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October 8, 2004

Sent via hand delivery and e-mail

Mary Cottrell, Secretary
Department of Telecommunications and Energy
One South Station
Boston, Massachusetts 02110

Re: Berkshire Gas, D.T.E. 04-47

Dear Secretary Cottrell:

Pursuant to the Hearing Officer's October 1, 2004 ruling, the Attorney General submits this letter as his Supplemental Brief in reply to Berkshire Gas Company ("Berkshire" or "Company") discovery responses, AG Set 3, filed on October 6, 2004[1] concerning a September 17, 2004 internal audit report ("Audit Report"). The Attorney General has reviewed the Company's responses and has not changed his positions set out in his Initial and Reply Briefs.[2]

The standard of review for derivative instruments, such as those contemplated in the Company's 2004 proposal, is whether the use of the instruments is in the Company ratepayers' interest.[3] The Company's responses to the Attorney General's Set 3 discovery show that the Energy East Audit Team focused on reconciling the numbers, not examining whether BP Energy ("BP") complied with the Energy East Derivative Policy. Exhs. AG 3-10, 3-11. The Audit Team did not review any of BP's derivative transactions and, thus, the Audit Team has no way of knowing whether BP acted in the Company ratepayers' interests in executing transactions under the 2002 Agreement.

The Department should require an independent audit of Optimization transactions not only to determine whether the derivative transactions entered into by BP as Berkshire's agent, under the terms of the contract, are in compliance with the Department's policies; but also to determine whether transactions using the Berkshire portfolio are in the best interests of the Berkshire customers. The

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[1] Given the Attorney General had an extremely short review time (two days) prior to the supplemental brief filing deadline, the Attorney General reserves his rights to file additional comments should additional issues arise during review of the discovery responses.

[2] The Attorney General moves to incorporate the Company's responses to AG Set 3 into evidence.

[3] D.T.E. 04-47 Attorney General Initial Brief, p. 3-4; G.L. c. 164, § 94A; *Berkshire Gas Company*, D.T.E. 03-89, Order at 30-31 (2004).

Energy East internal audit, by design, fails to provide any support for a conclusion that the optimization agreement is the best way to mitigate gas costs for Berkshire's customers. Department should require independent audits of the 2002/03 data, and for the upcoming 2004 period, to ensure that Berkshire is not circumventing Department policy against speculative investments using ratepayer-paid assets through contractual agreements with BP and that transactions are in the consumers' best interests.

Furthermore, the audit review process itself is deficient. First, the Company did not demonstrate that the three months selected (March, April and December 2003) reflect representative data for the entire two year contract period.[4] Second, Berkshire did not quantify the full impact of BP's $3000 savings error by revealing its statistical significance.[5] Third, the Allocation Team has not yet developed a document change process or updated Allocation Working Procedures. Exhs. AG 3-8, 3-5. Finally, the Audit Team could not review the Alliance's and Allocation Team's workpapers because the Allocation Team did not retain these documents. Exh. AG 3-6. These defects limit the Audit Report to a qualified, not complete, analysis, and therefore the Department should give the Audit Report little evidentiary weight.

Conclusion

For these reasons and those presented in the Attorney General's Initial and Reply Briefs, the Department should reject the audit's findings and require independent auditing and enhanced reporting requirements.[6]

Sincerely,

Karlen J. Reed
Assistant Attorney General
Utilities Division

cc: DTE 04-47 service list

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[4] The Company's description in Exh. AG 3-4 that these are close-out, storage fill, and storage withdrawal months is not the same as showing their representativeness of the remaining 21 months in the audit review period. Professional, comprehensive audits rely on random selections of data that represent a valid sample of the universe of data being audited. Although the auditors know what a statistically valid audit sample is, they again, have chosen not to employ validation techniques in auditing the optimization performance. *See Berkshire Gas Company*, DTE 02-19, Tr. Vol. 2, p. 208 (Confidential).

[5] The $3000 discrepancy for March 2003 reflected in Exh. AG 3-13 could have a significant impact on the Audit Report results. Had the audit been based on a statistically valid sample of transactions, the errors found could have been extrapolated to provide a valid determination of whether they represented the potential for significantly similar errors in unaudited transactions or whether they represented a truly immaterial level of error. Without validation, the Department is left to conclude that there are other errors that have not been corrected.

[6] The Department also should reject the Company's requests for margin sharing of optimized savings and should direct Berkshire to return $118,021.18 plus interest to its customers through the next CGA reconciliation docket. Attorney General Reply Brief, p. 5.