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August 23, 2006

Luly Massaro, Clerk
Division of Public Utilities & Carriers
89 Jefferson Boulevard
Warwick, RI 02888

Re: Interstate Navigation Company – Request for Financing Approval -
R.I.G.L. § 39-3-15 to 17

Dear Luly:

Enclosed for filing in this matter are an original and five copies of the Finance Testimony of Walter E. Edge, Jr., MBA, CPA, seeking Division approval for a \$5.6 million loan from the Washington Trust Company to Interstate Navigation Company for the purchase of the Rhode Island assets of Island Hi-Speed Ferry, LLC.

Please let me know if you want me to publish a filing notice or if you will handle the public notice.

If you have any questions, please feel free to call.

Very truly yours,



Michael R. McElroy

MRMc/kmc
IN26/IHSF/3742-Massaró 6
cc: Susan E. Linda
Walter E. Edge, Jr.
Paul Roberti, Esq.
Packer & O'Keefe
Block Island Town Clerk
Mark Hagopian, Esq.
Paul Baccari, Esq.

**FINANCE TESTIMONY
of
WALTER E. EDGE JR. MBA CPA**

**For
INTERSTATE NAVIGATION COMPANY**

**Before
RHODE ISLAND DIVISION OF
PUBLIC UTILITIES AND CARRIERS**

Docket No. D-06-____

August 2006

1 **Q. Will you please provide your full name and your employer for the record?**

2 A. Yes, my name is Walter Edward Edge Jr., MBA CPA. I am the president of B&E
3 Consulting LLC.

4
5 **Q. Are you the same Walter E. Edge Jr. who has previously filed expert accounting and
6 rate testimony for Interstate Navigation Company (Interstate) in previous dockets?**

7 A. Yes, I am.

8
9 **Q. Mr. Edge, what is the purpose of your testimony?**

10 A. As part of this testimony, I will provide some background information relating to Interstate's
11 proposed purchase of Island Hi-Speed Ferry's (IHSF) Rhode Island fast ferry business for
12 \$5,612,500. I will provide a short description of how the acquired fast ferry operation will be
13 merged financially into the current Interstate traditional operation from a bookkeeping point of
14 view. Further, I will address the financial impact of the proposed total financing which includes
15 the purchase of the MV *Athena*, the IHSF CPCN, and other considerations. I will also provide
16 the reasoning behind Interstate's selection of the financing terms for the \$5.6 million loan.
17 Lastly, I will present the information required by the Rules of the Division of Public Utilities and
18 Carriers (Division), so that the Division can review and evaluate the proposed financing package.

19
20 **Q. Mr. Edge did Interstate request proposals from other banks for this new financing?**

21 A. No. Interstate had previously (in 2002) negotiated with six banks to obtain the best
22 financing package available for its debt. The banks were as follows:

- 23 1. The Washington Trust Company
24 2. Fleet Bank
25 3. First Federal Savings Bank (First Fed)
26 4. Sovereign Bank of New England
27 5. Citizens Bank
28 6. Bank Rhode Island (Bank RI)

29
30 The Washington Trust Company was the winning bank and the Division recommended that
31 Interstate keep its loans with Washington Trust. The terms of this new borrowing to acquire
32 IHSF are similar to the \$3.1 million current debt which was approved by the Division to acquire
33 the M/V *Anna C* in Docket No. D-04-21.

1 **Q. How will the proceeds of this borrowing be used?**

2 A. Interstate is purchasing the entire Rhode Island operation of IHSF which includes the
3 purchase of the MV *Athena*, the IHSF CPCN to operate between Point Judith and Block Island
4 (New Harbor), the IHSF customer list, the IHSF berthing permit in Point Judith, and a perpetual
5 non-compete agreement, at a total cost of \$5,612,500. The proceeds of this borrowing in the
6 amount of \$5,600,000 will be used exclusively for this purchase.

7
8 **Q. Mr. Edge, what rate options are included in the Washington Trust commitment letter?**

9 A. First, it is important to point out that the Washington Trust is allowing Interstate to borrow
10 the money in up to three tranches (basically three parts) each of which will be allowed the
11 following rate options: (1) a floating rate at 30 day LIBOR plus 175 basis points (7.075% as of
12 8/17/06) or at prime (as stated in the Wall Street Journal) minus 1% (7.25% as of 8/17/06)
13 adjusted daily, (2) a fixed rate at the Federal Home Loan Bank of Boston's (FHLB) Ten Year
14 Cost of Funds (COF) Rate at time of election plus 190 basis points (7.40% as of 8/17/06) or
15 based upon 30-day Libor plus 175 basis points, with a swap to a fixed rate (7.20% as of 8/17/06).

16
17 After closing, from time to time, Interstate may elect to fix any floating rate tranche of the loan at
18 a fixed rate based upon the FHLB COF Rate based upon the remaining number of years until
19 maturity of the loan at time of election, plus 190 basis points.

20
21 **Q. What other terms are in the commitment letter?**

22 A. The loan is a 10 year loan with a 25 year mortgage style amortization. (Note: Washington
23 Trust has calculated that in the first year of the loan Interstate will pay \$81,420 of principal and
24 \$409,003 of interest, assuming solely for this calculation that Interstate elects to fund at prime
25 minus 1% and the prime rate does not change for the entire year.) The ten year term will result
26 in a balloon payment due at the end of the ten years. It is expected that this balloon payment
27 will probably be rolled over into a ten to fifteen year loan at that time.

28
29 WT has also agreed to have interest only payments in the winter and larger payments in the
30 summer. Although not in the commitment letter, the bank has assured Interstate that this
31 condition of seasonal payments will be in the final loan documents.

1 Other terms are as follows:
2

- 3 1. The collateral for the loan is a first preferred ships mortgage position on the *Athena*,
4 third priority preferred ships mortgage with respect to the *Nelseco*, *Manitou*, *Carol Jean*
5 and *Block Island* and a fourth priority preferred ships mortgage with respect to the *Anna*
6 *C*.

7
8 Also, Interstate will give the bank a security interest in its business assets, a collateral
9 assignment of its licenses, contracts and permits, and a conditional assignment of leases
10 with respect to the Point Judith and Block Island docking facilities. For the most part,
11 this is the same collateral that the bank already has on the current debt with the addition
12 of the new boat.

- 13
14 2. There are no prepayment penalties for tranches that have a floating interest rate keyed to
15 the prime rate. The prepayment penalty for any fixed interest rate tranches keyed to cost
16 of funds will be the so-called "make whole" penalty (not a yield maintenance type
17 penalty). This is the same penalty that is on Interstate's current debt.

- 18
19 3. Financial covenants have been changed to facilitate the deal as follows:
20

- 21 ➤ Borrower to maintain Debt Service Coverage (DSC) of 1.25X (previously
22 requirement was 1.35X). The DSC will be calculated as net income plus
23 depreciation/amortization and interest expense, divided by current maturities of long
24 term debt plus interest expense.
25 ➤ The DSC after routine capital expenditures must be 1.15X.
26 ➤ Interstate must maintain a global loan-to-value (LTV) ratio of 75% based upon the
27 aggregate debt of Interstate, including the proposed facility, and the appraised values
28 of the six collateral motor vessels.
29 ➤ Interstate will be required to establish a one year interest reserve in the approximate
30 amount of \$400,000, which may be placed in an interest bearing account.
31

32 **Q. What other conditions did Washington Trust request of or provide to Interstate for
33 this loan?**

34 A. Interstate allowed the bank to complete a business valuation of the IHSF business.
35 Washington Trust has established a maximum global LTV of 75% based on the aggregate debt
36 of Interstate Navigation, including the proposed facility, and the appraised values of the six
37 vessels that WTC will hold a preferred ships mortgage on.

1 WT has required that fees at closing will be the responsibility of Interstate and Interstate was
2 required to provide up front a \$10,000 check to cover bank costs which will be applied at the
3 closing.

4
5 **Q. What does Interstate want to do at this time?**

6 A. Interstate evaluated the rate options in the commitment letter and determined the following:

- 7 1. Interstate believes that it may be best initially for this start-up operation to select the
8 floating prime minus one rate for all three tranches.
- 9 2. Interstate currently intends at some point to convert to a fixed rate loan at the Federal
10 Home Loan Bank of Boston's Ten Year Cost of Funds Rate plus 190 basis points, but
11 wants the flexibility at this point, as it gets a better handle on the profitability of the
12 operations to close any of the tranches using any of the options in the commitment letter.

13
14 **Q. The Washington Trust commitment letter provides for one fixed rate conversion per**
15 **tranche. Is Interstate requesting the Division allow that the entire loan be converted at**
16 **one time to a fixed rate?**

17 A. Yes, if Interstate believes it would be appropriate when the loan closes to do so. Interstate
18 wants the option of locking in each tranche and locking in the fixed rates when it believes that it
19 is appropriate. Interest rates have been climbing quickly but they may be leveling out. We may
20 be reaching that point where all the debt should be locked in to fixed rates at closing. However,
21 Interstate has used the rate choice flexibility allowed by the Division with a previous financing
22 and locked in the final two thirds of the borrowing at a rate less than the rate locked in at the
23 initial closing. Although there are no guarantees, a daily review of interest rates significantly
24 reduces the risk.

25
26 Therefore, Interstate is requesting approval from the Division to finance \$5,600,000 with
27 Washington Trust on the terms set forth in the commitment letter as attached here to. Interstate
28 at this time intends to initially use the variable rate of prime minus 1% (currently 7.25%).
29 However, Interstate will evaluate all of its options at the closing and select the best deal for the
30 Company and the ratepayers. Also, Interstate will maintain a vigilant eye on interest rates and
31 utilize its options to lock into fixed rates at the appropriate time.

1 **Q. Mr. Edge, how does this financing impact the ratepayers?**

2 A. There is no immediate impact on the traditional service ratepayers (or the fast ferry rate
3 payers if the PUC continues the rates currently in place for Interstate's 2006 fast ferry lease).

4
5 **Q. When will the traditional ratepayers see an impact of the fast ferry operations?**

6 A. If Interstate's projections of revenues and expenses are correct (see attached proforma WEE-
7 1), the traditional ratepayers should see a positive impact from the fast ferry operations when the
8 1st rate filing, after the completion of a full year of fast ferry service, is made.

9
10 **Q. What happens if the fast ferry projections are not achieved?**

11 A. Interstate intends to account for the fast ferry operations as a separate division and account
12 for all direct revenues and direct costs separately. Should the fast ferry division have a loss
13 (which I believe is unlikely) the owners of Interstate have agreed to absorb any loss in the first
14 year of operations. Nevertheless, Interstate believes that the fast ferry operations will subsidize
15 the traditional operation and Interstate has agreed in writing that any net profits generated from
16 the fast ferry service will be used to either fund the purchase of Interstate's proposed larger car
17 carrying fast ferry, to subsidize its life line traditional rates, or otherwise to enhance its service to
18 customers.

19
20 **Q. Are the terms of the borrowing in the best interest of Interstate and its ratepayers?**

21 A. Absolutely. WT has shown a very positive response to Interstate's proposal to eliminate
22 competition and increase profits. In fact, the financial terms of Interstate's current debt have
23 been relaxed in order to facilitate this borrowing as noted above. Further, the bank believes that
24 Interstate's purchase of the IHSF operation will result in an overall financially stronger company
25 and therefore a more secure borrower of the bank. I believe that the financing options of three
26 tranches, each having the option of a variable rate with fixed rate conversion or initial fixed rates
27 provides Interstate with maximum financing flexibility.

1 **Q. Is there an impact of this financing on the debt/equity ratio or any of the other**
2 **information required by the Division's rules?**

3 A. Yes. Because the fast ferry service will be a division of Interstate, any borrowing by the
4 Fast Ferry Division will impact Interstate's overall debt/equity ratio. As of May 31, 2005, per
5 the financial statements in the 2005 annual report, Interstate had a debt to equity ratio of about
6 2.9 to 1 (debt \$11,351,659 to equity \$3,934,068) which is a little over 25% equity. This level of
7 equity, although lower than normal for Interstate, is still adequate.

8
9 The addition of the fast ferry borrowing in the amount of \$5,600,000 changes the debt equity
10 ratio to about 4.3 to 1 with debt of \$16,951,659 and equity of \$3,934,068. A 4.3 to 1 debt
11 equity ratio is not very good, even for a capital intensive utility such as Interstate. However, I
12 believe that the poor debt equity ratio will be only a short term problem.

13
14 **Q. Why?**

15 A. Interstate has never distributed dividends and does not intend to start doing so in the near
16 future. Therefore, if Interstate's fast ferry projections are correct, and Interstate can earn its
17 authorized rate of return in the traditional business, Interstate's equity should increase at a rate of
18 about \$500,000 per year (\$100,000 from the fast ferry service and about \$400,000 from the
19 traditional service) while Interstate's outstanding debt will decrease with the payment of
20 principal. Using this assumption, I calculate that by the end of three years, Interstate's debt
21 equity ratio should improve to about 2.5 to 1 (\$14,000,000 to \$5,500,000) or nearly 30% equity.
22 A 30% equity level is very good for this utility.

23
24 **Q. Have the total assets and liabilities of Interstate changed since the May 31st 2005**
25 **annual report?**

26 A. Not materially, however Interstate has invested in some additional assets and has continued
27 to make its debt service payments. Interstate's total assets at May 31st 2005 were \$15,980,047.
28 Current assets were \$1,297,204. Liabilities are about \$12,045,979. Of that \$1,594,357 is
29 current liabilities. The current ratio is .8 to 1 which is good.

1 **Q. Will Interstate require an increase in rates on its traditional operation to pay the debt**
2 **service on this new debt?**

3 A. No. Interstate has projected that the new fast ferry division will more than pay for all of its
4 direct expenses to include all debt service payments. My projection shows an anticipated
5 surplus of \$254,754 after paying all of the fast ferry direct expenses. Interstate does not plan to
6 request any rate increases to its traditional life line rates solely to pay the debt service on this
7 loan. In fact, this fast ferry operation should provide a subsidy to the life line business. If the
8 fast ferry service loses money in the first year of operations, Interstate's owners intend to cover
9 the shortfall with its authorized return from its traditional service.

10
11 **Q. Would Interstate file for a rate increase for its traditional rates if the fast ferry had a**
12 **profit but the overall Interstate rate of return earned was less than authorized?**

13 A. Yes. In fact, Interstate has recently filed for about a 30% increase in its traditional rates in
14 an effort to collect fuel costs in base rates and to true-up the traditional service return on rate
15 base in advance of the fast ferry subsidy. I would expect that Interstate would file for a rate
16 increase to its traditional rates if, even with the fast ferry subsidy, Interstate does not earn its
17 authorized rate of return. That rate increase would probably address both the traditional and fast
18 ferry rates.

19
20 **Q. Is there a need for expedited approval?**

21 A. Yes. The closing for the purchase of IHSF is scheduled for November 1st 2006 and it is a
22 "time is of the essence" closing. Interstate must have approval of the financing in place so that
23 the loan documents can be completed and executed by the closing. Therefore, Interstate
24 respectfully requests that the Division give its approval by September 30th 2006 or sooner if
25 possible.

26
27 **Q. Are there any other issues that you would like to discuss?**

28 A. Yes. Interstate is aware that unless it leases out the *Athena* in the winter the fast ferry
29 service will have debt service payments and no fast ferry revenue stream to pay them in the
30 winter. However, Interstate has negotiated a ships lease with IHSF for the first winter of its first
31 year of operations. That lease is reflected in Schedule WEE-1.

1 **Q. Have you attached Washington Trust's commitment letter?**

2 A. Yes. It is attached as WEE-2, together with related e-mails.

3

4 **Q. Have you provided a calculation of the projected fast ferry revenues and expenses?**

5 A. Yes I have. Please see the attached Schedule WEE-1.

6

7 **Q. Mr. Edge, would you please explain the entries that appear on your Schedule WEE-1?**

8 A. Yes. First however, it is important to point out that the projections on Schedule WEE-1
9 attached to this testimony are significantly different than the original projections that Interstate
10 used in its CPCN filing. Major differences in the size, design and usage of the Athena compared
11 to the size, design and usage of Interstate proposed new fast ferry has resulted in significantly
12 different projections.

13

14 The proposed new vessel described by Interstate in its fast ferry CPCN filing was a larger vessel
15 with more passenger capacity. Further, it was designed to have a small freight/car deck. The
16 fast ferry service that was to be provided under the CPCN with the new Fast Ferry was from
17 Point Judith to Block Island to Newport and return. The Athena on the other hand, is a smaller,
18 passenger only vessel that will operate strictly from Point Judith to Block Island (Old Harbor)
19 and return. Therefore, the revenues and expenses for these two fast ferry services are
20 significantly different.

21

22 It is also important to point out that the projections on Schedule WEE-1 attached to this
23 testimony are different than the projections made by Interstate to justify the 2006 lease of the
24 Athena. The most significant difference between the projections made by Interstate for the
25 Athena lease and projections on the attached Schedule WEE-1 are the debt service payments to
26 purchase of the Athena versus the 2006 lease payments for the Athena. The debt service
27 payments are much higher. The second difference is the fact that Interstate now has actual
28 ridership numbers from this summer (through July) and Interstate has made a better estimate of
29 the ultimate 2006 seasonal ridership on the Athena. The actual ridership has been less than
30 Interstate's original projections.

31

1 The last major difference between the lease projections and Schedule WEE-1 is the cost of
2 salaries and wages. Included with the lease of the Athena, Interstate also obtained the use of
3 IHSF captains and engineers to run the boat and provide valuable training. At the same time
4 Interstate was paying the IHSF captains and engineers, Interstate also paid its own captains and
5 engineers to ride the fast ferry and learn the fast ferry business. After purchasing the fast ferry
6 Interstate will no longer use the IHSF captains and engineers, so the labor costs will be less.

7
8 **Q. What are the main entries on Schedule WEE-1?**

9 A. Schedule WEE-1 reflects Interstate's current best estimate of passenger revenue for the
10 summer of 2006, utilizing actual passenger information through July, 2006. (Note: I calculated
11 the passenger revenue by taking the total one way ridership, divided that number by 2 to arrive at
12 the total round trips. I then multiplied the round trips by the adult round trip rate. This
13 calculation, although reasonable, is not exactly correct because of children tickets (which would
14 generate less revenue) and one way tickets (that would generate greater revenue).) I believe that
15 the calculation is conservative and probably slightly understates the actual revenue.

16
17 Added to the calculated round trip passenger revenue is Interstate's best estimate of other
18 revenues (bike, bar, etc.), fuel surcharge revenue and charter revenue. It should be noted that
19 Interstate is currently not collecting its full fuel costs through the fuel surcharge as a result of
20 Interstate's original over estimate of fast ferry ridership. Since the actual ridership is much less
21 than projected, Interstate is not collecting the entire \$195,000 of fuel cost this year. Interstate
22 expects that this situation will be corrected next year when actual ridership figures are available.

23
24 Expenses on Schedule WEE-1 reflect Interstate's original staffing, fuel, maintenance, and all
25 other operating expense projections. These projections have been modified slightly to reflect
26 more current information.

27
28 Debt service payments for the first year were calculated for Interstate by the bank assuming a
29 twenty five year amortization, an interest rate of prime less 1 percent (7.25%) and using a
30 mortgage style payment method.

1 Q. Are you still projecting a profit for the fast ferry operations?

2 A. Yes. The net profit is shown at the bottom of Schedule WEE-1 as \$254,754.

3

4 Q. Does that conclude your testimony?

5 A. Yes.

6

7

VERIFIED STATEMENT

8

9 Pursuant to R.I.G.L. § 39-3-17, I, Susan E. Linda, President and Secretary of the
10 Interstate Navigation Company, being first duly sworn, hereby verify under oath that the
11 information contained in the foregoing testimony of Walter E. Edge, Jr., C.P.A., is true and
12 accurate.

13

14

15

16


Susan E. Linda

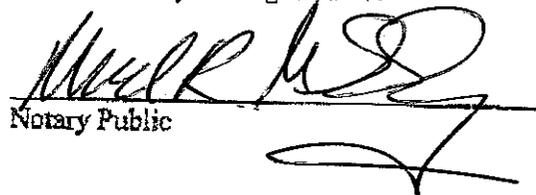
17 Sworn to and subscribed by Susan E. Linda on this 22nd day of August, 2006.

18

19

20

21


Notary Public

MICHAEL R. McELROY ESQ.
NOTARY PUBLIC
My Commission Expires 6-16-07

Projection of Revenues and Expenditures (purchase of IHSF)
 First Full Year of Operations
 Interstate Fast Ferry

Schedule WEE-1

Proforma
 1st year

Revenues:

Calculated Round Trip Ridership (May - July 2006) *	19,388 times \$29.00	\$ 562,252
Projected Round Trip Ridership (August - October 2006)	21,500 times \$29.00	<u>623,500</u>
Total Projected Passenger Revenue		1,185,752
Other Revenues (Bar, bike, etc)		75,000
Fuel Surcharge Revenue		195,000
Charter Revenue		<u>212,025</u>
Total Revenue		1,667,777

Expenses:

Salaries and wages (\$6,000 per week X 21 weeks)		126,000
Payroll taxes (10% of S&W)		12,600
Fuel (195,000 gallons * 2.20/gallon)		429,000
Maintenance:		
Annual engine top end and overhauls	Two year average	138,000
Dry Docking	Estimate	10,000
General Maintenance	Estimate	25,000
Insurance	Estimate	30,000
Advertising	Estimate	15,000
Berthing Point Judith		4,000
Bar expense		33,000
General and Administrative Expense		
Legal and accounting		
General office supplies		
Gross Receipts Taxes		
Fees (coast guard, banking, etc)		
Total G&A Expense Estimate		100,000

Debt service on \$5,600,000:

Principal	(\$5,600,000/25)	81,420
Interest	(\$5,600,000*.075)	409,003
Total Expense		<u>1,413,023</u>

Estimated net profit \$ 254,754

* See testimony page 10, lines 10-15.



Schedule WEE-2

April 7, 2006

The Interstate Navigation Company
a/k/a Interstate Navigation Co., Inc.
P.O. Box 482
New London, CT 06320
Attention: Ms. Susan Linda, President

Re: Loan Commitment

Dear Susan:

This letter supersedes our letter to you dated April 4, 2006. We are pleased to advise you of our commitment to make a new \$5,600,000 loan to The Interstate Navigation Company, substantially in accordance with the terms and conditions set forth on the Term Sheet which is attached hereto.

This Commitment is based upon our present understanding of the transaction. As additional facts and circumstances become known to us, we may impose additional terms and conditions. The terms and conditions of this Commitment are not limited to the Term Sheet. Those matters which are not covered by or made clear in the Term Sheet are subject to the mutual agreement of the parties.

This Commitment is conditional upon:

- (a) The preparation, execution, and delivery of legal documentation in form and substance satisfactory to the Lender and its legal counsel, Brown Rudnick Berlack Israels LLP, which substantially incorporate the terms and conditions outlined or referred to in this Commitment;
- (b) The absence of any material adverse change in the financial condition, business, operations, or control of the Borrower since the date of the financial statements most recently delivered to the Lender;
- (c) The receipt of evidence that the Borrower has obtained all necessary approvals from the Rhode Island Division of Public Utilities and Carriers with respect to (i) the credit facility outlined herein, (ii) Borrower's acquisition of the Rhode Island business and assets of Island Hi-Speed Ferry, (iii) landing the high-speed vessel "Athena" at Old Harbor, Block Island; and (iv) charging rates for the high-speed vessel "Athena" that are currently charged by Island Hi-Speed Ferry.
- (d) The review and approval by Lender's counsel of the Borrower's organizational documents;
- (e) The receipt by Lender of satisfactory verification from the DPUC that Borrower has the only Rhode Island license to land a high-speed ferry at Old Harbor from Point Judith;;



(f) The review and approval by Lender and Lender's counsel of a satisfactory non-compete agreement with the principal(s) of Island Hi-Speed Ferry;

(g) Lender's ability to sell a \$2.5 million participation interest in the proposed loan facility on terms and conditions satisfactory to Lender; and

(h) Lender's receipt of a business valuation appraisal of Island Hi-Speed Ferry supporting a business valuation of at least \$5,600,000.

By your acceptance of this Commitment, you agree to be responsible for all costs and expenses incurred by us including, but not limited to, legal fees and disbursements and other expenses incurred by us in connection with processing the transactions contemplated herein, whether or not the transactions do, in fact, close.

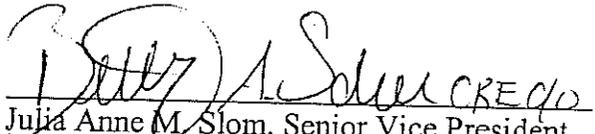
This Commitment supersedes your loan application, any outstanding commitment letters and all other prior dealings with the Lender in connection with the transactions contemplated herein. Prior receipt of any document will not constitute approval of that document unless expressly stated otherwise in the Term Sheet.

The terms of this Commitment may not be waived, modified, or in any way changed by implication, correspondence, or otherwise unless such waiver, modification, or change is made in the form of a written amendment to this Commitment agreed to by all parties. Also, this Commitment may not be assigned without the Lender's prior written consent.

If for any reason the transactions contemplated hereby do not close by July 15, 2006, time being of the essence, this Commitment shall lapse and shall be of no further force or effect unless the time for closing is extended in writing by the Lender.

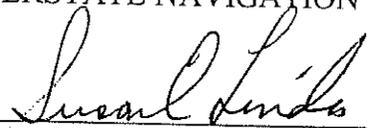
This Commitment shall become effective only upon your written acceptance hereof which must be returned to us not later than April 31, 2006, time being of the essence.

Very truly yours,


Julia Anne M. Slom, Senior Vice President

ACCEPTED AND AGREED TO THIS 11th DAY OF APRIL, 2006.

THE INTERSTATE NAVIGATION COMPANY A/K/A
INTERSTATE NAVIGATION CO., INC.

By: 
Susan Linda, President

TERM SHEET

BORROWER: The Interstate Navigation Company, a/k/a Interstate Navigation Co., Inc.

LOAN AMOUNT: \$5,600,000.00

PURPOSE: To purchase the Rhode Island business of Island Hi-Speed Ferry (the "Seller"), including the motor vessel "Athena", the Seller's certificate to operate the high-speed ferry, the Seller's customer list and berthing permit.

**LOAN TERM/
STRUCTURE:** Ten (10) year term and twenty-five (25) year amortization.

**REPAYMENT
SCHEDULE:** If the interest rate is floating, as provided below, accrued interest shall be payable monthly and principal repayment shall be customized to a modified 25-year mortgage-style amortization schedule with a loan term of ten (10) years as indicated above, resulting in a balloon payment at the end of the term.

If the interest rate is fixed, as provided below, principal and accrued interest shall be repaid on a 25-year mortgage-style amortization schedule with a loan term of ten (10) years as indicated above, resulting in a balloon payment at the end of the term.

COLLATERAL: This loan shall be secured by (a) a first priority Preferred Ship Mortgage from Borrower to Lender with respect to the motor vessel Athena, (b) a third priority Preferred Ship Mortgage from Borrower to Lender with respect to the motor vessels named Nelseco, Manitou, Carol Jean and Block Island (existing third priority ship mortgage on these vessels securing the Borrower's \$400,000 line of credit will be subordinated), (c) a fourth priority Preferred Ship Mortgage from Borrower to Lender with respect to the motor vessel Anna C., (d) a security interest in all of the Borrower's business assets, (e) a Collateral Assignment of Licenses, Contracts and Permits from Borrower to the Lender with respect to all Borrower's contracts, agreements, licenses, permits and warranties including, without limitation, those related in any manner to the operation of the high speed ferry service and (f) the Conditional Assignments of Leases from Borrower to Lender with respect to the Narragansett and Block Island docking facilities.

INTEREST: (a) At Closing, the Borrower shall have the following pricing options on up to three (3) tranches of the outstanding Loan balance:

(1) A floating rate at Borrower's option of 30-day Libor plus 175 basis points, or at Prime (as stated in the Wall Street Journal) minus one percent (1%); or

(2) A fixed rate based upon the the Federal Home Loan Bank of Boston's ("FHLB") Ten Year Cost of Funds Rate at time of election, plus 190 basis points, or based upon 30-day Libor plus 175 basis points, with a Swap to a fixed rate.

(b) After closing, from time to time, the Borrower may elect to fix any floating rate tranche of the Loan at a fixed rate based upon the FHLB Cost of Funds Rate based on the remaining number of years until maturity of the Loan at time of election, plus 190 basis points.

PREPAYMENT
PENALTIES:

If the loan is subject to the floating interest rate, it shall not be subject to any prepayment penalties. Should the Borrower elect the fixed rate, any prepayment will be subject to a so-called "make whole" penalty sufficient to compensate Lender for any net loss sustained or incurred as a result of such prepayment. Borrower will pay all fees associated with unwinding any swap agreements.

TITLE ABSTRACTS:

Prior to the closing, the Borrower shall submit to the Lender's counsel for approval current U.S. Coastguard abstracts of title with respect to each of the vessels securing the loan.

LENDER'S COUNSEL:

Michael K. Davis, Esquire
Brown Rudnick Berlack Israels LLP
121 South Main Street
Providence, Rhode Island 02903
Phone: (401) 276-2644
Fax: (401) 276-6244

ORGANIZATIONAL
DOCUMENTS:

The Borrower shall provide such organizational documents, votes, certificates, consents, and other materials as may be required by the Lender, and such documents must be satisfactory in form and content to Lender and Lender's counsel.

BORROWER'S COUNSEL
OPINION:

The Borrower shall deliver at closing an opinion of the Borrower's counsel, in form and substance satisfactory to the Lender's counsel, that the Borrower is legally existing and in good standing with all requisite power and authority to enter into and perform its obligations under the loan documents, and that the same have been duly authorized, validly executed, and delivered.

FINANCIAL COVENANTS: Borrower shall maintain the following ratios, to be measured at each fiscal year end based on accountant-prepared financial statements: Debt Service Coverage (calculated as net income plus depreciation/amortization and interest expense, divided by current maturities of long term debt for the year plus interest expense) of 1.25 or greater; debt service coverage after routine annual capital expenditures of 1.15 or greater; maximum, global loan-to-value ratio of 75% based on the aggregate debt of Borrower, including the proposed facility, and the appraised values of the six collateral motor vessels . Debt Service Coverage requirements in Borrower's existing loan arrangements with Lender will be reduced to 1.25.

INTEREST RESERVE: Borrower shall establish at closing and maintain in a blocked account with Lender a reserve account with an initial principal balance equal to one year's interest accrual on the Loan. The interest reserve shall be maintained with Lender until Borrower maintains Debt Service Coverage of 1.25 or greater based upon year end financials after at least one full year of high-speed ferry operation.

NON-ASSIGNABLE: The Borrower shall have no right to assign any rights under this Commitment Letter.

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Schedule WEE-3

Subj: **Interstate Commitment Letter**
Date: 7/11/2006 10:07:59 P.M. Eastern Daylight Time
From: jaslom@washtrust.com
To: McElroyMik@aol.com

Mike

As you know, the original commitment letter for Interstate Navigation to provide financing for their acquisition of Island High Speed Ferry will expire shortly. As we have discussed, purchase of the business is scheduled for late fall and we anticipate ratifying our existing approval and commitment for this transaction and expect to extend the commitment accordingly.

JMS

Julia Anne M. Slom
Senior Vice President, Commercial Real Estate Group
The Washington Trust Company
23 Broad Street
Westerly, RI 02891
Telephone: 401 348-1430
Fax: 401 348-1326

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Walter Edge

From: Bethany A. Schneider [baschneider@washtrust.com]
Sent: Friday, August 18, 2006 8:45 AM
To: mcElroyMik@aol.com
Subject: Interstate

Hello

The rates (as of 08/17/06) are as follows:

Prime - 1% = 7.25%

LIBOR + 1.75% = 7.075%

FHLB 10/25 = 1.90% = 7.40%

Swap equivalent of LIBOR + 1.75% = 7.20%

Principal and interest for the first year of the loan assuming that Prime - 1% does not change is as follows:

Principal: \$81,420

Interest: \$409,003

As I mentioned on the phone to you, we expect to have final re-approval by the 29th of August. Let me know how you would like to proceed after that - we can reissue the commitment letter if you would like. I just don't want to start spending money (legal costs) until we have to.

Thanks

Bethany

Bethany Schneider
Portfolio Manager, Commercial Real Estate
The Washington Trust Company
23 Broad Street
Westerly, RI 02891
Phone: 401-348-1538
Fax: 401-348-1326

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