prepare for integration and may, as a result, choose to discontinue their service with either company or choose another provider.
- The attention of management of each of SureWest and the Company may be diverted from the operation of the businesses toward the completion of the merger.

Regulatory Risks

The telecommunications industry is subject to extensive regulation that could change in a manner adverse to us.

Our main sources of revenues are our local telephone businesses in Illinois, Pennsylvania and Texas. The laws and regulations governing these businesses may be, and in some cases have been, challenged in the courts, and could be changed by Congress, state legislatures, or regulators. In addition, federal or state authorities could impose new regulations that increase our operating costs or capital requirements or that are otherwise adverse to us. We cannot predict future developments or changes to the regulatory environment or the impact such developments or changes may have on us.

Legislative or regulatory changes could reduce or eliminate the revenues our rural telephone companies receive from network access charges.

A significant portion of our ILECs' revenues come from network access charges paid by long-distance and other carriers for using our local telephone facilities to originate or terminate long-distance calls in our service areas. The amount of network access charge revenues that our ILECs receive is based on interstate rates set by the FCC and intrastate rates set by state regulators. The FCC has reformed, and continues to reform, the federal network access system.

The FCC order released November 18, 2011 addresses comprehensive reform of all access charges, state and interstate, as well as a complete overhaul of the universal service high cost program. The full impact of the comprehensive order is not known at this time, and the FCC through various regulatory processes could have material changes to its initial order. In addition, there are several companies, state commissions and associations that have filed an appeal of the order, including Consolidated. It is unclear at this time what impact, if any, there would be from any of these processes.

Our Pennsylvania rural telephone company is an average schedule rate of return company, which means its interstate access revenues are based upon a statistical formula developed by NECA and approved by the FCC, rather than upon its actual costs. The formulas are reviewed by NECA and the FCC annually and there could be changes to the formulas in the future, which could have an impact on our revenues. Illinois law now prohibits our Illinois ILEC from charging intrastate access rates higher than its interstate access rates, regardless of our costs.

Legislative or regulatory changes could reduce or eliminate the government subsidies we receive.

The federal and state systems of subsidies, which constitute a significant portion of our revenues, may be modified. On November 18, 2011 the FCC released its comprehensive order on intercarrier compensation and universal service reform. See Part I - Item 1- Business Regulatory Environment FCC Access Charge and Universal Service Reform Order. The PUCT has initiated proceedings to review the state high cost funds for large and small carriers. The proceedings will take a comprehensive review of high cost funds and provide recommended changes to the legislature.

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During the last three years, the FCC has modified the Federal Universal Service Fund system to change the sources of support and the method for determining the level of support that will be distributed. The FCC is considering proposals for additional changes to the Federal Universal Service Fund. These issues may become the subject of legislative amendments to the Telecommunications Act. In addition, the Pennsylvania PUC has a proceeding to review its state universal service fund program. As part of the proceeding, the PAPUC could attempt to override the current Pennsylvania statute 183 which provides for revenue offsets for any reduction to intrastate access.

If our rural telephone companies do not continue to receive federal and state subsidies, or if these subsidies are reduced, these subsidiaries likely will have lower revenues and may not be able to operate as profitably as they have in the past.

Proposed access and universal service reforms could have an adverse impact on our revenues.

When the FCC issued its National Broadband Plan on March 16, 2010, it included proposals for comprehensive reform in the areas of access and universal service regimes, the treatment of VOIP traffic, broadband services and net neutrality, all of which could have an adverse impact on our revenues. The FCC issued an order on net neutrality on December 23, 2010 implementing three core principles: 1) Transparency - all broadband Internet providers must disclose network management practices, performance characteristics and commercial terms of service; 2) No Blocking - fixed broadband providers may not block lawful content, applications or services or the attachment of non-harmful devices; and 3) Nondiscrimination - fixed broadband providers may not engage in unreasonable discrimination in transmitting lawful network traffic. Verizon filed a lawsuit on January 20, 2011 to reverse the FCC decision. The court has not ruled on this lawsuit as of this date and there is no timeline on when the court will rule.

The high costs of regulatory compliance could make it more difficult for us to enter new markets, make acquisitions, or change our prices.

Regulatory compliance is a significant expense for us and diverts the time and effort of management and our officers away from running the business. In addition, because regulations differ from state to state, it would be expensive to introduce services in states where we do not currently operate and understand the regulatory requirements. Compliance costs and information barriers could make it difficult and time-consuming to enter new markets or to evaluate and compete to acquire local access lines or businesses as they arise.

Our intrastate services generally are subject to certification, tariff filing and other ongoing state regulatory requirements. Challenges to our tariffs by regulators or third parties, or delays in obtaining certifications and regulatory approvals, could cause us to incur substantial legal and administrative expenses. Moreover, successful challenges could adversely affect the rates that we are able to charge to customers, which would negatively affect our revenues. Some states also require advance regulatory approval of mergers, acquisitions, transfers of control, stock issuance, and certain types of debt financing, which can increase our costs and delay strategic transactions.

Legislative and regulatory changes in the telecommunications industry could raise our costs and reduce potential revenues.

Currently, there is only a small body of law and regulation applicable to access to, or commerce on, the Internet. As Internet usage continues to grow, governments at all levels may adopt new rules and regulations or find new ways to apply existing laws and regulations. The FCC

currently is reviewing the appropriate regulatory framework governing broadband consumer protections for high-speed Internet

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access through telephone and cable providers' communications networks. The outcome of these proceedings may affect our regulatory obligations and costs and competition for our services, which could have a material adverse effect on our revenues.

We are subject to extensive laws and regulations relating to the protection of the environment, natural resources, and worker health and safety.

Our operations and properties are subject to federal, state, and local laws and regulations relating to protection of the environment, natural resources, and worker health and safety, including laws and regulations governing and creating liability in connection with the management, storage, and disposal of hazardous materials, asbestos and petroleum products. We also are subject to laws and regulations governing air emissions from our fleets of vehicles. As a result, we face several risks, including:

- Hazardous materials may have been released at properties that we currently own or formerly owned (perhaps through our predecessors). Under certain environmental laws, we could be held liable, without regard to fault, for the costs of investigating and remediating any actual or threatened contamination at these properties and for contamination associated with disposal by us or our predecessors of hazardous materials at third-party disposal sites.
- We could incur substantial costs in the future if we acquire businesses or properties subject to environmental requirements or affected by environmental contamination. In particular, environmental laws regulating wetlands, endangered species, and other land use and natural resource issues may increase costs associated with future business or expansion opportunities or delay, alter, or interfere with such plans.
- The presence of contamination can adversely affect the value of our properties and make it difficult to sell any affected property or to use it as collateral.
- We could be held responsible for third-party property damage claims, personal injury claims, or natural resource damage claims relating to contamination found at any of our current or past properties.

The cost of complying with environmental requirements could be significant. Similarly, the adoption of new environmental laws or regulations or changes in existing laws or regulations or their interpretations could result in significant compliance costs or unanticipated environmental liabilities.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

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Our corporate headquarters and most of the administrative offices for our Telephone Operations are located in Mattoon, Illinois.

We lease properties pursuant to agreements that expire at various times between 2012 and 2030. The following chart summarizes the principal facilities owned or leased by us as of December 31, 2011.

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Location	Primary Use	Owned/ leased	Operating segment		Approximate square footage
			Telephone Operations	Other Operations	
Gibsonia, PA	Office and switching	Owned	X	X	91,141
Conroe, TX	Regional office	Owned	X	X	51,900
Mattoon, IL	Corporate office	Leased	X	X	49,100
Mattoon, IL	Office	Owned	X	X	36,300
Mattoon, IL	Operations and distribution center	Leased	X	X	30,900
Lufkin, TX	Office and switching	Owned	X	X	28,707
Conroe, TX	Warehouse and plant	Owned	X	X	28,500
Lufkin, TX	Communications center and office	Owned	X	X	23,190
Katy, TX	Warehouse and office	Owned	X	X	19,716
Taylorville, IL	Communications center and office	Owned	X	X	15,900
Taylorville, IL	Operations and distribution center	Leased	X	X	14,700
Lufkin, TX	Warehouse	Owned	X	X	14,200
Cranberry Township, PA	Office and switching	Owned	X	X	13,110
Charleston, IL	Communications center and office	Owned	X	X	12,661
Litchfield, IL	Office and switching	Owned	X	X	12,190
Lufkin, TX	Office and data center	Owned	X	X	11,900
Conroe, TX	Office	Owned	X		