

MIDDLESEX WATER CO
Form 10-K
March 14, 2007

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549
FORM 10-K**

(Mark
One) ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT
p OF 1934
For the fiscal year ended December 31, 2006

OR

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

For the transition period from _____ to _____

Commission File Number 0-422

MIDDLESEX WATER COMPANY

(Exact name of registrant as specified in its charter)

New Jersey

(State of Incorporation)

22-1114430

(IRS employer identification no.)

1500 Ronson Road, Iselin NJ 08830

(Address of principal executive offices, including zip code)

(732) 634-1500

(Registrant's telephone number, including area code)

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

Title of Each Class:	Name of each exchange on which registered:
None	None

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

Common Stock, No par Value
(Title of Class)

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

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer

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

The aggregate market value of the voting stock held by non-affiliates of the registrant at June 30, 2006 was \$210,829,136 based on the closing market price of \$18.92 per share.

The number of shares outstanding for each of the registrant's classes of common stock, as of March 1, 2007:

Common Stock, No par Value 13,184,376 shares outstanding

Documents Incorporated by Reference

Proxy Statement to be filed in connection with the Registrant's Annual Meeting of Shareholders to be held on May 23, 2007, which will be filed with the Securities and Exchange Commission within 120 days, is incorporated as to Part III.

**MIDDLESEX WATER COMPANY
FORM 10-K**

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Forward-Looking Statements

Certain statements contained in this annual report and in the documents incorporated by reference constitute “forward-looking statements” within the meaning of Section 21E of the Securities Exchange Act of 1934 and Section 27A of the Securities Act of 1933. The Company intends that these statements be covered by the safe harbors created under those laws. These statements include, but are not limited to:

- statements as to expected financial condition, performance, prospects and earnings of the Company;
 - statements regarding strategic plans for growth;
- statements regarding the amount and timing of rate increases and other regulatory matters;
- statements as to the Company’s expected liquidity needs during fiscal 2007 and beyond and statements as to the sources and availability of funds to meet its liquidity needs;
- statements as to expected rates, consumption volumes, service fees, revenues, margins, expenses and operating results;
- statements as to the Company’s compliance with environmental laws and regulations and estimations of the materiality of any related costs;
 - statements as to the safety and reliability of the Company’s equipment, facilities and operations;
 - statements as to financial projections;
 - statements as to the ability of the Company to pay dividends;
- statements as to the Company’s plans to renew municipal franchises and consents in the territories it serves;
- expectations as to the amount of cash contributions to fund the Company’s retirement benefit plans, including statements as to anticipated discount rates and rates of return on plan assets;
 - statements as to trends; and
- statements regarding the availability and quality of our water supply.

These forward-looking statements are subject to risks, uncertainties and other factors that could cause actual results to differ materially from future results expressed or implied by the forward-looking statements. Important factors that could cause actual results to differ materially from anticipated results and outcomes include, but are not limited to:

- the effects of general economic conditions;
- increases in competition in the markets served by the Company;
- the ability of the Company to control operating expenses and to achieve efficiencies in its operations;
 - the availability of adequate supplies of water;
- actions taken by government regulators, including decisions on base rate increase requests;
 - new or additional water quality standards;
 - weather variations and other natural phenomena;
- the existence of attractive acquisition candidates and the risks involved in pursuing those acquisitions;
 - acts of war or terrorism;
 - significant changes in the housing starts in Delaware;
 - the availability and cost of capital resources; and
 - other factors discussed elsewhere in this prospectus.

Many of these factors are beyond the Company’s ability to control or predict. Given these uncertainties, readers are cautioned not to place undue reliance on any forward-looking statements, which only speak to the Company’s understanding as of the date of this report. The Company does not undertake any obligation to release publicly any revisions to these forward-looking statements to reflect events or circumstances after the date of this prospectus or to reflect the occurrence of unanticipated events, except as may be required under applicable securities laws.

For an additional discussion of factors that may affect the Company's business and results of operations, see Item 1A - Risk Factors.

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PART I

Item 1. Business.

Overview

Middlesex Water Company (“Middlesex”) was incorporated as a water utility company in 1897 and owns and operates regulated water utility and wastewater systems in New Jersey and Delaware. The Company also operates water and wastewater systems under contract on behalf of municipal and private clients in New Jersey and Delaware.

The terms “the Company,” “we,” “our,” and “us” refer to Middlesex Water Company and its subsidiaries, including Tidewater Utilities, Inc. (Tidewater) and Tidewater’s wholly-owned subsidiaries, Southern Shores Water Company, LLC (Southern Shores) and White Marsh Environmental Systems, Inc. (White Marsh). The Company’s other subsidiaries are Pinelands Water Company (Pinelands Water) and Pinelands Wastewater Company (Pinelands Wastewater) (collectively, Pinelands), Utility Service Affiliates, Inc. (USA), Utility Service Affiliates (Perth Amboy) Inc., (USA-PA) and Tidewater Environmental Services, Inc. (TESI).

Middlesex principal executive offices are located at 1500 Ronson Road, Iselin, New Jersey 08830. Our telephone number is (732) 634-1500. Our internet website address is <http://www.middlesexwater.com>. We make available, free of charge through our internet website, reports and amendments filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, after such material is electronically filed with or furnished to the Securities and Exchange Commission (SEC).

Middlesex System

The Middlesex System in New Jersey provides water services to approximately 59,200 retail customers, primarily in eastern Middlesex County, New Jersey and provides water under wholesale contracts to the City of Rahway, Township of Edison, the Boroughs of Highland Park and Sayreville and both the Old Bridge and the Marlboro Township Municipal Utilities Authorities. The Middlesex System treats, stores and distributes water for residential, commercial, industrial and fire prevention purposes. The Middlesex System also provides water treatment and pumping services to the Township of East Brunswick under contract. The Middlesex System, through its retail and contract sales, produced approximately 67% of 2006 revenue.

The Middlesex System’s retail customers are located in an area of approximately 55 square miles in Woodbridge Township, the City of South Amboy, the Boroughs of Metuchen and Carteret, portions of the Township of Edison and the Borough of South Plainfield in Middlesex County and, to a minor extent, a portion of the Township of Clark in Union County. Retail customers include a mix of residential customers, large industrial concerns and commercial and light industrial facilities. These customers are located in generally well-developed areas of central New Jersey. The contract customers of the Middlesex System comprise an area of approximately 146 square miles with a population of approximately 303,000. Contract sales to Edison, Sayreville, Old Bridge, Marlboro and Rahway are supplemental to the existing water systems of these customers. The State of New Jersey in the mid-1980’s approved plans to increase available surface water supply to the South River Basin area of the state to facilitate a reduction in groundwater use in this area. The Middlesex System provides treated surface water under long-term agreements to East Brunswick, Marlboro, Old Bridge and Sayreville consistent with the state-approved plan.

Middlesex provides water service to approximately 300 customers in Cumberland County, New Jersey. This system is referred to as Bayview and is not physically interconnected with the Middlesex system. Bayview produced less than 1% of our total revenue in 2006. Bayview was legally merged into Middlesex effective January 1, 2006.

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Tidewater System

Tidewater, together with its wholly-owned subsidiary, Southern Shores, provides water services to approximately 30,100 retail customers for domestic, commercial and fire protection purposes in over 271 separate community water systems in New Castle, Kent and Sussex Counties, Delaware. An additional wholly-owned subsidiary, White Marsh, operates water and wastewater systems under contract for approximately 5,000 residential customers and also owns the office building that Tidewater uses as its business office. White Marsh's rates for water and wastewater operations are not regulated by the Delaware Public Service Commission (PSC). The Tidewater System produced approximately 21% of total revenue in 2006.

Utility Service Affiliates-Perth Amboy

USA-PA operates the City of Perth Amboy, New Jersey's water and wastewater systems under a 20-year agreement, which expires in 2018. USA-PA serves approximately 9,600 customers, most of whom are served by both systems. The agreement was effected under New Jersey's Water Supply Public-Private Contracting Act and the New Jersey Wastewater Public/Private Contracting Act and requires USA-PA to lease from Perth Amboy all of its employees who currently work on the Perth Amboy water and wastewater systems. Under the agreement, USA-PA receives both fixed and variable fees. The variable position is based on customer billing. Fixed fee revenues were \$7.6 million in 2006 and are to increase over the term of the 20-year contract to \$10.2 million based upon a schedule of rates. USA-PA produced approximately 10% of total revenue in 2006.

In connection with the agreement, Middlesex guaranteed a series of Perth Amboy's municipal bonds in the principal amount of approximately \$26.3 million, of which approximately \$23.4 million remains outstanding. In connection with the agreement with Perth Amboy, USA-PA entered into a 20-year subcontract with a wastewater operating company for the operation and maintenance of the Perth Amboy wastewater system. The subcontract provides for the sharing of certain fixed and variable fees and operating expenses.

Pinelands System

Pinelands Water provides water services to approximately 2,500 residential customers in Burlington County, New Jersey. Pinelands Water produced less than 1% of total revenue in 2006. Pinelands Water is not physically interconnected with the Middlesex System.

Pinelands Wastewater provides wastewater services to approximately 2,500 primarily residential retail customers. Under contract, it also services one municipal wastewater system in Burlington County, New Jersey with about 200 residential customers. Pinelands Wastewater produced approximately 1% of total revenue in 2006.

Utility Service Affiliates, Inc.

USA provides residential customers a service line maintenance program called LineCareSM. LineCareSM is an affordable maintenance program that covers all parts, material and labor required to repair or replace specific elements of the customer's water service line and customer shut-off valve in the event of a failure. USA produced less than 1% of total revenue in 2006.

TESI System

TESI, which was formed in 2005, provides wastewater services to approximately 115 residential retail customers in Delaware. TESI produced less than 1% of our total revenue in 2006.

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Financial Information

Consolidated operating revenues and operating income are as follows:

	(Thousands of Dollars)		
	Years Ended December 31,		
	2006	2005	2004
Operating Revenues	\$ 81,061	\$ 74,613	\$ 70,991
Operating Income	\$ 21,318	\$ 17,218	\$ 16,933

Operating revenues were earned from the following sources:

	Years Ended December 31,		
	2006	2005	2004
Residential	42.6%	41.9%	39.9%
Commercial	10.0	9.8	9.5
Industrial	10.7	11.0	10.9
Fire Protection	10.7	10.4	10.2
Contract Sales	12.3	13.4	12.8
Contract Operations	11.0	10.8	11.2
Other	2.7	2.7	5.5
TOTAL	100.0%	100.0%	100.0%

Water Supplies and Contracts

Our New Jersey and Delaware water supply systems are physically separate and are not interconnected. In New Jersey, the Pinelands System and Bayview System are not interconnected with the Middlesex System or each other. We believe that we have adequate sources of water supply to meet the current service requirements of our present customers in New Jersey and Delaware.

Middlesex System

Our Middlesex System, which produced approximately 17 billion gallons in 2006, obtains water from surface sources and wells, or groundwater sources. In 2006, surface sources of water provided approximately 71% of the Middlesex System's water supply, groundwater sources provided approximately 23% from 31 wells and the balance was purchased from a non-affiliated water utility. Middlesex System's distribution storage facilities are used to supply water to customers at times of peak demand, outages and emergencies.

The principal source of surface water for the Middlesex System is the Delaware & Raritan Canal, which is owned by the State of New Jersey and operated as a water resource by the New Jersey Water Supply Authority. Middlesex is under contract with the New Jersey Water Supply Authority, which expires November 30, 2023. The contract provides for average purchases of 27 million gallons per day (mgd) of untreated water from the Delaware & Raritan Canal, augmented by the Round Valley/Spruce Run Reservoir System. Surface water is pumped to, and treated, at the Middlesex Carl J. Olsen (CJO) Plant. Middlesex also has an agreement with a non-affiliated regulated water utility for the purchase of treated water. This long-term agreement, which expires February 27, 2011, provides for minimum purchase of 3 mgd of treated water with provisions for additional purchases.

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Tidewater System

Our Tidewater System, which produced approximately two billion gallons in 2006, obtains 100% of its supply from groundwater sources from 184 wells. In 2006, 19 new wells were placed into service. We deactivated, sealed and abandoned 10 wells for either water quality reasons or for the purpose of consolidating production facilities for more cost-efficient operation. Tidewater continues to submit applications to Delaware regulatory authorities for the approval of additional wells as growth, demand and water quality warrants. The Tidewater System does not have a central treatment facility but has several regional treatment plants. Several of its water systems in New Castle, Kent and Sussex Counties, Delaware have interconnected transmission systems.

Pinelands System

Water supply to our Pinelands System is derived from groundwater sources from four wells which provided overall system delivery of 197 million gallons in 2006. The pumping capacity of the four wells is 2.2 million gallons per day.

Bayview System

Water supply to Bayview customers is derived from groundwater water sources from two wells, which delivered 7.7 million gallons in 2006.

Pinelands Wastewater System

The Pinelands Wastewater System discharges into the South Branch of the Rancocas Creek through a tertiary treatment plant that provides clarification, sedimentation, filtration and disinfection. The total capacity of the plant is 0.5 mgd, and the system provided overall treatment to 114 million gallons in 2006.

TESI System

The TESI System owns and operates five wastewater treatment systems in Southern Delaware. The treatment plants provide clarification, sedimentation, and disinfection. The combined total treatment capacity of the plants is 218,000 gallons per day. The treated effluent is disposed of through land application. Current average flow is approximately 12,000 gallons per day.

Employees

As of December 31, 2006, we had a total of 243 employees. In addition, we lease 19 full-time employees under the USA-PA contract with the City of Perth Amboy, New Jersey. No employees are represented by a union except the leased employees who are subject to a collective bargaining agreement with the City of Perth Amboy. We believe our employee relations are good. Wages and benefits, other than for leased employees, are reviewed annually and are considered competitive within both the industry and the regions where we operate.

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Competition

Our business in our franchised service area is substantially free from direct competition with other public utilities, municipalities and other entities. However, our ability to provide contract water supply and wastewater services and operations and maintenance services is subject to competition from other public utilities, municipalities and other entities. Although Tidewater has been granted an exclusive franchise for each of its existing community water systems, its ability to expand service areas can be affected by the PSC awarding franchises to other regulated water utilities with whom we compete for such franchises and for projects.

Regulation

We are regulated as to rates charged to customers for water and wastewater services in New Jersey and Delaware, as to the quality of the services we provide and as to certain other matters. Our USA, USA-PA and White Marsh subsidiaries are not regulated utilities. We are subject to environmental and water quality regulation by the United States Environmental Protection Agency (EPA), and the New Jersey Department of Environmental Protection (DEP) with respect to operations in New Jersey and by Department of Natural Resources and Environmental Control (DNREC), the Delaware Department of Health and Social Services-Division of Public Health (DPH), and the Delaware River Basin Commission (DRBC) with respect to operations in Delaware. In addition, our issuances of securities are subject to the prior approval of the SEC and the New Jersey Board of Public Utilities (BPU) or the PSC.

Regulation of Rates and Services

New Jersey water and wastewater service operations (excluding the operations of USA and USA-PA) are subject to regulation by the BPU. Similarly, our Delaware water and wastewater operations (excluding the operations of White Marsh) are subject to regulation by the PSC. These regulatory authorities have jurisdiction with respect to rates, service, the issuance of securities and other matters of utility companies operating within the States of New Jersey and Delaware, respectively. For ratemaking purposes, we account separately for operations in New Jersey and Delaware to facilitate independent ratemaking by the BPU for New Jersey operations and the PSC for Delaware operations.

In determining our rates, the BPU and the PSC consider the income, expenses, rate base of property used and useful in providing service to the public and a fair rate of return on investments within their separate jurisdictions. Rate determinations by the BPU do not guarantee particular rates of return to us for our New Jersey operations nor do rate determinations by the PSC guarantee particular rates of return for our Delaware operations. Thus, we may not achieve the rates of return permitted by the BPU or the PSC.

On April 28, 2006, Tidewater filed for a \$5.5 million, or 38.6%, base rate increase with the Delaware Public Service Commission (PSC). The request was intended to recover increased costs of operations, maintenance and taxes, as well as capital investment of approximately \$23.8 million since rates were last established in March 2005. Since June 27, 2006, Tidewater has been billing and recognizing additional revenues through a 15% interim rate increase subject to refund as allowed under PSC regulations. A settlement was reached amongst the parties which concluded that a 26.9% overall increase in base rates would be implemented. The PSC approved the settlement and the remaining 11.9% increase was put into effect on February 28, 2007. The combined effect of the interim and final rate increases was \$3.9 million in additional annual operating revenues.

Effective April 13, 2006, Pinelands Water and Pinelands Wastewater received approval from the New Jersey Board of Public Utilities (BPU) for base rate increases of 7.02% and 0.98%, respectively. These increases

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represent a total base rate increase of approximately \$0.1 million for Pinelands to offset increased costs associated with capital improvements and the operation and maintenance of their systems.

In accordance with the tariff established for Southern Shores, an annual rate increase of 3% was implemented on January 1, 2007. Under the terms of a contract with Southern Shores Homeowners Association, the increase cannot exceed the lesser of the regional Consumer Price Index or 3%.

There can be no assurance that any future rate increases will be granted or, if granted, that they will be in the amounts requested.

Water Quality and Environmental Regulations

Both the EPA and the DEP regulate our operations in New Jersey with respect to water supply, treatment and distribution systems and the quality of the water, as do the EPA, DNREC, DPH and DRBC with respect to operations in Delaware.

Federal, New Jersey and Delaware regulations adopted relating to water quality require us to perform expanded types of testing to ensure that our water meets state and federal water quality requirements. In addition, environmental regulatory agencies are reviewing current regulations governing the limits of certain organic compounds found in the water as byproducts of treatment. We participate in industry-related research to identify the various types of technology that might reduce the level of organic, inorganic and synthetic compounds found in the water. The cost to water companies of complying with the proposed water quality standards depends in part on the limits set in the regulations and on the method selected to implement such reduction. We believe the CJO Plant capabilities put us in a strong position to meet any such future standards with regard to our Middlesex System. We regularly test our water to determine compliance with existing federal, New Jersey and Delaware primary water quality standards.

Well water treatment in our Tidewater System is by chlorination for disinfection purposes and, in some cases, pH correction and filtration for nitrate and iron removal.

Well water treatment in the Pinelands and Bayview Systems (disinfection only) is done at individual well sites.

The DEP and the DPH monitor our activities and review the results of water quality tests that are performed for adherence to applicable regulations. Other regulations applicable to us include the Lead and Copper Rule, the maximum contaminant levels established for various volatile organic compounds, the Federal Surface Water Treatment Rule and the Total Coliform Rule.

Management

This table lists information concerning our executive management team:

Name	Age	Principal Position(s)
Dennis W. Doll	48	President and Chief Executive Officer
A. Bruce O'Connor	48	Vice President and Chief Financial Officer
Ronald F. Williams	57	Vice President-Operations and Chief Operating Officer
Kenneth J. Quinn	59	Vice President-General Counsel, Secretary and Treasurer
James P. Garrett	60	Vice President-Human Resources
Richard M. Risoldi	50	Vice President-Subsidiary Operations
Gerard L. Esposito	55	President, Tidewater Utilities, Inc.

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Dennis W. Doll - Mr. Doll, a Certified Public Accountant, joined the Company in November 2004 as Executive Vice President. He was elected President and Chief Executive Officer and became a Director of Middlesex effective January 1, 2006. Prior to joining the Company, Mr. Doll was employed by Elizabethtown Water Company since 1985, serving most recently as a member of the senior leadership team of the Northeast Region of American Water, which was comprised of Elizabethtown Water Company, New Jersey-American Water Company and Long Island Water Corporation and included other regulated and non-regulated subsidiaries. In this capacity, Mr. Doll most recently served as Vice President - Finance & Controller and served previously, as Vice President - Merger Integration. Prior to 2001, Mr. Doll served as Vice President & Controller of Elizabethtown, Elizabethtown's parent company, E'town Corporation, and various other regulated and non-regulated subsidiaries, primarily engaged in the water and wastewater fields. Effective January 1, 2006, Mr. Doll became Chairman of the Board and Director of all Middlesex subsidiaries. Mr. Doll is a director of the New Jersey Utilities Association and the National Association of Water Companies effective January 1, 2006.

A. Bruce O'Connor - Mr. O'Connor, a Certified Public Accountant, joined the Company in 1990 as Assistant Controller and was elected Controller in 1992 and Vice President in 1995. He was elected Vice President and Chief Financial Officer in 1996. He is responsible for financial reporting, customer service, rate cases, cash management and financings. He is Treasurer and a Director of Tidewater Utilities, Inc., Tidewater Environmental Services, Inc., Utility Service Affiliates, Inc., and White Marsh Environmental Systems, Inc. He is Vice President, Treasurer and a Director of Utility Service Affiliates (Perth Amboy) Inc., Pinelands Water Company and Pinelands Wastewater Company.

Ronald F. Williams - Mr. Williams joined the Company in 1995 as Assistant Vice President-Operations, responsible for the Company's Engineering and Distribution Departments. He was elected Vice President-Operations in October 1995. Mr. Williams was elected to the additional posts of Assistant Secretary and Assistant Treasurer for Middlesex in 2004. He was formerly employed by Garden State Water Company as President and Chief Executive Officer. He is a Director and President of Utility Service Affiliates (Perth Amboy) Inc., and Director of Utility Service Affiliates, Inc., Pinelands Water Company and Pinelands Wastewater Company.

Kenneth J. Quinn - Mr. Quinn joined the Company in 2002 as General Counsel and was elected Assistant Secretary in 2003. In 2004, Mr. Quinn was elected Vice President, Secretary and Treasurer for Middlesex and Secretary and Assistant Treasurer for all subsidiaries of Middlesex. Prior to joining the Company he had been employed in private law practice. Prior to that, Mr. Quinn spent 10 years as in-house counsel to two major banking institutions located in New Jersey. In May 2003, he was elected Assistant Secretary of Tidewater Utilities, Inc., Pinelands Water Company, Pinelands Wastewater Company, Utility Service Affiliates (Perth Amboy) Inc., and White Marsh Environmental Systems, Inc. He is a member of the New Jersey State Bar Association and is also a member of the Public Utility Law Section of the Bar.

James P. Garrett - Mr. Garrett joined the Company in 2003 as Assistant Vice President-Human Resources. In May 2004, he was elected Vice President- Human Resources. Prior to his hire, Mr. Garrett was employed by a national retail chain as Director of Organizational Development.

Richard M. Risoldi - Mr. Risoldi joined the Company in 1989 as Director of Production, responsible for the operation and maintenance of the Company's treatment and pumping facilities. He was appointed Assistant Vice President of Operations in 2003. He was elected Vice President in May 2004, responsible for regulated subsidiary operations and business development. He is a Director of Tidewater Utilities, Inc., Tidewater Environmental Services, Inc., White Marsh Environmental Systems Inc and USA-PA. He also serves as Director and President of Pinelands Water Company, Pinelands Wastewater Company and Utility Service Affiliates, Inc.

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Gerard L. Esposito - Mr. Esposito joined Tidewater Utilities, Inc. in 1998 as Executive Vice President. He was elected President of Tidewater and White Marsh Environmental Systems, Inc. in 2003 and elected President of Tidewater Environmental Services, Inc. in January 2005. Prior to joining the Company he worked in various executive positions for Delaware environmental protection and water quality governmental agencies. He is a Director of Tidewater Utilities, Inc., Tidewater Environmental Services, Inc., and White Marsh Environmental Systems, Inc.

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Item 1A. Risk Factors.

Our revenue and earnings depend on the rates we charge our customers. We cannot raise utility rates in our regulated businesses without filing a petition with the appropriate governmental agency. If these agencies modify, delay, or deny our petition, our revenues will not increase and our earnings will decline unless we are able to reduce costs.

The BPU regulates our public utility companies in New Jersey with respect to rates and charges for service, classification of accounts, awards of new service territory, acquisitions, financings and other matters. That means, for example, that we cannot raise the utility rates we charge to our customers without first filing a petition with the BPU and going through a lengthy administrative process. In much the same way, the PSC regulates our public utility companies in Delaware. We cannot give assurance of when we will request approval for any such matter, nor can we predict whether the BPU or PSC will approve, deny or reduce the amount of such requests.

Certain costs of doing business are not completely within our control. The failure to obtain any rate increase would prevent us from increasing our revenues and, unless we are able to reduce costs, would result in reduced earnings.

We are subject to environmental laws and regulations, including water quality and wastewater effluent quality regulations, as well as other state and local regulations. Compliance with those laws and regulations requires us to incur costs and we are subject to fines or other sanctions for non-compliance.

The EPA and DEP regulate our operations in New Jersey with respect to water supply, treatment and distribution systems and the quality of the water. Our operations in Delaware are regulated by the EPA, DNREC, DPH, and DRBC with respect to water supply, treatment and distribution systems and the quality of water. Federal, New Jersey and Delaware regulations relating to water quality require us to perform expanded types of testing to ensure that our water meets state and federal water quality requirements. We are subject to EPA regulations under the Federal Safe Drinking Water Act, which include the Lead and Copper Rule, the maximum contaminant levels established for various volatile organic compounds, the Federal Surface Water Treatment Rule and the Total Coliform Rule. There are also similar state regulations by the DEP in New Jersey. The DEP and DPH monitor our activities and review the results of water quality tests that we perform for adherence to applicable regulations. In addition, environmental regulatory agencies are continually reviewing regulations governing the limits of certain organic compounds found in the water as byproducts of treatment.

We are also subject to regulations related to fire protection services. In Delaware, fire protection is regulated statewide by the Office of State Fire Marshal. In New Jersey there is no state-wide fire protection regulatory agency. However, state regulations exist as to the size of piping required regarding the provision of fire protection services.

The cost of compliance with the water and wastewater effluent quality standards depends in part on the limits set in the regulations and on the method selected to implement them. If new or more restrictive standards are imposed, the cost of compliance could be very high and have an adverse impact on our revenues and results of operations if we cannot recover those costs through our rates that we charge our customers. The cost of compliance with fire protection requirements could also be high and make us less profitable if we cannot recover those costs through our rates charged to our customers.

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In addition, if we fail to comply with environmental or other laws and regulations to which our business is subject, we could be fined or subject to other sanctions, which could adversely impact our business or results of operations.

We are currently appealing a notice of violation and request for corrective action issued by the Delaware Fire Marshal regarding the alleged failure of one of the community water systems operated by Tidewater to meet Delaware fire protection requirements. If our appeal is unsuccessful, our operating results could be materially affected.

In July 2005, Tidewater received a notice of violation and request for corrective action issued by the Delaware Fire Marshal regarding the alleged failure of one of the community water systems operated by Tidewater to meet Delaware fire protection requirements. Tidewater appealed the Fire Marshal's decision with the Delaware State Fire Prevention Commission (the "SFPC") and, in November 2005, the SFPC denied Tidewater's appeal. In December 2005, Tidewater filed an appeal of the SFPC's decision with the Sussex County Superior Court in Delaware, which is still pending. There are approximately 67 of our other systems that may not meet the Delaware Fire Marshal's recent interpretation of the fire protection requirements. If the Delaware Fire Marshal's interpretation of the regulations is upheld upon appeal, we may be required to make corrections to the system at issue with an estimated cost of \$1.6 million, and there is a possibility that the Delaware Fire Marshal could subsequently issue notices of violation and requests for corrective action for some or all of 67 of our other community systems. At this time, we cannot predict how many community water systems would ultimately require corrective action in that case, the time of the required corrective actions, or the costs we would incur to take the actions. We will apply to the PSC to increase base rates to recover the costs of any such corrective actions. However, if corrective actions need to be taken at several community water systems, our costs could be significant, and to the extent the PSC does not approve rate increases to offset these costs, or if there is a significant delay in receiving approval for such rate increases, such costs could have a material adverse effect on our operating results.

We depend upon our ability to raise money in the capital markets to finance some of the costs of complying with laws and regulations, including environmental laws and regulations or to pay for some of the costs of improvements to or the expansion of our utility system assets. Our regulated utility companies cannot issue debt or equity securities without regulatory approval.

We require financing to fund the ongoing capital program for the improvement of our utility system assets and for planned expansion of those systems. We expect to spend between \$122 million and \$194 million for capital projects through 2009. We must obtain regulatory approval to sell debt or equity securities to raise money for these projects. If sufficient capital is not available or the cost of capital is too high, or if the regulatory authorities deny a petition of ours to sell debt or equity securities, we may not be able to meet the costs of complying with environmental laws and regulations or the costs of improving and expanding our utility system assets to the level we believe necessary. This might result in the imposition of fines or restrictions on our operations and may curtail our ability to improve upon and expand our utility system assets.

Weather conditions and overuse of underground aquifers may interfere with our sources of water, demand for water services and our ability to supply water to customers.

Our ability to meet the existing and future water demands of our customers depends on an adequate supply of water. Unexpected conditions may interfere with our water supply sources. Drought and overuse of underground aquifers may limit the availability of ground and/or surface water. Freezing weather may also contribute to water transmission interruptions caused by pipe and/or main breakage. Any interruption in our water supply could cause a reduction in our revenue and profitability. These factors might adversely affect our ability to supply water in sufficient quantities to our customers. Governmental drought restrictions might result in decreased use of water services and can adversely affect our revenue and earnings.

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Our business is subject to seasonal fluctuations, which could affect demand for our water service and our revenues.

Demand for our water during the warmer months is generally greater than during cooler months due primarily to additional consumption of water in connection with irrigation systems, swimming pools, cooling systems and other outside water use. Throughout the year, and particularly during typically warmer months, demand may vary with temperature and rainfall levels. In the event that temperatures during the typically warmer months are cooler than normal, or if there is more rainfall than normal, the demand for our water may decrease and adversely affect our revenues.

Our water sources may become contaminated by naturally-occurring or man-made compounds and events. This may cause disruption in services and impose costs to restore the water to required levels of quality.

Our sources of water may become contaminated by naturally-occurring or man-made compounds and events. In the event that our water supply is contaminated, we may have to interrupt the use of that water supply until we are able to install treatment equipment or substitute the flow of water from an uncontaminated water source through our transmission and distribution systems. We may also incur significant costs in treating the contaminated water through the use of our current treatment facilities, or development of new treatment methods. Our inability to substitute water supply from an uncontaminated water source, or to adequately treat the contaminated water source in a cost-effective manner may reduce our revenues and make us less profitable.

We face competition from other water and wastewater utilities and service providers which might hinder our growth and reduce our profitability.

We face risks of competition from other utilities authorized by federal, state or local agencies. Once a state utility regulator grants a franchise to a utility to serve a specific territory, that utility has an exclusive right to service that territory. Although a new franchise offers some protection against competitors, the pursuit of franchises is competitive, especially in Delaware where new franchises may be awarded to utilities based upon competitive negotiation. Competing utilities have challenged, and may in the future challenge, our applications for new franchises. Also, third parties entering into long-term agreements to operate municipal systems might adversely affect us and our long-term agreements to supply water on a contract basis to municipalities, which adversely affect our operating results.

We have a long-term contractual obligation for water and wastewater system operation and maintenance under which we may incur costs in excess of payments received.

Middlesex Water Company and USA-PA operate and maintain the water and wastewater systems of the City of Perth Amboy, New Jersey under a 20-year contract expiring in 2018. This contract does not protect us against incurring costs in excess of revenues we earn pursuant to the contract. There can be no absolute assurance that we will not experience losses resulting from this contract. Losses under this contract or our failure or inability to perform may have a material adverse effect on our financial condition and results of operations. Also, in connection with the contract, Perth Amboy, through the Middlesex County Improvement Authority, issued approximately \$68.0 million in three series of bonds. Middlesex guaranteed one of those series of bonds, designated the Series C Serial Bonds, in the principal amount of approximately \$26.3 million. As of December 31, 2006, approximately \$23.4 million of the Series C Serial Bonds remain outstanding. If Perth Amboy defaults on its obligations to pay the bonds we have guaranteed, we would have to raise funds to meet our obligations under that guarantee.

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An important element of our growth strategy is the acquisition of water and wastewater assets, operations, contracts or companies. Any pending or future acquisitions we decide to undertake may involve risks.

The acquisition and/or operation of water and wastewater systems is an important element in our growth strategy. This strategy depends on identifying suitable opportunities and reaching mutually agreeable terms with acquisition candidates or contract partners. These negotiations, as well as the integration of acquired businesses, could require us to incur significant costs and cause diversion of our management's time and resources. Further, acquisitions may result in dilution of our equity securities, incurrence of debt and contingent liabilities, fluctuations in quarterly results and other related expenses. In addition, the assets, operations, contracts or companies we acquire may not achieve the sales and profitability expected.

The current concentration of our business in central New Jersey and Delaware makes us susceptible to any adverse development in local regulatory, economic, demographic, competitive and weather conditions.

Our Middlesex System provides water services to retail customers who are located primarily in eastern Middlesex County, New Jersey and provides water under wholesale contracts to the Township of Edison, the Boroughs of Highland Park and Sayreville, and both the Old Bridge and the Marlboro Township Municipal Utilities Authorities, and the City of Rahway in Union County, New Jersey. Our Tidewater System provides water services to retail customers in the State of Delaware. Our revenues and operating results are therefore subject to local regulatory, economic, demographic, competitive and weather conditions in a relatively concentrated geographic area. A change in any of these conditions could make it more costly or difficult for us to conduct our business. In addition, any such change would have a disproportionate effect on us, compared to water utility companies that do not have such a geographic concentration.

The necessity for increased security has and may continue to result in increased operating costs.

Since the September 11, 2001 terrorist attacks and the continuing threats to the health and security of the United States of America, we have taken steps to increase security measures at our facilities and heighten employee awareness of threats to our water supply. We have tightened our security measures regarding the delivery and handling of certain chemicals used in our business. We are at risk for terrorist attacks and have incurred, and will continue to incur increased costs for security precautions to protect our facilities, operations and supplies from such risks.

Our ability to achieve growth in Delaware is somewhat dependent on the residential building market in the territories we serve. If housing starts decline significantly, our rate of growth may not meet our expectations.

We expect our revenues to increase from customer growth in Delaware for our regulated water operations and, to a lesser degree, our regulated wastewater operations as a result of the anticipated construction and sale of new housing units in the territories we serve. Although the residential building market in Delaware has experienced growth in recent years, this growth may not continue in the future. If housing starts in the Delaware territories we serve decline significantly as a result of economic conditions or otherwise, our revenue growth may not meet our expectations and our financial results could be negatively impacted.

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We have restrictions on our dividends. There can also be no assurance that we will continue to pay dividends in the future or, if dividends are paid, that they will be in amounts similar to past dividends.

Our Restated Certificate of Incorporation and our Indenture of Mortgage dated as of April 1, 1927, as supplemented, impose conditions on our ability to pay dividends. We have paid dividends on our common stock each year since 1912 and have increased the amount of dividends paid each year since 1973.

Our earnings, financial condition, capital requirements, applicable regulations and other factors, including the timeliness and adequacy of rate increases, will determine both our ability to pay dividends on common stock and the amount of those dividends. There can be no assurance that we will continue to pay dividends in the future or, if dividends are paid, that they will be in amounts similar to past dividends.

If we are unable to pay the principal and interest on our indebtedness as it comes due or we default under certain other provisions of our loan documents, our indebtedness could be accelerated and our results of operations and financial condition could be adversely affected.

Our ability to pay the principal and interest on our indebtedness as it comes due will depend upon our current and future performance. Our performance is affected by many factors, some of which are beyond our control. We believe that our cash generated from operations, and, if necessary, borrowings under our existing credit facilities, will be sufficient to enable us to make our debt payments as they become due. If, however, we do not generate sufficient cash, we may be required to refinance our obligations or sell additional equity, which may be on terms that are not as favorable to us.

No assurance can be given that any refinancing or sale of equity will be possible when needed or that we will be able to negotiate acceptable terms. In addition, our failure to comply with certain provisions contained in our trust indentures and loan agreements relating to our outstanding indebtedness could lead to a default under these documents, which could result in an acceleration of our indebtedness.

We depend significantly on the services of the members of our senior management team, and the departure of any of those persons could cause our operating results to suffer.

Our success depends significantly on the continued individual and collective contributions of our senior management team. If we lose the services of any member of our senior management or are unable to hire and retain experienced management personnel, it could affect our operating results.

We are subject to anti-takeover measures that may be used by existing management to discourage, delay or prevent changes of control that might benefit non-management shareholders.

Subsection 10A of the New Jersey Business Corporation Act, known as the Shareholder Protection Act, applies to us. The Shareholder Protection Act deters merger proposals, tender offers or other attempts to effect changes in our control that are not negotiated and approved by our Board of Directors. In addition, we have a classified Board of Directors, which means only one-third of the Directors are elected each year. A classified Board can make it harder for an acquirer to gain control by voting its candidates onto the Board of Directors and may also deter merger proposals and tender offers. Our Board of Directors also has the ability, subject to obtaining BPU approval, to issue one or more series of preferred stock having such number of shares, designation, preferences, voting rights, limitations and other rights as the Board of Directors may fix. This could be used by the Board of Directors to discourage, delay or prevent an acquisition that might benefit non-management shareholders.

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Item 1B. Unresolved Staff Comments.

None.

Item 2. Properties.

Utility Plant

The water utility plant in our systems consist of source of supply, pumping, water treatment, transmission and distribution, general facilities and all appurtenances, including all connecting pipes.

Middlesex System

The Middlesex System's principal source of surface supply is the Delaware & Raritan Canal owned by the State of New Jersey and operated as a water resource by the New Jersey Water Supply Authority.

Water is withdrawn from the Delaware & Raritan Canal at New Brunswick, New Jersey through our intake and pumping station, located on state-owned land bordering the canal. Water is transported through two raw water pipelines for treatment and distribution at our CJO Plant in Edison, New Jersey.

The CJO Plant includes chemical storage and chemical feed equipment, two dual rapid mixing basins, four upflow clarifiers which are also called superpulsators, four underground reinforced chlorine contact tanks, twelve rapid filters containing gravel, sand and anthracite for water treatment and a steel washwater tank. The CJO Plant also includes a computerized Supervisory Control and Data Acquisitions system to monitor and control the CJO Plant and the water supply and distribution system in the Middlesex System. There is an on-site State certified laboratory capable of performing bacteriological, chemical, process control and advanced instrumental chemical sampling and analysis. The firm design capacity of the CJO Plant is 45 mgd (60 mgd maximum capacity). The main pumping station at the CJO Plant has a design capacity of 90 mgd. The four electric motor-driven, vertical turbine pumps presently installed have an aggregate capacity of 72 mgd.

In addition, there is a 15 mgd auxiliary pumping station located at the CJO Plant location. It has a dedicated substation and emergency power supply provided by a diesel-driven generator. It pumps from the 10 million gallon distribution storage reservoir directly into the distribution system.

The transmission and distribution system is comprised of 732 miles of mains and includes 23,200 feet of 48-inch reinforced concrete transmission main connecting the CJO Plant to our distribution pipe network and related storage facilities. Also included is a 58,600 foot transmission main and a 38,800 foot transmission main, augmented with a long-term, non-exclusive agreement with the East Brunswick system to transport water to several of our contract customers.

Middlesex System's storage facilities consist of a 10 million gallon reservoir at the CJO Plant, 5 million gallon and 2 million gallon reservoirs in Edison (Grandview), a 5 million gallon reservoir in Carteret (Eborn) and a 2 million gallon reservoir at the Park Avenue Well Field.

In New Jersey, we own the properties on which Middlesex System's 31 wells are located, the properties on which our storage tanks are located as well as the property where the CJO Plant is located. We also own our headquarters complex located at 1500 Ronson Road, Iselin, New Jersey, consisting of a 27,000 square foot office building and an adjacent 16,500 square foot maintenance facility.

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Tidewater System

The Tidewater System is comprised of 87 production plants that vary in pumping capacity from 26,000 gallons per day to 2.0 mgd. Water is transported to our customers through 520 miles of transmission and distribution mains. Storage facilities include 45 tanks, with an aggregate capacity of 5.8 million gallons. Our Delaware operations are managed from Tidewater's offices in Dover, Delaware and Millsboro, Delaware. Tidewater's Dover, Delaware office property, located on property owned by White Marsh, consists of a 6,800 square foot office building situated on an eleven-acre lot.

Pinelands System

Pinelands Water owns well site and storage properties in Southampton Township, New Jersey. The Pinelands Water storage facility is a 1.2 million gallon standpipe. Water is transported to our customers through 18 miles of transmission and distribution mains.

Pinelands Wastewater System

Pinelands Wastewater owns a 12 acre site on which its 0.5 million gallons per day capacity tertiary treatment plant and connecting pipes are located. Its wastewater collection system is comprised of approximately 25 miles of main.

Bayview System

Bayview owns two well sites, which are located in Downe Township, Cumberland County, New Jersey. Water is transported to its customers through our 3.5 mile distribution system.

TESI System

The TESI System owns and operates five wastewater treatment systems in Southern Delaware. The treatment plants provide clarification, sedimentation, and disinfection. The combined total capacity of the plants is 218,000 gallons per day.

USA-PA, USA and White Marsh

Our non-regulated subsidiaries, namely USA-PA, USA and White Marsh, do not own utility plant property.

Item 3. Legal Proceedings.

In July 2005, Tidewater received a notice of violation and request for corrective action issued by the Delaware Fire Marshal regarding the alleged failure of one of the community water systems operated by Tidewater to meet Delaware fire protection requirements. Tidewater appealed the Fire Marshal's decision with the Delaware State Fire Prevention Commission (the "SFPC") and, in November 2005, the SFPC denied Tidewater's appeal. In December 2005, Tidewater filed an appeal of the SFPC's decision with the Sussex County Superior Court in Delaware, which is still pending. There are approximately 67 of our other systems that may not meet the Delaware Fire Marshal's recent interpretation of the fire protection requirements. If the Delaware Fire Marshal's interpretation of the regulations is upheld upon appeal, we may be required to make corrections to the system at issue and the Delaware Fire Marshal could issue notices of violation and requests for corrective action for some or all of the approximately 67 other community systems. At this time, we cannot predict how many community water systems would ultimately require corrective action if our appeal is unsuccessful nor can we predict the timing and the cost of any required corrective actions. We will apply to the PSC to increase base rates to recover the costs of any such corrective actions. However, if corrective

actions need to be taken at several community water systems, our costs could be significant, and to the extent

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the PSC does not approve rate increases to offset these costs, or if there is a significant delay in receiving approval for such rate increases, such costs could have a material adverse effect on our operating results.

The Court action is currently on hold while the parties, with the assistance of a mediator, have met in an attempt to resolve as many open issues as possible. If any significant issues remain open after these discussions, they will be referred back to the Court for ultimate decision.

The Company is a defendant in lawsuits in the normal course of business. We believe the resolution of pending claims and legal proceedings will not have a material adverse effect on the Company's consolidated financial statements.

Item 4. Submission of Matters to a Vote of Security Holders.

None.

PART II

Item 5. Market for the Registrant's Common Equity and Related Stockholder Matters.

The Company's common stock is traded on the NASDAQ Stock Market, under the symbol MSEX. The following table shows the range of high and low share prices per share for the common stock and the dividend paid to shareholders in such quarter. As of December 31, 2006, there were 2,032 holders of record.

2006	High	Low	Dividend
Fourth Quarter	\$ 19.50	\$ 17.96	\$ 0.1725
Third Quarter	20.50	17.58	