Joint response from Consumers Energy, DTE Energy and MEGA

Additional Question 15? What are the major reasons for the cost increases seen over the past several years for delivered coal to Michigan?

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Executive Summary:

1. Increases in the cost of transporting coal to Michigan have been the primary driver of increases in the delivered cost of coal over the last several years.

2. Mileage based fuel surcharges, indexed to the price of diesel fuel, have been implemented by railroads and contributed to the increase in transportation costs. The coal used by Michigan power plants travels a long distance from the point of production to the point of consumption. Coal transportation costs to Michigan are reflective of this longer distance.

3. Michigan's total coal costs increased 96% from 2004 to 2012, yet were in line with neighboring Great Lakes states during this time.

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**1. Increases in the cost of transporting coal to Michigan have been the primary driver of increases in the delivered cost of coal over the last several years.**

Changes in the pricing practices of the railroads that deliver low cost coal out of the Powder River Basin ("PRB") region in Wyoming and Montana have been driving the increase in transportation costs. PRB coal is plentiful and much easier to mine than coal from other regions and therefore has a much lower production cost. Additionally, PRB coal is a much more "environmentally friendly" coal due to its low sulfur content, which makes it a choice fuel of many utilities to comply with environmental regulations.

The significant cost advantage of PRB coal over other coals has resulted in significant growth in PRB coal utilization since the 1980's. As PRB coal usage expanded, the two railroads serving the PRB region (the BNSF Railway "BNSF" and the Union Pacific "UP", or collectively "western railroads") appeared to compete vigorously for the business, even through periodic rail capacity shortages. The rates charged by the railroads during this time were "cost based", where the railroads would establish competitive rates based on their cost to provide the service, plus a modest profit margin.

Beginning in about 2004, the rates offered began to transition from "cost based" to "market based", which reflects the railroads recognition of the significant price advantage of PRB coal over other fuels, and their belief that an increase in their rates (by increasing the profit margin included in their rates) could be achieved and still allow PRB coal to maintain its price advantage (albeit a lower price advantage) over other fuels. The other Class I railroads that interchange with the BNSF and the UP to complete the delivery of PRB to power plants in Michigan have also moved from "cost based" to "market based" rates. The market-based rates have seen significant increases over recent years.

2. **Mileage based fuel surcharges, indexed to the price of diesel fuel, have been implemented by railroads and contributed to the increase in transportation costs. The coal used by Michigan power plants travels a long distance from the point of production to the point of consumption. Coal transportation costs to Michigan are reflective of this longer distance.**

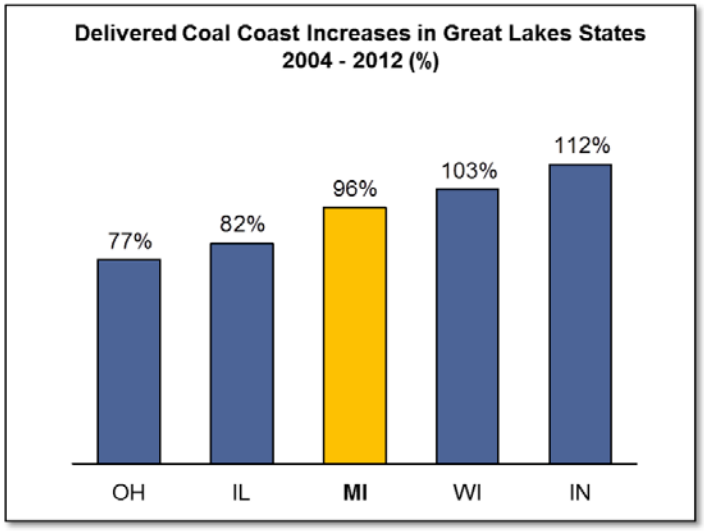
   Much of the coal consumed in the state of Michigan is from the PRB region. Both of the state's two largest utilities, Consumers Energy and DTE Electric, have had legacy transportation contracts (with cost based rates) expire in the past several years. These contracts have been replaced with new transportation contracts reflective of the higher market based rates discussed above.

   The actions of the other Class I railroads serving Michigan to change their rate making process from "cost based" to "market based" and implementing fuel surcharges has also contributed to an increase in the cost of transporting coal from the Central Appalachian and Northern Appalachian coal producing regions.

3. **Michigan's total coal costs increased 96% from 2004 to 2012, yet were in line with neighboring Great Lakes states during this time.**

   Much of the increase was realized after 2010 (MI total coal cost increased 28% 2010-2012), as lower-priced transportation contracts expired. Since 2004, Michigan's delivered coal cost increases have been in line with neighboring states. Michigan predominately uses rail or rail-to-vessel transportation; states with direct access to truck or barge delivery (such as Ohio) have seen lower increases.

Figure 1




Source: EIA and Ventyx, Percent increases based on $ per MMBtu