



# Memorandum

U.S. Department of  
Transportation  
Office of the Secretary  
of Transportation  
Office of Inspector General

Subject: INFORMATION: OIG Comments on  
Lake Express LLC Title XI Loan  
Guarantee Application

Date: June 23, 2003

From: Kenneth M. Mead  
Inspector General

Reply to  
Attn. of: J-1

To: Capt. William G. Schubert  
Administrator, Maritime Administration

On April 16, 2003, Congress appropriated \$25 million to the Maritime Administration (MARAD) for new Title XI loan guarantees<sup>1</sup>. As part of the Appropriation, the Office of Inspector General (OIG) was required to certify that the recommendations set forth in our March 27, 2003 report had been implemented before MARAD could access those funds. Although this certification specifically applied to the newly appropriated funds, the Secretary decided that it would be prudent for MARAD to adhere to the OIG's recommendations on *any* new commitments, even those funded by prior year appropriations.

In December 2002, Lake Express LLC applied for a Title XI loan guarantee to build a high-speed ferry to provide service on Lake Michigan between Milwaukee, Wisconsin and Muskegon, Michigan. MARAD had completed its analysis of the application in April 2003 and presented it to you for final approval. Before taking this final step, the Secretary suggested that we review both the application and MARAD's processing of it to ensure that our recommendations had been incorporated. We were not asked to nor did we opine on the merits of the application.

Of the five recommendations set forth in our March report, only two apply to the pre-approval stage of the loan guarantee, and thus the Lake Express application. The first recommends a rigorous analysis of the risks from modifying any loan approval criteria and the imposition of compensating provisions on the loan guarantee to mitigate those risks. In this instance, there were no material modifications to the loan guarantee approval criteria that would require MARAD to impose any compensating provisions on Lake Express.

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<sup>1</sup> *Making Emergency Wartime Supplemental Appropriations for the Fiscal Year Ending September 30, 2003*

The second recommendation is for MARAD to formally establish an external review process as a check on MARAD's internal loan application review and as assistance in crafting loan conditions and covenants. We are currently working with MARAD to finalize the procedures for establishing this process which will ultimately allow the independent reviews to proceed simultaneously with MARAD's internal review process.

MARAD retained an independent financial analyst to review Lake Express' business plan and capitalization. MARAD also engaged a market analyst to review the applicant's market research and demand forecast. Given the narrow window in which these analyses needed to be performed, their scope was more limited than we would anticipate from future independent analyses. However, given the circumstances, we believe that these reviews were consistent with the underlying intent of the recommendation.

The financial analysis resulted in a finding that Lake Express represents a viable business proposition and that there is a reasonable probability of repayment of financing according to its terms should MARAD decide to provide a Title XI loan guarantee. The analyst recommended that several steps be taken to further protect the Government's interests and MARAD has agreed to implement these changes.

The market analysis raised some concerns about the underlying market research, although it is not clear whether these issues would materially affect the financial projections of the venture. Given these concerns, however, if MARAD decides to approve the Lake Express Title XI loan guarantee application, it would be prudent for MARAD to limit the Government's risk by establishing a firm limit on the guarantee amount. MARAD will do so by including explicit language to this effect in the commitment letter.

Lake Express has applied for a loan guarantee in the amount of \$14.5 million and its owners have committed to invest \$8.5 million in equity. That equity will be used both for boat construction (\$4.4 million), and initial start-up costs and working capital (\$4.1 million). If the cost of construction increases beyond the currently contemplated total vessel cost of \$18.9 million (\$14.5 million + \$4.4 million), the investors in and owners of Lake Express should be required to provide new equity funds to cover the increases with no decrease in the \$4.1 million in pledged start-up funds/working capital or increase to the \$14.5 million loan guarantee. The applicant must seek sources of funds to cover any shortfalls from sources other than the Government.

cc: The Secretary  
Deputy Secretary  
Chief of Staff