

Direct Testimony and Schedules
Michael C. Connelly

Before the North Dakota Public Service Commission
State of North Dakota

In the Matter of the Application of Northern States Power Company
a Minnesota corporation and Wholly Owned Subsidiary of Xcel Energy Inc.
For Authority to Increase Rates for
Natural Gas Service in North Dakota

Case No. PU-06-____
Exhibit____

EMPLOYEE COMPENSATION

December 15, 2006

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I. INTRODUCTION AND QUALIFICATIONS

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Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Michael C. Connelly. My business address is 414 Nicollet Mall, 2nd Floor, Minneapolis, MN 55401.

Q. BY WHOM ARE YOU EMPLOYED AND WHAT IS YOUR POSITION?

A. I am employed by Xcel Energy Services Inc., which provides services to Northern States Power Company, (“Xcel Energy” or the “Company”), a Minnesota corporation and wholly owned subsidiary of Xcel Energy Inc. I am the Vice President of Human Resources for Xcel Energy.

Q. PLEASE SUMMARIZE YOUR QUALIFICATIONS AND EXPERIENCE.

A. A description of my qualifications and experience is included with my Direct Testimony as Exhibit____(MCC-1), Schedule 1.

Q. FOR WHOM ARE YOU TESTIFYING?

A. I am providing testimony on behalf of Xcel Energy.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

A. The purpose of my testimony is to discuss several topics related to employee compensation. First, I will describe Xcel Energy’s compensation plan, including the 2006 Annual Incentive Compensation Plan (the “Annual Incentive Plan”), and discuss how that plan benefits both its employees and customers. I will also compare Xcel Energy’s total compensation levels to the general market.

1 **II. DESCRIPTION OF XCEL ENERGY'S COMPENSATION PLAN**
2 **AND CUSTOMER BENEFITS OF THAT PLAN**

3
4 Q. WHAT ARE XCEL ENERGY'S COMPENSATION GOALS?

5 A. Xcel Energy's compensation programs are intended to attract, retain, and
6 motivate the employees we need to achieve Xcel Energy's performance
7 objectives. Xcel Energy's Annual Incentive Plan is designed to reward
8 elements of employee performance that will lead to excellent overall utility
9 operations. Xcel Energy provides market competitive compensation, which
10 includes the use of base salaries and annual incentive compensation for the
11 majority of employees. Executives are also eligible for long-term incentives.

12
13 Q. WHICH COMPENSATION COMPONENTS HAS THE COMPANY PROPOSED FOR
14 RECOVERY IN THE REVENUE REQUIREMENT?

15 A. In this case, the Company is seeking recovery of base salaries plus the 2007
16 target amount of annual incentive compensation, subject to a cap at 25
17 percent of employees' salaries, but is *not* seeking recovery of *any* long-term
18 incentives or the cost of the Supplemental Executive Retirement Plan. Mr.
19 Jeffrey Robinson will describe the specific compensation costs included in the
20 revenue requirement in his Direct Testimony.

21
22 Q. PLEASE SUMMARIZE THE COMPANY'S ANNUAL INCENTIVE PLAN.

23 A. The Company uses a broad-based Annual Incentive Plan that covers the
24 majority of employees across all states and operating companies, with the
25 exception of unionized employees. Performance goals are set at the
26 Individual, Business Unit, and Corporate levels. The weightings assigned to
27 the various components are determined by position level, with non-

1 supervisory positions weighted more heavily on Individual and Business Unit
2 performance and executive positions more heavily weighted towards
3 Corporate goals.

4
5 Q. PLEASE DESCRIBE THE INDIVIDUAL, BUSINESS UNIT, AND CORPORATE
6 COMPONENTS OF THE ANNUAL INCENTIVE PLAN.

7 A. The 2006 Annual Incentive Plan includes the following:

8
9 Individual: Individual objectives consist of objectives determined by the
10 employee and the employee's manager through the Individual Performance
11 and Development system. The objectives tie specifically to the employee's
12 job functions.

13
14 Business Unit: Business Unit objectives consist of objectives specific to the
15 Business Unit in which the employee works. These goals are typically
16 comprised of measures related to operational performance, such as
17 environmental performance, system reliability, safety and customer
18 satisfaction, as well as meeting budget targets.

19
20 Corporate: Corporate objectives consist of objectives tied to both
21 operational and financial performance. For 2006, the Corporate goals
22 contained objectives related to system reliability, environmental performance,
23 generation availability, customer satisfaction, safety, employee engagement,
24 and financial performance.

25
26 Q. HOW ARE TARGETS DETERMINED AND INCORPORATED INTO THE ANNUAL
27 INCENTIVE PLAN?

1 A. Each eligible employee has a targeted annual incentive expressed as a
2 percentage of base salary. The percentage is determined by the position level
3 within the organization and, when combined with the employee's base salary,
4 delivers a market-competitive level of total cash compensation. Target levels
5 assume 100 percent achievement of Individual, Business Unit, and Corporate
6 objectives. Based on performance, actual payments may exceed or fall below
7 target for a given performance period.

8
9 Q. HOW ARE AWARDS AND PAYMENTS DETERMINED?

10 A. Annual Incentive Plan awards are calculated from an employee's Individual,
11 Business Unit, and Corporate scores. Weightings of these components vary
12 between employees, based on their positions and responsibilities.
13 Exhibit____(MCC-1), Schedule 2 shows the 2006 weightings of these different
14 categories for all employee classifications. The weightings for the 2007
15 Annual Incentive Plan have not been finalized. The weightings modify the
16 mix of accomplishments needed for employees to achieve the target levels,
17 but do not change the target levels.

18
19 Financial performance affects both the cost of debt and equity needed to
20 fund appropriate levels of investment in assets that are of benefit to our
21 customers. Managing costs prudently is also a key aspect of providing quality
22 utility service at reasonable rates. Thus, financial performance is also taken
23 into consideration when actual payment levels are determined. Since 2003,
24 the Company has applied an objective measure of financial performance,
25 called the Corporate Funding Factor ("CFF"), to reduce the role of subjective
26 discretion in management's determination of how financial performance
27 should be taken into account. The CFF is a factor that can range from 0% to

1 100% that is multiplied by an individual's annual incentive compensation
2 score to determine the individual's payment. The amount of the CFF
3 percentage is determined annually and is the same for all employees.
4

5 Q. DOES INCLUSION OF INCENTIVE COMPENSATION AS PART OF AN OVERALL
6 COMPENSATION PLAN PROVIDE ADVANTAGES?

7 A. Yes. An overall compensation plan that includes incentive compensation has
8 several advantages for both customers and the Company.
9

10 First, as described above, incentive compensation has become part and parcel
11 of the market for almost all large corporations, including utilities. The
12 provision of quality service to our customers demands that we attract and
13 retain employees with specialized skills. Our ability to attract and retain
14 qualified engineers, plant managers, and other professional positions within
15 the Company would be adversely affected if we did not offer market
16 competitive rates. In addition, the loss of skilled employees results in added
17 costs associated with recruitment, training, and lost productivity.
18

19 Second, an incentive plan can provide incentives for employee performance
20 to achieve overall operational excellence, and we believe that the Annual
21 Incentive Plan accomplishes this goal. The Annual Incentive Plan reflects a
22 favorable balance of components that encourage employees to focus on
23 customer service and sound operations. The Annual Incentive Plan focuses
24 on Individual, Business Unit, and Corporate objectives that promote overall
25 customer satisfaction, reliability, safety, and environmental goals along with
26 efficient and cost effective operations. Annual incentive compensation is
27 only received if the employee demonstrates that the employee has met his or

1 her annual objectives, which motivates employees to accomplish specific
2 goals.

3
4 Third, in contrast to an approach that includes incentive compensation, a
5 pure base salary approach lessens the link between pay and performance.
6 Base salaries are paid whether annual performance objectives are met or not,
7 and sole reliance on base salary would significantly limit the Company's ability
8 to motivate and reward its employees for superior performance. Eliminating
9 incentive compensation would lead to the loss of efficiencies that result from
10 the Company's ability to motivate and reward specific employee
11 accomplishments toward core objectives.

12
13 **III. COMPENSATION LEVELS COMPARED TO THE**
14 **COMPETITIVE MARKET**

15
16 Q. HAS THE COMPANY COMPARED ITS COMPENSATION LEVELS TO THE
17 COMPETITIVE MARKET?

18 A. Yes. The Company regularly compares its compensation levels and plans to
19 other firms, including other utilities and non-utilities. In addition, the
20 Company has obtained a study from the consulting firm of Towers Perrin
21 comparing the compensation levels of utilities (at both full targeted annual
22 incentive compensation levels and subject to a cap of 25 percent of an
23 individual employee's base salary) for 2006, the most recent year for which
24 data was available. That study shows that Xcel Energy's total compensation
25 levels are comparable to those of other utilities.

26

1 Q. IS IT COMMON PRACTICE FOR UTILITIES TO USE ANNUAL INCENTIVE
2 COMPENSATION AS PART OF THEIR COMPENSATION PACKAGES?

3 A. Yes. Data that has been provided to the Company shows that virtually all
4 utilities use annual incentive compensation plans as part of their incentive
5 packages for their executive employees, and the vast majority of investor
6 owned utilities also use annual incentive compensation plans for their non-
7 executive, salaried (non-hourly) employees.

8

9 Q. PLEASE EXPLAIN HOW THE COMPANY USES INFORMATION ABOUT
10 COMPENSATION PAID BY OTHER FIRMS.

11 A. External market data obtained from third-party surveys is the basis for
12 Company compensation programs. Our intent is to identify data that reflects
13 the market-competitive rate for a given skill set and is inclusive of companies
14 with which Xcel Energy competes for talent. Data is considered from a
15 variety of surveys, including both utility and non-utility companies. However,
16 many of the Company's positions exist only in the utility industry, so general
17 industry data is not used for those positions. When reviewing these surveys,
18 essential job duties are defined in a position description. Salary surveys are
19 then reviewed to find positions with similar essential skills and functions.
20 The median of the survey data is then used to determine the appropriate
21 market for the position and a salary range for the position. The market for a
22 position is based on the median, but is not limited to the single data point of
23 the median. Rather, the relevant market for a position includes a range above
24 and below the median.

25

26 The Company selects benchmark positions that are representative of
27 positions within each salary range and compares the Company's salaries to

1 external market data. Once a job is placed within the structure, individual pay
2 is determined by employee performance.

3
4 The Company also sets annual incentive compensation targets, which are the
5 annual bonuses available to employees if targeted levels of performance are
6 met under Xcel Energy's Annual Incentive Plan. The annual incentive targets
7 are set to deliver market-comparable total cash compensation. Total cash
8 compensation data is reviewed on an annual basis to ensure that annual
9 incentive targets remain appropriate for delivering market-competitive cash
10 compensation.

11
12 Q. PLEASE DESCRIBE THE STUDY CONDUCTED FOR THIS PROCEEDING,
13 COMPARING THE COMPANY'S COMPENSATION LEVELS TO OTHER UTILITIES.

14 A. The consulting firm of Towers Perrin conducted an analysis of the
15 Company's total cash compensation for 2006 compared to other utility
16 companies. The analysis included the following elements:

- 17
18 1) The Company's base salary levels were compared to competitive market
19 total cash compensation levels (total cash compensation was defined as
20 base salary plus annual incentive compensation).
- 21 2) The Company's annual incentive targets were compared to market
22 annual incentives.
- 23 3) The Company's total cash compensation levels (including salaries plus
24 annual incentive targets) were compared to competitive market total cash
25 compensation levels.
- 26 4) The sum of the Company's 2006 annual salaries and the 2006 target
27 annual incentive compensation (up to a cap of 25 percent of employees'

1 salaries) were compared to competitive market total cash compensation
2 levels.

3
4 Q. WHAT COMPARISON GROUPS DID THE STUDY INCLUDE?

5 A. Company compensation levels were compared to two sets of data. The first
6 set of comparison data was national data reflecting a large majority of U.S.
7 electric and gas companies (with median revenues of \$3 billion). The second
8 set of comparison data was data reflecting U.S. electric and natural gas
9 companies similar in size to Xcel Energy Inc. (with revenue greater than \$4.5
10 billion). The second set of data is significant because managerial positions in
11 larger organizations typically have greater complexity and therefore require
12 more skill, which in turn increases the compensation requirement.

13
14 Q. WHAT WERE THE RESULTS OF THAT STUDY?

15 A. The study findings are as follows:

16 1) The Company's total cash compensation levels without its Annual
17 Incentive Plan would lag the overall utility market by an average of 9
18 percent. When compared to similar-sized utilities, the Company's total
19 cash compensation levels without its Annual Incentive Plan would fall
20 below the competitive market by an average of 13 percent.

21 2) The Company's annual incentive targets are well aligned with other
22 utilities. On average, the Company's annual incentive targets are
23 approximately equal to competitive levels when compared to both the
24 overall market of other utilities and similar-sized utilities.

25 3) On average, the Company's total cash compensation levels, including the
26 Annual Incentive Plan at target levels, are 4 percent above the market for
27 other utilities, and 1 percent below market for similar-sized utilities. This

1 information demonstrates that adding annual incentives helps to close
2 the gap between base salary and market levels, as discussed in item 1,
3 above.

4 4) The level of annual total compensation (salaries plus the annual incentive
5 target levels subject to a cap at 25 percent of base salary) for all positions
6 is 2 percent above the market for all other utilities, and 3 percent below
7 the market for similar-sized utilities.

8

9 Q. WHAT DO YOU CONCLUDE FROM THE STUDY?

10 A. The results of the study lead to several conclusions. Without its Annual
11 Incentive Plan, the Company would be at a significant disadvantage in the
12 competition for talented employees. Target level annual incentives are aligned
13 with those for similar positions in the external market. As referenced in item
14 4 above, the total compensation levels, including incentive compensation at
15 target levels, are 97 to 102 percent of the market when compared to other
16 utilities.

17

18 IV. CONCLUSION

19

20 Q. CAN YOU PLEASE SUMMARIZE YOUR CONCLUSIONS?

21 A. Yes. The Company needs to provide a competitive total cash compensation
22 package in order to attract and retain the talent necessary to achieve customer
23 and business objectives. The Company believes that the current
24 compensation plan is the most appropriate method of providing market
25 competitive compensation and incenting employee excellence toward goals
26 that will directly benefit ratepayers. The Company's total compensation levels
27 are comparable to those of other utilities. For these reasons, I believe that the

1 Company's proposed employee compensation costs are reasonable, and
2 should be included in rates.

3

4 Q. DOES THIS CONCLUDE YOUR TESTIMONY?

5 A. Yes, it does.

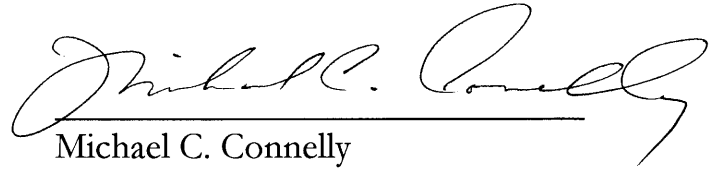
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1
2 STATE OF NORTH DAKOTA
3 BEFORE THE
4 PUBLIC SERVICE COMMISSION
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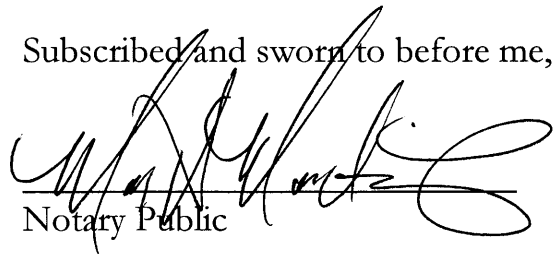
7 In the Matter of the Application of Northern)
8 States Power Company, a Minnesota corporation) **Notice of Change in Rates**
9 and wholly owned Subsidiary of Xcel Energy Inc.)
10 for Authority to Increase Rates For Natural Gas) Case No. PU-06-____
11 Service in North Dakota)
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13
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15 **AFFIDAVIT OF**
16 **Michael C. Connelly**
17
18

19 I, the undersigned, being duly sworn, depose and say that the foregoing is
20 the Direct Testimony of the undersigned, and that such Direct Testimony and the
21 exhibits or schedules sponsored by me to the best of my knowledge, information
22 and belief, are true, correct, accurate and complete, and I hereby adopt said
23 testimony as if given by me in formal hearing, under oath.
24

25 
26
27 Michael C. Connelly
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31
32 Subscribed and sworn to before me, this 14 day of December, 2006.
33
34

35 
36 Notary Public
37
38



MICHAEL C. CONNELLY

EMPLOYMENT

2005-Present	Xcel Energy Inc. <i>Vice President, Human Resources</i>	Minneapolis, MN
2003-2005	Xcel Energy Inc. <i>Vice President & Deputy General Counsel</i>	Minneapolis, MN
2000-2003	Xcel Energy Inc. <i>Deputy General Counsel</i>	Minneapolis, MN
1993-2000	Northern States Power Company Senior Attorney	Minneapolis, MN
1990-1993	Northern States Power Company <i>Attorney</i>	Minneapolis, MN
1986-1990	Oppenheimer, Wolff and Donnelly <i>Associate</i>	St. Paul, MN

EDUCATION

1986	University of Chicago School of Law	Chicago, IL
	<ul style="list-style-type: none">• Juris Doctor• Mandel Legal Aid Clinic	
1983	Carleton College	Northfield, MN
	<ul style="list-style-type: none">• Bachelor of Arts, <i>Magna Cum Laude</i>, Economics with Concentration in Science, Technology and Public Policy• Phi Beta Kappa	

PROFESSIONAL ACTIVITIES

1990-2002	William Mitchell School of Law	St. Paul, MN
	<ul style="list-style-type: none">• Adjunct Professor	
1999-2000	Policy Fellow, Humphrey Institute Policy Forum	
	<ul style="list-style-type: none">• Program designed to develop leadership and encourage participation and effective involvement in public affairs	

COMMUNITY ACTIVITIES

2004-Present	Twin Cities Housing Development Corporation	
	<ul style="list-style-type: none">• Board Member for non-profit agency developing affordable housing in Minneapolis and St. Paul	
2002-2005	Learning Center for Children	
	<ul style="list-style-type: none">• Board Member for alternative school providing elementary education, primarily to children in transitional housing	
2005-Present	St. Clements Episcopal Church	
	<ul style="list-style-type: none">• Member of Vestry; Chair, Stewardship Committee	

	2006 Non-union Annual Incentive Program Weights		
2006 Salary Tiers/Grades	Individual	Business Unit	Corporate
Non-exempt, Exempt M-R Project Directors 1 & 2 T1-T4	40%	40%	20%
Management S-V Project Director 3 TRS	20%	50%	30%
Managing Director, Business Unit Vice President	0%	60%	40%
Corporate Vice President	0%	50%	50%
Business Unit President	0%	33%	67%
President, Utilities Group, Chief Financial Officer	0%	33%	67%
President & CEO, Chairman	0%	0%	100%