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By e-mail

Members of the *ad hoc* Committee
Professor Emmanuel Gaillard
Professor Michael C. Pryles
Professor Christoph Schreuer

c/o Mr. Marco Tulio Montañés-Rumayor
Secretary of the *ad hoc* Committee

Re: Commerce Group Corp. and San Sebastian Gold Mines, Inc. v. Republic of El Salvador, ICSID Case No. ARB/09/17 (Annulment Proceeding)

Dear Members of the Committee,

We are writing in response to the August 17, 2011 and October 24, 2011 letters from the ICSID Secretariat requesting an advance payment to fund the annulment proceeding. We are also writing in response to the Applicants' letter dated November 17, 2011, notifying the Committee that they are unable to make the requested advance payment.

For the reasons stated below, El Salvador cannot relieve Applicants from their obligation under Rule 14 of the ICSID Administrative and Financial Regulations to make all advance payments in connection with their application for annulment. In addition, El Salvador needs to set the record straight in response to Applicants' decision to include incorrect or misleading allegations in their recent letter to the Committee.

1. El Salvador cannot spend more resources defending against a frivolous claim

El Salvador notified ICSID and then-Claimants (now Applicants) before the Notice of Arbitration was registered, that there was manifest lack of jurisdiction related to a violation of the CAFTA waiver requirement on the face of the Notice of Arbitration.[1] But Applicants chose to ignore this warning and ICSID registered the arbitration.

Counsel for El Salvador then immediately wrote a second letter affording Applicants the opportunity to discontinue their arbitration before the Tribunal was constituted to save both parties the expense of going forward with an arbitration that would have to be dismissed based on the lack of compliance with the waiver provision.[2] El Salvador recalled that NAFTA and CAFTA tribunals had already decided this issue and even provided advanced written consent to discontinuance of the arbitration.[3] Applicants, again, ignored this letter, forcing El Salvador to assume the costs of raising its preliminary objection based on the lack of compliance with the waiver.

Of course, El Salvador had no duty to inform Applicants of the problems with their Notice of Arbitration, much less tell Applicants how to fix the problem with the waiver. Applicants were entirely responsible for understanding and complying with the CAFTA requirements before seeking to benefit from its provisions. The letters are just evidence that Applicants willfully continued their arbitration despite advanced warnings that they had failed to comply with the very same treaty they relied on for protection and arbitration.

In fact, Applicants chose to continue with the parallel proceedings that were still pending before the Supreme Court of El Salvador. They tried to have "two bites at the apple," which is what the CAFTA waiver requirement is intended to prevent once the investor invokes the international arbitration provision in the Treaty. Applicants already had their day in court in the Supreme Court of El Salvador, the venue in which they chose to initiate and maintain their claims until the very end, when the Supreme Court decided against Applicants.

During the arbitration, two non-disputing CAFTA Parties, Costa Rica and Nicaragua, submitted their views recalling the same precedent to which El Salvador had pointed Applicants before the Tribunal was constituted. Rather than respectfully consider the views of non-disputing Parties participating in an early CAFTA case to ensure the proper interpretation of their

[1] Letter from Attorney General of El Salvador to Secretary-General of ICSID, Aug. 14, 2009, at 1-2 (Exhibit R-8 in the original arbitration).
[2] Letter from counsel for El Salvador to ICSID Senior Counsel, Aug. 24, 2009, at 1 (Exhibit R-10).
[3] Letter from counsel for El Salvador to ICSID Senior Counsel, Aug. 24, 2009, at 1 (Exhibit R-10).

Treaty, Applicants actually insulted those sovereign States by publicly impugning their motives for exercising their Treaty rights.[4]

The Tribunal upheld in its Award the letter and the spirit of the Treaty, denying Applicants an improper second opportunity to re-litigate before an ICSID Tribunal the dispute about the same measures they had already lost before the Supreme Court of El Salvador. Still, after the Tribunal agreed with the precedent and the non-disputing CAFTA Parties, and correctly interpreted the Treaty, Applicants refuse to accept that they were required to comply with the Treaty, and have initiated this annulment proceeding.

El Salvador already spent $800,000 of unreimbursed legal expenses defending itself against this frivolous arbitration. In light of Applicants' inability to make the first advance payment requested by the ICSID Secretariat, it would be imprudent for El Salvador to continue spending its scarce resources in a proceeding that not only is frivolous but also would likely not be completed because of lack of funding. Therefore, El Salvador must decline the invitation to make an advance payment that is the sole responsibility of Applicants to make under the rules Applicants chose by initiating arbitration and applying for annulment under the ICSID Convention.

2. Applicants' letter is incorrect and misleading

El Salvador is not responsible for Applicants' inability to pay the initial advance payment of $150,000 requested in August.

Applicants' financial difficulties existed long before any alleged actions by the Government of El Salvador. Back in 2002, when seeking more rights in El Salvador, Commerce Group recorded a net loss and was capitalizing millions of dollars in interest accruing on debt to related third parties. At that time, Commerce Group already owed millions of dollars for, among other debts, 21 years of salary owed to its former President, legal fees going back to 1980, consulting fees going back to 1994, and deferred Directors' fees going back to 1981.[5]

Nevertheless, Applicants imply that El Salvador is somehow to blame for their lack of funds, representing to this Committee that El Salvador's action in 2006 prevented them from earning revenue. In their most recent letter, Applicants stated that:

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[4] Transcript of Hearing on Preliminary Objection, Nov. 15, 2010, at 221: 18-22 (Mr. Machulak: "As to the other two states that we have in connection with these proceedings, it doesn't escape notice, looking at the Dewey & LeBoeuf web site, that their law firm is representing those two countries. So to sit here and listen, in all fairness to my clients, that everybody else in the world is against us in our interpretation of the treaty is just plain not true.").

[5] Commerce Group Corp., Annual Report (Form 10-K) (May 28, 2002) (Exhibit R-21).

> Historically, Commerce and San Sebastian were engaged in exploration and production of gold and other precious metals in the country of El Salvador since 1968, interrupted by El Salvador's civil war between 1978 and 1987. In 2006 the Republic of El Salvador declared a country-wide moratorium on precious metal mining and revoked the companies' permits for both production and exploration. As a result of the moratorium, Commerce and San Sebastian were unable to obtain revenue from the production of gold or to develop their business.[6]

This paragraph is misleading because it suggests that Applicants were producing gold and other precious metals in El Salvador until 2006, except for a break during the civil war. In fact, as El Salvador pointed out in its Preliminary Objection, after obtaining the new concession in 2003, Applicants never began work on the mine or plant and had not done any work by late 2006.

In fact, Applicants had stopped work under the previous concession at the end of 1999.[7] Applicants planned on resuming work when "adequate funding bec[ame] available."[8] That never happened. Indeed, according to their own documents, Commerce Group had not had any revenues since April 1, 2000.[9] Thus, the two government resolutions in 2006 had no effect on any "revenue" Applicants were or were not earning.

In addition, there are several issues with Applicants' representation that they have been expecting a refund of about $70,000 from El Salvador based on a letter Mr. John Machulak, counsel to Applicants in this proceeding, sent in March of this year to members of El Salvador's cabinet, with copy to the President of El Salvador and even President Obama.[10]

Without going into too much detail—it is not El Salvador's obligation to provide legal advice to Applicants—suffice to say that the reimbursement requests were not made by an authorized legal representative of the companies in El Salvador; they were not addressed to the appropriate authorities in El Salvador; one request is inconsistent with Salvadoran tax law; and the other request is subject to the companies' obligation to cover costs for closing the facilities and environmental clean-up in El Salvador. In short, once again, Applicants fail to recognize that they are not exempt from a general obligation to follow rules and procedures.

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[6] Letter from Applicants to the *ad hoc* Committee, Nov. 17, 2011, at 1-2.
[7] Commerce Group Corp., Annual Report (Form 10-K), at 41 (July 14, 2010) (Exhibit R-14).
[8] Commerce Group Corp., Annual Report (Form 10-K) (May 28, 2002) (Exhibit R-21).
[9] Commerce Group Corp., Annual Report (Form 10-K), at 94 (July 14, 2010) (Exhibit R-14).
[10] Letter from Applicants to the *ad hoc* Committee, Nov. 17, 2011, at 2, and attachment.

3. *Even if Applicants make this initial payment, what will happen mid-proceeding when the next advance payment is required?*

El Salvador trusts that it will not escape the Committee's notice that this is only the first payment for these annulment proceedings. The Committee will recall that Applicants insisted on two rounds of written submissions.[11] There will be more requests for payment, and Applicants will be responsible for covering all the payments during the two rounds of written pleadings, the scheduled hearing in Paris, and the Committee's deliberations. Given the current situation, El Salvador is concerned that Applicants will not be able to make future payments, leaving the proceedings partially realized or delaying the release of the Committee's decision indefinitely.

El Salvador has already spent substantial time, money, and effort in defending itself against these claims, not only in the ICSID proceeding, but also in domestic proceedings in El Salvador. El Salvador was not awarded costs in the underlying arbitration even though it had warned Applicants from the outset what the result would be. El Salvador cannot waste more resources seeing this process get underway only to have it be abandoned partway through for lack of funds.

In light of the above, El Salvador respectfully requests that the *ad hoc* Committee suspend this proceeding as soon as possible and discontinue the proceeding in accordance with the applicable rules if payment is not forthcoming within the established time limit.

Sincerely,

Derek C. Smith

[11] Minutes of First Session, Sept. 26, 2011, Item 12.