

**IN THE MATTER OF AN ARBITRATION  
 UNDER THE RULES OF ARBITRATION OF THE  
 INTERNATIONAL CENTRE FOR SETTLEMENT OF INVESTMENT DISPUTES, THE  
 CENTRAL AMERICA – UNITED STATES – DOMINICAN REPUBLIC FREE TRADE  
 AGREEMENT AND THE FOREIGN INVESTMENT LAW OF EL SALVADOR**

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|--------------------------|---|--------------------------|
| PAC RIM CAYMAN LLC,      | ) |                          |
|                          | ) |                          |
| Claimant,                | ) |                          |
|                          | ) |                          |
| v.                       | ) | ICSID Case No. ARB/09/12 |
|                          | ) |                          |
| REPUBLIC OF EL SALVADOR, | ) |                          |
|                          | ) |                          |
| Respondent               | ) |                          |

**WITNESS STATEMENT OF THOMAS C. SHRAKE**

**Introduction and Overview**

1. My name is Thomas C. Shrake. I was born in Bloomington, Illinois, U.S.A. and am a U.S. citizen. Since 1983, I have continuously lived in Nevada, U.S.A. with the exception of approximately three years (1990 to 1993), when I lived in Hermosillo, Mexico. I currently live and work in Reno, Nevada.

2. I am currently the President and Chief Executive Officer (“CEO”) of Pacific Rim Mining Corp., which is the ultimate corporate parent of Pac Rim Cayman LLC (“Pac Rim Cayman”) and its two Salvadoran subsidiaries, Pacific Rim El Salvador, S.A. de C.V. (“PRES”) and Dorado Exploraciones, S.A. de C.V. (“DOREX”). In this Statement, I will refer to Pac Rim Cayman, PRES, and DOREX collectively as the “Claimant.” In my capacity as the CEO of Pacific Rim Mining Corp., a position that I have held since 1997, I am the executive ultimately

responsible for all of the decisions made with respect to these companies, as well as all of the other subsidiaries of Pacific Rim Mining Corp., which I will refer to collectively as the “Pacific Rim Companies” or the “Companies.” Since 1997, I have made those decisions primarily from the Companies’ offices in Reno, Nevada.

3. In addition to my positions as President and CEO of Pacific Rim Mining Corp., I also serve as the President, Treasurer, and Secretary of Pacific Rim Exploration, Inc. (“Pac Rim Exploration”), which is a Nevada corporation, headquartered in Reno, and which was set up at my direction to serve as the exploration arm of the Pacific Rim Companies in 1997. In addition, I am the Treasurer of Dayton Mining (U.S.) Inc., another Nevada corporation that is part of the Pacific Rim Companies. Until recently, Dayton Mining (U.S.) Inc. owned 49% of a Nevada gold mining operation that earned over US\$20 million for the Companies – nearly all of which was invested through Pac Rim Cayman into El Salvador. I am also one of the current “Managers” of Pac Rim Cayman, although I am effectively Pac Rim Cayman’s chief executive. That is, I make and am ultimately responsible for virtually all of the key management decisions affecting Pac Rim Cayman and its subsidiaries.

4. I submit this Witness Statement to support Claimant’s Counter Memorial in opposition to the Objections to Jurisdiction filed by Respondent, the Republic of El Salvador (“Respondent,” “El Salvador,” or the “Government”).

5. I understand that Respondent has argued, among other things, that Pac Rim Cayman is nothing but a “shell” subsidiary set up in Nevada, solely for the purpose of obtaining jurisdiction to claims under CAFTA at ICSID; and that the dispute between Claimant and El

Salvador arose prior to Pac Rim Cayman's December 2007 domestication as a Nevada corporation.

6. My Witness Statement will address why, as a factual matter, both of those assertions are untrue. It will cover five general areas.

7. First, I will summarize my personal and professional background. I believe it is important for the Tribunal to understand the extensive background that I have as an exploration geologist working for a variety of different companies, as well as the extensive experience that I have in Latin America specifically.

8. Second, I will provide an overview of the Pacific Rim Companies – including how they are organized, managed, and financed – dating back to 1997, when I first joined the Companies. Although the structure and number of the Companies have changed somewhat over these years, several things have not changed:

- Since April 2002, the Companies have been ultimately owned and controlled by a majority of U.S. shareholders;
- A substantial amount of the capital invested by the Companies in El Salvador originated from the United States, from the combination of equity investments of U.S. shareholders and profits earned by the Companies from gold mining operations in Nevada;
- Since at least 2005, nearly all of the financial capital invested by the Companies in El Salvador was made through Pac Rim Cayman, and I have always managed Pac Rim Cayman – including its holdings – from Nevada;

- My geology team and I planned and developed the El Salvador project largely from our offices in Nevada, and the vast majority of the intellectual property invested in the El Salvador project is of U.S. origin.

9. Third, I will generally describe our project in El Salvador, including the regulatory delays we faced in our repeated efforts to obtain an environmental permit and an exploitation concession for the El Dorado site. Although the delays were frustrating, Salvadoran officials at the highest levels of the Government constantly assured us that, if we would only be patient, we would definitely receive our permit and concession. We were committed to working with the Government constructively to complete a project that we thought would be of great benefit to El Salvador as well as to our shareholders, and, for the most part, we thought the Government shared our beliefs and was committed to working with us in the same manner.

10. Fourth, I will describe the corporate reorganization that took place at the end of 2007, which resulted in the domestication of Pac Rim Cayman to Nevada. This was only one of several corporate reorganizations that took place over the years. As described below, we undertook such reorganizations for a variety of reasons, including, for example, the need to incorporate entities in jurisdictions where we had acquired assets; the need to deactivate entities in jurisdictions where we were no longer doing business; and the desire to take into account changing regulations and regulatory regimes in the places where our Companies were located, in order to save costs and otherwise gain the best legal and regulatory protection available for the Companies.

11. Fifth, I will discuss the events following President Saca's announcement of a *de facto* mining ban in March 2008, including our numerous discussions with high-level Salvadoran

officials (including President Sacca himself) seeking to clarify the meaning and intent of the March 2008 statement (and subsequent similar statements). It was only after President Sacca's announcement of a *de facto* mining ban in March 2008 that we began to believe that a dispute with the Government was a real possibility. Even after March 2008, however, we tried to work with the Government constructively, and in June 2008, President Sacca personally told me that we would receive the permits after presidential elections scheduled for early 2009. It was only after it became clear that the Government had no intention of honoring that commitment that we reluctantly filed this arbitration at the end of April 2009.

12. At the outset, I will also state that we have no desire to be engaged in a dispute with El Salvador. We would much prefer to return to a project that we believe would be of great benefit not only to our Companies and their shareholders, but also to the people and economy of El Salvador. Our project would provide hundreds of direct jobs (and possibly thousands of indirect ones) and tens of millions of dollars in taxes and royalties to El Salvador – while also setting new standards for environmentally clean mining in the Americas.

13. If, however, we are unable to return to that project, then we are legally obligated to our shareholders to try to recover the fair market value of an investment into which the Companies have put virtually all of their resources during much of the past decade, at the express invitation and encouragement of the Salvadoran Government.

## **I. PERSONAL, EDUCATIONAL, AND PROFESSIONAL BACKGROUND**

14. As summarized below, I have over thirty years' experience in the mining business, with a particular focus on locating, developing, and managing economically feasible gold and copper deposits. During my three decades in the mining industry, I have acquired both

an expertise in and reputation for finding high-quality mineral deposits, which are then developed into profitable mining projects.

15. I am also deeply committed to the environment and to sustainable development. I have seen firsthand that, under the proper circumstances and with the right safeguards in place, gold can be mined with *de minimus* risk to the environment and can also provide enormous benefits to the local communities and even the national economy where a project is located.

**A. Education**

16. I received my Bachelor of Arts Degree in Geology from Western State College in Gunnison, Colorado in 1980.

17. I received my Masters of Science Degree in Economic Geology from the University of Idaho in 1984. In lay terms, economic geology is the science of mineral deposits.

18. My Masters thesis at the University of Idaho was entitled, “Geology and Hydrothermal Alteration of the Pan Disseminated Gold Occurrence, White Pine County, Nevada.” The State of Nevada is extraordinarily rich and diverse in its geology, which is why many U.S. geologists (including the key geological team on the El Salvador project) have studied, worked, and/or lived there, and which is one of the reasons that a mining site in Nevada provided the basis for my Masters thesis. Put simply, my Masters thesis, and my research at the University of Idaho more generally, entailed the three-dimensional study of the chemical and mineralogic changes to rocks that are located near ore deposits.

19. I have continued to develop that particular expertise ever since graduate school. In short, my expertise lies in understanding how the rocks around specific gold and copper

deposits change as a result of the hydrothermal activity that created the deposit. That expertise enables me to recognize and assess potentially mineable orebodies.

**B. Employment Prior to the Pacific Rim Companies**

20. I first started working as a geologist in 1979 while I was still in college. I found jobs working on exploration projects in Colorado and Alaska for companies called, respectively, Mineral Industries Engineers, Inc. and WGM, Inc.

21. My first full-time position was with Amselco Exploration Ltd. (“Amselco”) in Nevada, where I had begun working on exploration projects while still in the Masters program at the University of Idaho. During my tenure at Amselco, I was instrumental in locating a multimillion-ounce gold ore deposit at Bald Mountain, Nevada that is still being mined today. I worked for Amselco from 1983 to 1985.

22. After Amselco, I joined Galli Exploration Associates (“Galli”) in Reno, Nevada as a Senior Geologist, where I remained through 1986. While at Galli, I successfully utilized a theory I had developed to locate a specific type of gold ore deposit known as a Carlin-type deposit. This theory is now commonly accepted and understood within the mining industry as a viable method of locating Carlin-type deposits. During my tenure at Galli, I staked the Maverick Springs Carlin-type deposit, located in White Pine County, Nevada.

23. From 1987 through 1990, I worked as a Senior Geologist for Tenneco Minerals Company (“Tenneco”) in Reno, Nevada. At Tenneco, my work primarily involved gold project generation both by grassroots reconnaissance and advanced project acquisition in the western United States. I also had my first mining experience in Latin America, involving a gold project

in Costa Rica, where I was involved in exploration activities. Although Tenneco did not pursue the project, my experience in Costa Rica convinced me that the likelihood of finding valuable mineral resources in Latin America is greater than that which exists in the United States. This position was also where I sharpened my skill in understanding the economic and financial aspects of developing a profitable mine.

24. From July 1990 to October 1993, I served as the General Manager-Mexico for Placer Dome Inc. (“PDI”), in Hermosillo, Mexico. My family and I moved from Reno, Nevada to Hermosillo, where I lived during the time I held that position. My responsibilities were two-fold. First, I managed gold exploration throughout Mexico for PDI, which was one of the largest gold mining companies in the world (and which, in 2006, merged with *the* largest gold mining company in the world, Barrick Gold Corporation (“Barrick”). Second, I oversaw Mineral Real de Angeles, which was PDI’s joint venture with Empresas Frisco S.A. de C.V., a large Mexican mining company. Among other accomplishments at PDI in Mexico, I led the acquisition of Mulatos, Sonora, a now 4 million plus ounce gold mine; and Promontorio, Chihuahua, a 250,000-plus ounce gold resource.

25. In October 1993, I moved back to Reno, Nevada, where I had accepted a position as Vice-President for Exploration at Gibraltar Mines Limited (“Gibraltar”). At Gibraltar, I managed copper exploration and corporate development (*i.e.* acquisition evaluation) in the United States, Canada, Chile, and Mexico. Among other accomplishments at Gibraltar, I recommended the company’s entry into Chilean exploration, which enabled Gibraltar to focus on leachable copper deposits, which can be mined in a far more environmentally sound manner than other forms of copper deposits. In particular, I identified and delineated over thirteen billion

pounds of low-cost copper in two separate ore bodies. Those assets led to the acquisition of Gibraltar by Westmin Resources Limited (“Westmin”) in late 1996.

**C. Employment at the Pacific Rim Companies**

26. After the acquisition of Gibraltar, I planned to take time off to relax and be with my family. Shortly after leaving Gibraltar, however, I was contacted by Catherine McLeod-Seltzer. She asked me if I would accept a job as the CEO of the Pacific Rim Companies, which at the time owned an interest in the Diablillos silver mine in Salta, Argentina.

27. At the time, I knew Ms. McLeod-Seltzer by reputation because of her role in co-founding and financing a company called Arequipa Resources Ltd. (“Arequipa”), which had just been acquired by Barrick for close to US\$1 billion. At Arequipa, Ms. McLeod-Seltzer had shown great talent in financing a remarkably successful project. But, as Ms. McLeod-Seltzer explained to me, her background was in finance, not geology. She was looking for someone with a proven track record of finding and developing significant mineral deposits, and leading teams of geologists and mining engineers. She hoped I could play that role for the Pacific Rim Companies.

28. Ms. McLeod-Seltzer’s offer provided the potential to be part of another successful mining project, but at the time, I was receiving many other offers that would have afforded that same opportunity. I had not intended to rejoin the work force so shortly after leaving Gibraltar. But I quickly recognized that Ms. McLeod-Seltzer and I shared certain values as well as the same philosophy as to how a mining operation should be run.

29. Ms. McLeod-Seltzer's father and grandfather had worked as gold miners in Canada. She fully understands the impact that management, engineering, and technology can have on safety, the environment, and the entire community where a mine is located. At that point in my career, I had spent nearly twenty years working as an exploration geologist in some of the most naturally beautiful areas in the world. I was (and remain) an avid environmentalist and outdoorsman. I know that certain types of mining can be performed in an environmentally benign manner, while also bringing enormous economic benefits to local communities.

30. Thus, both Ms. McLeod-Seltzer and I believe that mining companies – especially those operating in the developing world – should place a heavy emphasis on social and environmental responsibility and on sustainable development. We share these beliefs as a matter of personal conviction. But we also believe that well-run mining projects, with proper environmental and safety controls, are more profitable in the long-run for investors, for several reasons. First, we are both convinced that there should and increasingly will be no tolerance for mining operations in developing countries that do not meet the highest safety and environmental standards. Second, we both recognize that the human and financial costs of avoiding environmental problems are dramatically less expensive than cleaning them up after they have already arisen. Third, we believe that, in the long run, consumers of precious metals will be willing to pay more for such products if they are produced from “green” operations. And in fact, over the last decade, many companies purchasing gold and other precious metals have begun to require environmental certifications concerning the producer's operations (as in, for example, Tiffany's “Green Gold” initiative).

31. Ms. McLeod-Seltzer and I were very much “on the same page” from a philosophical standpoint. This was extremely important to me at that stage of my life and career.

32. On a practical level, Ms. McLeod-Seltzer also assured me that I could establish offices in Reno, hire my own team of geologists to work with me, and run the mining operations of the Companies from there.

33. After discussing Ms. McLeod-Seltzer’s offer with my family, I decided to accept it, and began work as the CEO of the Pacific Rim Mining Corp. in February 1997. Ms. McLeod-Seltzer was the President of Pacific Rim Mining Corp. through 2005. I assumed the title of President, which I held in addition to that of CEO, commencing in January 2006. At that point, Ms. McLeod-Seltzer became the Chairman of the Board of Directors, a position she still holds today.

## **II. OVERVIEW OF THE PACIFIC RIM COMPANIES**

### **A. Early History**

34. Shortly after assuming the CEO position in February 1997, I set up offices in Reno.<sup>1</sup> I hired an Office Manager, Marjorie L. Scherer, who holds that position today. In March 1997, we established Pac Rim Exploration (originally called Andes Exploration Inc.) as a Nevada corporation headquartered in Reno. Pac Rim Exploration was directly owned by Pacific

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<sup>1</sup> The offices were established at their current location, 3545 Airway Drive, Reno, Nevada 89511. From April 2001 to June 2003, they were relocated to the 3550 Barron Way, Suite 12-B, Reno, Nevada 89511, but then returned to the Airway Drive address.

Rim Mining Corp. from March 1997 to December 2007, when, as part of a corporate reorganization, it became a direct subsidiary of Pac Rim Cayman, which, at the same time was domesticated to Nevada from the Cayman Islands. (I describe this reorganization, and the reasons for it, further below.)

35. From the beginning, Pac Rim Exploration served as the exploration arm of the Companies. In Reno, we planned the Companies' exploration and mining activities. Pac Rim Exploration employed the Companies' senior geologists (including myself), paying their salaries and benefits and providing them with office space. Pacific Rim Mining Corp. handled the financing, accounting, and other administrative functions of the Companies in Vancouver. We were leanly staffed in both offices. We have never had more than five full-time employees in Reno. We have never had more than seven full-time employees in Vancouver.

36. From the outset, I oversaw virtually every operational aspect of the Companies. Although Ms. McLeod-Seltzer held the title of President, she was principally focused on finance and marketing. Her financial expertise – and her reputation and credibility in the financial markets – is one of the reasons that we are still in existence today. But Ms. McLeod-Seltzer was not involved in the Pacific Rim Companies on a full-time basis. Since 1997, my sole focus has been on running the Pacific Rim Companies, which has been more than a full-time job.

37. In early 1997, I hired two top-flight geologists, William T. Gehlen and David Ernst. I have known both of them since I was a student, and was a research assistant with Mr. Gehlen at the University of Idaho. Like me, Mr. Gehlen and Mr. Ernst are both U.S. citizens and long-time residents of Nevada.

38. I had worked with Mr. Gehlen and Mr. Ernst on previous projects for other companies and had been sufficiently impressed by their talent and capabilities that I hired them as full-time geologists when I was the Vice President of Exploration at Gibraltar. Together, Mr. Gehlen, Mr. Ernst, and I formed the core team of geologists at Gibraltar. We became the core team of geologists for the Pacific Rim Companies in 1997 and remain so today.

39. Mr. Gehlen currently serves as the Vice-President of Exploration for both Pacific Rim Mining Corp. and Pac Rim Exploration and maintains an office in the Companies' Reno offices. He also serves as the President of the Companies' two Salvadoran subsidiaries, PRES and DOREX. Since 2002, Mr. Gehlen has primarily divided his time between the Companies' El Salvador and Reno offices. Mr. Ernst serves as the Chief Geologist for Pacific Rim Mining Corp. and Pac Rim Exploration and also maintains his office in Reno. The salaries of Messers Gehlen and Ernst are paid by Pac Rim Exploration and the Salvadoran entities, and both men report directly to me.

40. As you can see from the organizational chart appended to my witness statement,<sup>2</sup> in addition to Pac Rim Exploration, we also established Pac Rim Cayman in 1997 as a holding company in the Cayman Islands to hold the Companies' subsidiaries outside of the United States. At the time, for tax and other reasons, international mining companies were often organized with this type of structure, *i.e.*, with an ultimate Canadian parent and one or more intermediate offshore holding companies to own the other foreign subsidiaries.<sup>3</sup> At the time, I

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<sup>2</sup> The Pacific Rim Mining Companies' Organizational Structure (1997) (C-23).

<sup>3</sup> See Rocky Mountain Mineral Law Special Institute, Mineral Development in Latin America, Chapter 13, Taxes and the Structuring of Investments in International Mining Ventures (Nov. 1997) (CL-71).

was advised by an outside consultant that this was the best way to structure the Companies, and it was at my direction that Pac Rim Cayman was created.

41. I am surprised and puzzled by Respondent's assertion in its Memorial on Jurisdiction that Pac Rim Cayman is not, as we described it in our Notice of Arbitration, "an environmentally and socially responsible mining company dedicated to the exploration, development, and extraction of precious metals in the Americas."<sup>4</sup> The Pacific Rim Companies, individually and collectively, work toward the same goal: "environmentally and socially responsible mining." The Companies, individually and collectively, are "dedicated to the exploration, development, and extraction of previous metals in the Americas." That statement applies with equal force to Pacific Rim Mining Corp., Pac Rim Exploration, Pac Rim Cayman, the Salvadoran subsidiaries, and all of the entities that comprise the Pacific Rim Companies. A mining holding company is and should be defined by the types of holdings it has, and how it manages those holdings. I stand by the statement that Pac Rim Cayman – as the company through which we owned and managed our Salvadoran mining project, and which we intended would establish new standards for environmentally and socially responsible mining – is accurately described in our Notice of Arbitration.

**B. The Merger with Dayton Mining Corporation in 2002**

42. Beginning in 1997, and over the next few years, we continued to devote attention to the Diablillos project in Argentina. We also acquired several additional projects in Argentina and spent considerable time exploring in Mexico and Peru.

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<sup>4</sup> Republic of El Salvador's Memorial Objections to Jurisdiction, paras. 51-52 (15 Oct. 2010) ("Objections") (quoting Notice of Arbitration, para. 14).

43. By 2001, despite our efforts in Argentina, Mexico, and Peru, we had not found a project with which we were satisfied.

44. We decided to refocus our strategic planning and limit our exploration activities specifically to low-sulfidation type epithermal gold deposits. Low sulfidation is important to be able to mine the deposit with minimal environmental impact. In addition, this type of deposit has the capability to yield large amounts of high quality gold at relatively low costs. It is important to remember that in 2001, the price of gold was trading at about US\$270 an ounce (whereas current gold prices are close to US\$1400 an ounce). Given the relatively low price of gold at the time, we were looking for a low cost operation with the potential for significant, high-quality output, and where environmental risks could be controlled with careful planning but with relative ease. We were looking for such sites throughout Latin America.

45. It was around this time that I heard about the El Dorado project in El Salvador. I learned about the project while attending a meeting of the Prospectors & Developers Association in Toronto, where companies often set up booths to provide information about their ongoing projects. At the time, the El Dorado project was owned by Dayton Mining Corporation (“Dayton”), a publicly traded Canadian company that was headed up by Mr. William Myckatyn, who had been my boss at Gibraltar, and who, in 2001, was an independent member of the Board of Directors of the Pacific Rim Mining Corp. (He remains on the Board today.)

46. I recall speaking to Mr. Robert Johansing, a geologist who, at the time, was Dayton’s Project Manager for El Salvador. He told me that the El Dorado site was a low sulfidation gold deposit located in the north of El Salvador, with a resource estimate of around

300,000 ounces. My interest was sparked and I traveled to El Salvador to spend time on the property.

47. After seeing El Dorado firsthand, I recognized that there was tremendous potential – and probably far more gold than the 300,000 ounces estimated by Dayton. I quickly concluded that El Dorado was exactly what we were looking for: a very large, high-quality, low-sulfidation type epithermal deposit. Because of the nature of the deposit and its geology, it could be mined underground, in a manner that would pose minimal environmental risk, especially if accompanied by proper safety and environmental controls.

48. In addition, the deposit was located in one of the poorest regions of El Salvador, which desperately needed foreign investment and which, because of its poor soil and remote location, held little promise for agricultural development or other projects of economic value. Moreover, although El Salvador is generally a densely populated country, the area where the project is located is not densely populated. We later determined that the surface facilities for the mine would be located entirely on a former cattle ranch, and thus would pose no disturbance to local residents – while at the same time providing hundreds of well-paid, skilled jobs for the community.

49. For all of these reasons, the project appeared to have a high likelihood of meeting all of the criteria that the Companies were seeking. It promised high-yield, high-quality gold; relatively low costs; minimal environmental risks; and sustainable development for a community that desperately needed it. In candor, I also believed that my U.S.-based geological team had better experience and expertise than Dayton's to develop the project in a more efficient, productive, and environmentally sound manner.

50. Although I was originally interested only in buying Dayton's El Salvador assets, I eventually concluded that a merger with Dayton in its entirety – not just an acquisition of its assets in El Salvador – would be beneficial. In addition to its assets in El Salvador, Dayton Mining Corporation owned Dayton Mining (U.S.) Inc., which, as mentioned above, is a Nevada corporation that owned a 49% interest in a Nevada gold mining operation called the Denton-Rawhide Joint Venture (“Denton-Rawhide”). Located near Fallon, Nevada, Denton-Rawhide was expected to generate steady income for Dayton Mining (U.S.) Inc. for the next several years. I hoped that those revenues – combined with cash from the sale of the Diablillos assets in Argentina– could fund further exploration activities at the El Dorado site. Dayton also owned an asset in Chile called the Andacollo Gold Mine, which we eventually sold in 2005 to the Trend Mining Company for a total of US \$5.4 million. (Like nearly all of revenues we received between 2002 and the present, most of those monies were reinvested in El Salvador through Pac Rim Cayman.)

51. Ms. McLeod-Seltzer and Mr. Myckatyn each sat on both the Boards of Directors of Pacific Rim Mining Corp. and Dayton Mining Corporation. Therefore, they both recused themselves from consideration of the proposed merger. I headed up the Pacific Rim Special Committee that was formed to review the proposed merger. I traveled to El Salvador a second time and studied detailed information about the gold deposits and the work that had been so far done by Dayton. I also studied El Salvador's mining, environmental, and investment laws, its investment ratings, and the investment climate more generally. Beginning in the mid-1990s, El Salvador had introduced numerous reforms to encourage foreign investment in the wake of its devastating civil war, which had lasted from 1972 to 1992. As of 2001, its economy had

improved and its investment climate and regulatory environment had received relatively high ratings for the region.

52. I also met with high-ranking government officials, including Ms. Gina Navas de Hernández, the Director of the *Dirección de Hidrocarburos y Minas* (“Bureau of Mines”). Ms. Navas expressed great enthusiasm for the El Dorado project and the possibility of the Pacific Rim Companies’ investment in the country. She confirmed our understanding that Dayton’s permits were in good order; that upon satisfying the regulatory requirements of El Salvador’s Mining and Environmental Laws, we would be entitled to a mining concession; and that the Salvadoran Government was eager to build its mining industry and welcomed our proposed investment.

53. For all of these reasons, I recommended approval of the Dayton merger to Pacific Rim Mining Corp.’s Board of Directors, which in turn recommended approval of the merger to the shareholders. Following the approval of their respective shareholders, the Pac Rim Companies and Dayton merged in April 2002.

### **C. After the Merger**

54. Following the merger, the ultimate parent of the merged companies retained the name Pacific Rim Mining Corp. and remained a publicly-traded Canadian company. I retained the title of CEO and Ms. McLeod-Seltzer retained the title of President. Pacific Rim Mining Corp. retained its office in Vancouver and Ms. McLeod-Seltzer remained principally responsible for the financing, accounting, and other administrative functions of the Companies. Pac Rim Exploration retained its office in Reno and I remained principally responsible for the core mining functions of the Companies.

55. A press release issued by Pacific Rim Mining Corp. in January 2006 – when I assumed the title of President in addition to that of CEO – accurately described the respective roles that Ms. McLeod-Seltzer and I played in the Companies both before and after the merger:

The board of directors of Pacific Rim Mining Corp. (“Pacific Rim” or “the Company”) is pleased to announce the appointment of Catherine McLeod-Seltzer to the position of Chairman of the Company, reflecting her vital role in stewarding Pacific Rim toward its goal of becoming a low cost intermediate level gold producer. Ms. McLeod-Seltzer will continue to participate in Pacific Rim’s finance, marketing and administrative functions as an Executive Officer of the Company.

Thomas Shrake, previously CEO of Pacific Rim, has been appointed President and Chief Executive Officer and will continue to oversee the Company’s technical direction and strategic plans.<sup>5</sup>

Again, from 1997 to the present, I oversaw “the Company’s technical direction and strategic plans” from the Companies’ offices in Reno, Nevada. The “finance, marketing and administrative” functions of the Companies were performed in Vancouver, although all of the functions also reported to me in Nevada.

56. After the merger, we remained a small group of companies in terms of the number of full-time employees we maintained in our Reno and Vancouver offices. I was principally responsible for the strategic direction of the Companies – including what projects the Companies would undertake, where they would undertake them, and how those projects would be managed. And again, our principal focus after the merger was on our project in El Salvador,

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<sup>5</sup> Pacific Rim Mining Corp. Press Release # 06-01 “Pacific Rim Makes New Corporate Appointments” (9 Jan. 2008) (C-22).

which I managed largely from our offices in Nevada, with the advice and input from my U.S.-based geological team, who, when they were not in the field, worked with me in Reno.

57. As a result of the merger, the Companies acquired not only substantial assets in El Salvador, but also in the United States. Our consolidated 2002 Annual Report (issued to the public in August 2002) set forth that, as a result of the merger, the value of the Companies' assets were higher in the United States than in any other jurisdiction (with El Salvador second and Canada third). Every Annual Report since 2002 has shown that the Companies have significant assets in the United States. The 2002 Annual Report (and the Annual Reports that followed it) also explained that nearly all of the Companies' profit was derived from its operations in the United States – and that virtually all of that profit would be reinvested in El Salvador, which was now the principal focus of the Companies' exploration efforts.

58. Moreover, as a result of the merger, the Companies now had a majority of shareholders based in the United States and began to trade on the American Stock Exchange as well as on the Toronto Stock Exchange. Because Pacific Rim Mining Corp. maintains the status of a “foreign private issuer” in the United States, we were required to keep track of whether more than 50 percent of the outstanding voting securities of Pacific Rim Mining Corp. are held by residents of the United States. We are advised on this issue by our U.S. securities lawyers at the law firm of Dorsey & Whitney. My understanding is that if more than 50 percent of the outstanding voting securities of Pacific Rim Mining Corp. are held by residents of the United States, then Pacific Rim Mining Corp. has to satisfy other requirements to maintain its foreign private issuer status in the United States (for example, a majority of the issuer's executive officers or directors cannot be U.S. citizens or residents, and more than 50% of the issuer's assets cannot be located within the United States).

59. Accordingly, we have monitored shareholding through a variety of means, including, for example, reports generated by Broadridge Financial Solutions, Inc. (“Broadridge”), a proxy processing firm; reports generated by a firm called Computershare Ltd., which assists us in sending out shareholder material mailouts; and reports on trading volume on the U.S. and Canadian stock exchanges on which Pacific Rim Mining Corp. is traded. For each of the years 2003 to 2010, a majority of the outstanding voting securities in Pacific Rim Mining Corp. has been held by residents of the United States. For the past four years, U.S. residents have held, on average, around 60% of the outstanding voting securities. In prior years, the percentage was closer to 70%. In all the years that we have been conducting this monitoring (from mid-2002 to the present), the U.S. ownership level has never fallen below 50%.

60. The shares in Pacific Rim Mining Corp. are widely traded, but to the best of our knowledge, no single person or entity has owned more than 15% of the outstanding shares dating back to December 2003 (when Kinross Gold Corporation sold its 22% stake in Pacific Rim Mining Corp.) Each share carried one vote, so the majority U.S. shareholders have had ultimate and effective control over the Companies from 2002 forward. Their equity investments, along with profits from the Denton-Rawhide mining operations in Nevada, have substantially financed the Companies’ investments in El Salvador.

### **III. THE COMPANIES' WORK AND INVESTMENT IN EL SALVADOR**

#### **A. Planning and Developing the Project**

61. As stated above, following the merger, nearly all of the Companies' resources were devoted to El Salvador. Mr. Gehlen, Mr. Ernst and I all spent considerable time undertaking exploration activities at El Dorado and other locations in El Salvador, traveling back and forth between El Salvador and our offices in Reno.

62. We also moved Mr. Frederick H. Earnest – a U.S. citizen who had been President of Dayton's subsidiary in Chile – to El Salvador. Mr. Earnest is a highly competent and experienced mining engineer, who served as the President of PRES through late 2006, when he left the Companies to pursue another opportunity in the United States.<sup>6</sup>

63. Exploring for and finding gold – and preparing to extract it in an economical feasible and environmentally responsible manner – of course requires financial capital. But even more important – and often harder to find – are highly sophisticated, experienced, and skilled scientists who come from a variety of disciplines, and who know how to put together the various components of what ultimately comprise a successful gold mining project. A considerable part of the value that Mr. Earnest, Mr. Ernst, Mr. Gehlen and I brought to the table (in addition to our own geology and engineering skills) was being able to identify and work with the best minds in

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<sup>6</sup> The W-2 forms of Pac Rim Exploration from 2003 – 2009 are submitted as Claimant's Exhibits C-69 through C-75. They show that Pac Rim Exploration provided compensation and benefits to Mr. Gehlen, Mr. Ernst, Mr. Earnest, and myself, as well as to our Office Manager, Ms. Marjorie L. Scherer. Pacific Rim also provided compensation and benefits to Mr. Scott Wood, a U.S. citizen who worked for the Companies in El Salvador as a metallurgist and safety officer from 2005 to 2009. He was also a Vice President of PRES. The Salvadoran subsidiaries also contributed a portion of the compensation paid to those employees of Pac Rim Exploration who spend extended periods of time in El Salvador (such as Messrs. Gehlen, Earnest, and Wood).

the business to develop the El Salvador project. A significant part of the project entailed our working with outside firms to plan, design, and develop the project. We developed these plans and designs working primarily in the United States with U.S. firms. We used these firms because we believed them to be the best in the world and because we wanted our project to be the best of its kind in the world.

64. For instance, I selected SRK Consulting, based out of Denver, Colorado – and one of the leading independent preparers of mining feasibility studies in the world – to be the lead author of the required Pre-Feasibility Study (which, in all of the jurisdictions that I am aware of, is more than sufficient to meet the regulatory requirements for an exploitation concession, while also meeting standards applicable to the financing of mining companies that are publicly traded in the United States and Canada). In fact, the bank with which we were discussing financing at the time had specifically recommended SRK to play this role.

65. Other components of the application relied upon reports and studies generated by several other consultants who are recognized internationally in the mining industry for the quality of their work in their respective areas of expertise. For example, Mine & Mill Engineering, a company based out of Salt Lake City, Utah, helped us to design the mine’s above-ground facilities. McIntosh Engineering Inc., in Tempe, Arizona, helped us design the underground mine. McClelland Laboratories, Inc., a Reno, Nevada firm, performed all of the necessary metallurgical testing. Call & Nicholas, a Tucson, Arizona company, performed the rock mechanics and stability testing. Vector Engineering, based out of Grass Valley, California and Denver, Colorado, performed all the hydro-geologic work regarding aquifers, designed the tailing impoundment design, and took the lead in preparing the *Estudio de Impacto Ambiental* (“Environmental Impact Statement”) submitted by the Companies in conjunction with the

environmental permit application. Furthermore, the “core samples” obtained by exploratory drilling in El Salvador were analyzed in Reno, Nevada and parts of these core samples are stored in a facility in Colorado. The core is a cylinder of material retrieved by drilling below the surface of the ground. Geologists study the core for mineral percentages and the location of the minerals within the rock formations, which give them the information necessary to begin or abandon mining operations in a particular area, as well as to proceed with further exploration and mining if the decision is made to do so. Exploration geologists consider the core samples to be among the keys to unlocking and understanding mineral deposits as well as determining the “rock mechanics” for designing sound underground workings.

66. In addition, the monies used to pay these U.S. firms came principally from the profits earned by Dayton Mining (U.S.) Inc. from the Denton-Rawhide gold mine in Nevada. Virtually all of the invoices issued by these firms were sent to our offices in Reno, Nevada.<sup>7</sup> Pac Rim Exploration would then pay those invoices with monies that were often transferred directly from Dayton Mining (U.S.) Inc.

67. Thus, virtually all of the intellectual property invested by the Companies in El Salvador originated in the United States, and was paid for by the Companies’ U.S. subsidiaries with monies earned by the Companies in the United States.

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<sup>7</sup> Attached as Claimant’s Exhibits C-37 through C-42 are documents directing all of these consultants to send their invoices to our Reno office.

**B. Working with the Government and the Local Communities**

68. From the beginning of our work in El Salvador, my colleagues and I worked hard to develop open relationships with officials throughout the Government, and in particular with officials from the *Ministerio de Medio Ambiente y Recursos Naturales*, or the Ministry of the Environment (“MARN”) and the *Ministerio de Economía*, or the Ministry of the Economy (“MINEC”), in which the Bureau of Mines resided. We of course wanted these officials to like and trust us. But we also wanted to listen to their concerns so we could understand and address them. It was important to us that this be a “two-way street.”

69. For the same reasons, we held numerous community meetings in and around Sensuntepeque and San Isidro, the main towns in the area, located some 12 kilometers from the El Dorado site and on the El Dorado site, respectively, so that we could describe our plans for the mine as well as listen to the community’s concerns. One of the cardinal rules of Corporate Social Responsibility (“CSR”) is to maintain an open dialogue with the local communities where the corporation intends to work, recognizing that those communities are going to be significantly affected by the corporation’s presence. We honored that rule throughout our time in El Salvador. As discussed below, we designed our project specifically to address numerous, legitimate concerns raised by the local community members during our many meetings and discussions with them.

70. Based on our conversations with officials in MINEC and MARN (as well as our consultations with the local community) we believed that we had the support we needed for our project to succeed.

### C. The Application Process

71. At the time of the 2002 merger, Dayton had held two exploration licenses for El Dorado. One covered a portion of the site known as El Dorado Norte. The other covered a portion of the site known as El Dorado Sur. By 2004, we had verified substantial gold deposits at the El Dorado Norte and El Dorado Sur license areas. In March 2004, we filed on PRES's behalf an application with MARN for an environmental permit. We also worked on the required Environmental Impact Statement ("EIA") for exploitation activities for submission to MARN. As the Tribunal knows from an earlier part of this case, the Mining Law requires these items (among others) to obtain an exploitation concession.

72. Over the summer of 2004, Mr. Earnest expressed concern to Ms. Navas, the Director of the Bureau of Mines, that MARN appeared not to be moving on our application for an environmental permit. He wondered if that would affect PRES's ability to solicit an exploitation concession. In response, Ms. Navas wrote Mr. Earnest a letter in which she assured him that PRES's application for an exploitation concession would not be affected by any potential delay in receiving the environmental permit.<sup>8</sup>

73. We worked closely with Ms. Navas and MINEC in preparing our application for the exploitation concession, which we planned to submit in December 2004. For example, we had told MINEC that we originally intended to submit an application for an exploitation concession that would cover the entire El Dorado Norte and El Dorado Sur exploration areas. In response, MINEC told us that it could not approve a concession covering such a large area.

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<sup>8</sup> Letter from Ms. Gina Navas de Hernández, Director of Department of Mines to Pacific Rim (25 Aug. 2004) (Notice of Arbitration, Exhibit 6).

Accordingly, we worked with MINEC to define an acceptable portion of the two license areas over which we could solicit an exploitation concession. We agreed to remove certain areas from the ambit of the concession application. These areas were called Huacuco, Pueblos, and Guaco. Again, in consultations with MINEC, we established a new company – DOREX – which then applied for and received exploration licenses, so that we could continue our exploration activities in these areas, without losing our right to apply for an exploitation concessions covering these areas at a later date. I believe this was one of many examples where we worked constructively with officials of MINEC to address their concerns and to make our way together through a regulatory process that was new both to us and to the Salvadoran government.

74. In the meantime, in September 2004, we submitted our Exploitation EIA with MARN. By December 2004, we had not received any formal response. In a letter dated 15 December 2004, Mr. Earnest wrote a letter to the Minister of the Environment, Mr. Hugo Barrera, asking for the reasons for the delay, and requesting a meeting. Mr. Earnest noted that more than sixty days had passed since the submission of the EIA.<sup>9</sup>

75. Early in the application process, it became apparent that the Government was not going to adhere strictly to many of the time periods which, under the laws and regulations, the Government was supposed to follow. Having previously worked in countries with relatively new regulatory regimes, we were not particularly surprised. We wanted to be flexible and cooperative; we did not want to rush the Government officials who, at the time, expressed support for our project. At that time, the Government officials with whom we were working appeared to be proceeding out of caution rather than any sort of opposition to the project. They

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<sup>9</sup> Letter from PRES to the Minister of the Environment (15 Dec. 2004) (R-55).

appeared to want to work with us constructively – and we with them – as we together navigated El Salvador’s relatively new Mining and Environmental laws and regulations. Again, we realized that our project was one of the first of its kind and we were willing to be patient and work with the Government in responding to its questions and concerns.

76. In February 2005, MARN responded to our Exploitation EIA with a series of observations. We spent the next several months addressing these observations. We prepared a supplemental volume to the Exploitation EIA addressing these observations, which we submitted to MARN in April 2005.

77. We then received additional comments and input from MARN. Over the summer of 2005, working with MARN (which continued to provide us comments and observations through August 2005), we revised the Exploitation EIA. We submitted the revised and updated Exploitation EIA to MARN in September 2005.

78. In October 2005, in accordance with the Environmental Law and MARN’s instructions, we published information related to the EIA in local newspapers in order to allow the public the opportunity to provide comments on the assessment. At the same time, we held another round of public meetings with local community members to present and explain the EIA.

79. In March 2006, MARN provided us with the observations to the EIA that had been submitted during this required public comment period. In July 2006, MARN supplemented these observations with thirteen additional comments. The provision of these additional comments was not specifically provided for within the permitting process, which was supposed to conclude with the public comment period. But again, we wanted to be as cooperative, forthcoming, and flexible as possible. Thus, in September 2006, we filed a response to the

public comments on the EIA, and in October 2006, we filed a response to MARN's additional thirteen comments.

80. Finally, in December 2006, we presented MARN with a design for a state-of-the-art water treatment facility and reservoir. This is one of the aspects of the mine design that I am most proud of. When we arrived in El Salvador in 2002, the river system near the El Dorado site was already severely polluted with fertilizers, insecticides, defoliates, detergents, and bacteria. These waters serve for farming, laundry, bathing, and sanitation.

81. In addition to the community's concerns about the polluted water, one of the concerns most frequently expressed to us in our meetings with local community members had been about the water supply. In the rainy season, water was plentiful; in the dry season, however, water was scarce. Accordingly, we designed a reservoir system that would collect water during the rainy season and maintain it for the mine's use during the dry season. In this way, the mining operations would never utilize the already-scarce river water. To the contrary, some of the mining operations would have discharged used rainwater into a local tributary, after first running it through the water treatment facility. This discharged water would have been in a state clean enough to meet federal discharge standards in the United States and would have significantly increased the amount of water present in the river during the dry season.<sup>10</sup>

82. Our plans, if implemented, would have significantly increased the amount of clean water available in the area and provided clean water for community use during the dry season, when water shortages are more critical.

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<sup>10</sup> Pacific Rim Mining Corp., Social and Environmental Responsibility (C-59).

83. Although I realize that this is not the place to describe our mine design and environmental safeguards in detail, I will add that the proposed design and safeguards were “state-of-the art” in all other respects – and in many ways would have raised the bar for what “state-of-the-art” means for environmentally clean mining in the Americas (including North America). We were so insistent on adhering to the highest standards for environmental safety that we intended to implement a plan, developed in part by the United Nations Environment Programme, under which our operations would be regularly audited by *independent* auditors who would require adherence to the highest environmental standards. These standards, and the audits, would include every aspect of the operations to ensure that they were carried out in accordance with the highest global health and safety standards.

84. During the same time frame that we were working with MARN to complete our application and EIA, and to address all of MARN’s concerns, we were also in constant contact with the Bureau of Mines and MINEC. One of the many issues that we discussed with MINEC was the so-called land surface ownership, which, as the Tribunal may recall, came up during the first round of El Salvador’s objections. Specifically, in March 2005, shortly after PRES’s submission of an exploitation concession for El Dorado, the Director of the Bureau of Mines, Ms. Navas, informed us that several persons in MINEC were of the view that the Mining Law required PRES to acquire ownership of, or authorization to use, the land ownership surface overlaying the concession.

85. In consultation with our legal counsel in El Salvador, we had studied this issue closely. We believed that the Mining Law did not require ownership of or authorization to use the entire land surface overlaying the concession, and, moreover, that such a requirement was nonsensical for a variety of legal and practical reasons. Many of the Salvadoran officials with

whom we spoke seemed to share our views. Even those officials who did not share our view that the language of the Mining Law was clear on this issue thought that a contrary reading of the law made no sense.

86. As a result of consultations with the Government – and at the encouragement of Government officials – PRES’s legal counsel in El Salvador requested an “authentic interpretation” of the law and also suggested a legislative amendment to clarify and resolve the issue. Between 2004 and 2006, we tried both approaches, but neither moved forward. At the same time, it was never clear to us whether the Government reached a consensus view on this point. (In fact, in during the first round of preliminary objections, El Salvador attached a number of documents to its submission regarding the “authentic interpretation” that I had never seen before.) We could have revised our application for an exploitation concession to focus on a much smaller part of the El Dorado site. As mentioned above, we had previously removed the Huacuco, Pueblos, and Guaco areas from the application in consultation with the Bureau of Mines. Or we could have tried to buy or acquire authorization to use the entire land surface overlaying the concession area. It seemed to us that that the legislative approach might be successful (and certainly preferable to reducing the concession size or trying to buy up all the land overlaying the proposed concession size), or that the Government might ultimately resolve the land ownership issue in our favor without legislation, and in any event, we were still waiting for MARN to issue our environmental permit for El Dorado.

87. Here, too, our approach to the issue to the mining legislation was meant to be constructive and reflect our commitment to sustainable development and the environment, which, again, we believed to be in the best interests of the Companies as well as El Salvador. In addition to suggesting amendments to the Mining Law to address the land ownership issue, we

also offered proposals to increase the royalty payments that would be paid by concessionaires to the Government; to add enhanced environmental rules and protections; to levy an additional tax against mining operations, with revenues going directly to a mining division of MARN to increase the agency's ability to properly regulate the industry; and to establish Legacy Funds at all mining operations, which would provide millions of dollars in capital to local communities to establish new businesses once the mining resources are exhausted and the operations ceased. I summarized these proposals in a letter I sent to the Minister of the Economy on 13 June 2006,<sup>11</sup> although they were also made through our counsel in El Salvador. None of these proposals was ever adopted.

88. As also discussed at length in the first round of objections, from October through December 2006, Ms. Navas exchanged correspondence with PRES concerning documentation requested by the Bureau of Mines concerning PRES's application for an exploitation concession for El Dorado. Although I was not personally involved in this exchange of correspondence, I was continuously apprised of the communications and I know that PRES submitted documentation as requested by Ms. Navas. As of December 2006, PRES believed it had submitted all of the documentation required for an exploitation concession at El Dorado, except for the environmental permit.

**D. The Government's Repeated Statements of Support for the Project and Its Assurances that the Permits Would be Issued**

89. I was particularly surprised to learn that the Government is now claiming that there was a dispute between the parties in 2006. In fact, nothing could be further from the case.

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<sup>11</sup> Letter from Tom Shrake to Yolanda de Gavidia (13 June 2006) (C-15).

During the duration of our investment, I frequently traveled to El Salvador to personally inspect the project developments and to maintain my good relationships with the various Government officials who were shepherding our applications through the permitting process or otherwise following the project.

90. From my meetings with Salvadoran officials prior to the 2002 merger with Dayton and well into 2008, officials at the highest levels in the Salvadoran Government repeatedly expressed support for our project, and, particularly in 2007 and 2008, assured us that the permits necessary to conduct extraction activities at El Dorado would be forthcoming. I recall numerous such meetings on my many trips to El Salvador.

91. For example, in October 2005, Mr. Earnest and I met with El Salvador's Vice President, Ms. Ana Vilma de Escobar, and the Minister of the Economy, Ms. Yolanda de Gavidia. The Government's officials at this meeting told us that the Saca Administration strongly supported the El Dorado project.

92. In May 2006, Ms. McLeod-Seltzer and I visited El Salvador and met with a number of Salvadoran officials, including the Vice President and the Minister of the Economy. Again, these high-ranking officials repeatedly assured us that the Government was supportive and enthusiastic about our work in El Salvador.

93. The only time prior to 2008 that I can recall hearing that any senior official in the Saca Administration was opposed to mining came shortly after the May 2006 trip that Ms. McLeod-Seltzer and I had taken to El Salvador. In July 2006, the press reported that Mr. Hugo Barrera, the Minister of the Environment, was reported as stating that he "personally" found mining to be "inconvenient" ("*no conveniente*") for El Salvador. I was sufficiently concerned

that I immediately traveled to San Salvador, where I met with Ms. Yolanda de Gavidia, the Minister of the Economy. Minister de Gavidia assured me that Mr. Barrera's statements represented only his personal views; that those views were at odds with Administration policy; that the Administration fully supported the project and intended to comply with El Salvador's applicable laws; and that Mr. Barrera no longer remained in good standing within the Administration. I also met personally with Mr. Barrera himself, who downplayed the remarks that were reported in the press and said they did not represent official policy. In any event, Mr. Barrera proceeded to depart MARN by the end of 2006 (*i.e.*, within about six months after his remarks had been reported by the press).

94. Officials representing the Salvadoran Legislature also visited me in Nevada in this time frame. I had invited them to tour the Midas Gold Mine, an underground gold mine in north-central Nevada, because I thought it would give them a good idea of what our mining operations in El Salvador would look like. The delegation, which came to Nevada in November 2006, included Mr. Guillermo Antonio Gallegos, who at the time was a senior member of President Saca's ARENA Party and the Majority Leader of El Salvador's Congress. The delegation also included Mr. Edgar Bonilla, who at the time was the Mayor of Sensuntepeque and also a member of the ARENA Party. In August 2006, I had taken Mr. Francisco de Sola on a tour of the Midas Mine in Nevada. Mr. de Sola is a prominent Salvadoran businessman and a board member of El Salvador's Business Council for Sustainable Development (which had recommended the creation of MARN). Mr. de Sola was sufficiently impressed that we decided to invite a larger delegation to visit the site in Nevada. The larger delegation that visited us in Nevada in November 2006 was equally impressed and was all very supportive of our work in El Salvador.

95. In the meantime, in December 2006, as stated above, officials from PRES presented their plans for the water treatment facility to MARN.

96. In January 2007, Mr. Peter Neilans, who then served as the Chief Operating Officer (“COO”) at Pacific Rim Mining Corp., traveled to El Salvador. A new official, Mr. Carlos José Guerrero Contreras, had by then replaced Mr. Barrera as the Minister of the Environment. Mr. Neilans met with Minister Guerrero during his trip, and reported to me that Minister Guerrero had committed that he would move the bureaucratic process forward. Neither Minister Guerrero nor any other official in the Government ever suggested that there were any problems with PRES’s EIA or its application for an environmental permit to conduct exploitation at El Dorado.

97. Based on the Government’s repeated statements of support, and its repeated assurances that the permits necessary for conducting exploitation at El Dorado would be issued, the Companies continued their work and investment in El Salvador through 2007 and afterwards. We also understood that in this timeframe, which was leading up to national elections scheduled for early 2009, some members of the Government were concerned that there was generalized opposition to mining in certain segments of the country (including among some members in the hierarchy of the Catholic Church and some members of the main opposition party, the FMLN). We thought this opposition, at least insofar as it included our operations, was extremely ill-founded. In addition, according to polls, opposition to mining represented a decidedly minority position. Most Salvadorans supported gold mining, especially if it was conducted with strong safety and environmental protections in place. Nonetheless, as long as we believed that the Government would ultimately address our El Dorado exploitation applications in accordance with El Salvador’s Mining and Environmental Laws, we continued our efforts to be patient and

cooperative. Moreover, through 2007 and into 2008, we were continuing our exploration activities, with considerable success. In each of the fiscal years 2006, 2007, and 2008, we increased the level of financial capital invested in El Salvador through Pacific Rim Cayman.

98. In March 2007, the Companies reported new discoveries of gold from exploration drilling in El Dorado Sur at a deposit called Balsamo.<sup>12</sup> We were very excited about the potential of the Balsamo gold zone. In April 2007, we reported that we were using four exploration drills and planned to add another.<sup>13</sup> In August 2007, the Companies reported that the “[o]n-going delineation drilling at the Balsamo deposit [was] nearing completion.”<sup>14</sup>

99. Also in August 2007, DOREX submitted EIAs for the Guaco and Pueblos exploration areas. In November 2007, MARN acknowledged receiving the Guaco EIA, and requested DOREX to respond to observations on it. In January 2008, MARN acknowledged receipt of Pueblos EIA, and requested that DOREX respond to observations on it. DOREX responded to MARN concerning its observations regarding the Guaco license in February 2008 and the Pueblos license in March 2008.

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<sup>12</sup> Pacific Rim Mining Corp. – News Release # 07-04, “Pacific Rim Mining’s Zamora Project Yields High Grade Gold in Surface Trenching” (27 Mar. 2007) (C-67).

<sup>13</sup> Pacific Rim Mining Corp. – News Release # 07-05, “Balsamo Gold Zone on Pacific Rim Mining’s El Dorado Project Continues to Yield High Gold Grades and Take Shape” (10 Apr. 2007) (C-49).

<sup>14</sup> Pacific Rim Mining Corp. – News Release # 07-07, “Pacific Rim Mining’s Balsamo Gold Deposit Delineation Nearing Completion; Another Gold-Bearing Vein Discovered” (2 Aug. 2007) (C-50).

100. In January 2008, we reported updated estimates of gold and silver resources at El Dorado, which at that time included total “measured and indicated resources of 1,430,000 gold equivalent ounces.”<sup>15</sup>

101. Also in January 2008, I traveled to El Salvador, where I again met with senior officials of the Government, including Mr. Guillermo Gallegos. As mentioned above, Mr. Gallegos was, at the time, the Majority Leader in Congress, who had been part of the delegation that had visited us in Nevada in November 2006. During my visit in January 2008, Mr. Gallegos told me he was confident that MARN would issue the permits, and, moreover, that the proposed amendments to the Mining Law (which included clarification of any outstanding issue concerning the surface property issue) would be approved in February of 2008.

102. In the meantime, during the 2006-08 timeframe, PRES and DOREX devoted considerable time and effort not only to exploration efforts – which employed hundreds of Salvadorans – but also to contributing to the community in other respects. As part of our community-outreach and sustainable development efforts, the Companies (among other things):

- funded health services, including free eye care to children in the community, to help them see and read better and do better in school;
- established environmental education programs in the local schools;
- established the first recycling program in the region;
- helped remove tons of refuse from the local river system; and
- planted over 40,000 trees.

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<sup>15</sup> Pacific Rim Mining Corp. – News Release, “El Dorado Gold Project M&I Resources Top 1.4 Million Gold Equivalent Ounces With an Additional 0.3 Million Gold Equivalent Ounces Inferred” (17 Jan. 2008) (C-51).

In addition, we implemented an adult literacy program. This program was created so that our existing local labor force would qualify for the skilled mining jobs which require some level of literacy.

103. As summarized above, in the many meetings I had with high-level Salvadoran officials through 2008, I was assured that the delays we were experiencing would ultimately be resolved and that our permits would be issued. Indeed, many of these officials were eager for the project to commence so that additional jobs would be created for the local communities and the mine could begin to generate tax revenues for the Government.

104. For the Government to now claim that a dispute had materialized between the parties prior to President Saca's announcement in March 2008 is highly disingenuous and completely contradicts what its officials were consistently telling me prior to that time.

#### **IV. THE DECEMBER 2007 CORPORATE REORGANIZATION**

105. As I mentioned above, the overall structure of the Pacific Rim Companies have undergone a number of changes during the roughly fourteen-year period that I have been leading them. The most significant changes came as a result of the 2002 merger with Dayton, but there were a number of changes after that as well.

106. The corporate structure that emerged from the 2002 merger was complicated and did not make sense from various tax and administrative perspectives.<sup>16</sup> Immediately following the merger, the Companies held foreign subsidiaries through a variety of different

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<sup>16</sup> The Pacific Rim Companies' Organizational Structure Immediately Following the 2002 Merger With Dayton. (C-68).

holding companies, some of which were incorporated in Canada, others of which were incorporated in the Cayman Islands. The Companies also held entities in jurisdiction where we no longer conducted business.

107. However, we did not move to clean up this structure immediately following the merger. We were leanly staffed and were focused on exploration activities, principally those in El Salvador. The first significant change in the corporate structure inherited from the Dayton merger that I can recall came in late 2004. Prior to the merger, PRES had been held by a Canadian subsidiary of Dayton Mining Corp. As mentioned above, I had previously been advised that it was preferable, for tax reasons, to hold foreign subsidiaries through companies in the Cayman Islands. Accordingly, at my direction, in around November 2004, we moved PRES from under the Canadian subsidiary and made it a direct subsidiary of Pac Rim Cayman. When we later incorporated DOREX as a new holding company in El Salvador, we also established DOREX as a direct subsidiary of Pac Rim Cayman.

108. In 2005, the Companies underwent another restructuring when we sold our interest in the Andacollo Gold Mine in Chile, which we had obtained as part of the 2002 merger. (Again, as mentioned above, the monies from that sale were largely re-invested in El Salvador.) As part of that sale, we effectively removed an entire “chain” of companies from the corporate structure.

109. In 2007, the Companies were looking for ways to save money. As reported in the Companies’ 2007 Annual Report, for the fiscal year ended 30 April 2007, the Companies

recorded a loss of US\$9.4 million for the fiscal year ended 30 April 2007.<sup>17</sup> By comparison, the Companies had recorded a loss of only \$600,000 for the fiscal year ended April 2006.<sup>18</sup> This significant increase in losses arose mainly from greater exploration activities undertaken in El Salvador, combined with less cash flow generated from the Denton-Rawhide operations in Nevada and our other investments. Accordingly, we were looking for ways to cut costs where possible.

110. At some point in 2007, our then Chief Financial Officer, Ms. April Hashimoto, suggested to me that we could cut costs by deactivating subsidiaries in jurisdictions where the Companies had not conducted business for some time, but where we still paid various fees and costs, and devoted administrative time, in order to maintain the business in good standing. In particular, as of 2007, we still maintained subsidiaries in Mexico and Peru, even though we had not done any work there for many years. Pacific Rim Mining Corp. owned the Mexican and Peruvian subsidiaries through a Cayman Islands subsidiary called Pacific Rim Caribe. To save costs, we decided to dissolve all three of these companies.

111. These discussions led us to an examination of the overall structure of the Companies. There were also administrative costs involved in maintaining Pac Rim Cayman as a Cayman Islands entity. At the same time, we were advised that there would be no adverse tax consequences to domesticating Pac Rim Cayman to Nevada – the jurisdiction from which I had managed it since 1997. In other words, we believed that by domesticating Pac Rim Cayman to Nevada, we could save administrative costs, without losing any tax benefits.

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<sup>17</sup> Pacific Rim Mining Corp. – 2007 Annual Report at 5 (C-32).

<sup>18</sup> Pacific Rim Mining Corp. – 2007 Annual Report at 5 (C-33).

112. As part of this overall assessment of the Companies' organizational structure, I also considered the Companies' potential avenues of recourse if a dispute with El Salvador were ever to arise in the future. As mentioned above, national elections were scheduled for March 2009, and at least some members of the main opposition party, the FMLN, were openly opposed to metallic mining of any type. In addition, as I watched the legislative process unfold in connection with the proposed amendments to the Mining Law, it occurred to me that amendments could be enacted that would adversely affect the Companies' enormous investments in El Salvador, which had been almost the exclusive focus of the Companies dating back to 2002.

113. In 2007, I did not think it likely that the Salvadoran Congress would enact legislation that would adversely affect our investments. I did not know that the ARENA party would lose national elections in 2009. The ARENA Party had consistently held power in El Salvador dating back to 1994. Still, prudence dictated caution. The ability of Pac Rim Cayman to bring claims under CAFTA, *if* a dispute with El Salvador were to arise in the future, was one of the factors I considered, and which – with others – weighed in favor of the reorganization. By consent resolution dated 4 December 2007, the Board of Directors approved the reorganization.<sup>19</sup>

114. Especially given Respondent's allegations that Pac Rim Cayman is nothing but a "shell" company, which was domesticated to Nevada by a Canadian company that otherwise had no ties to the United States, solely for the purpose of creating CAFTA jurisdiction over a

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<sup>19</sup> A chart showing the corporate structure of the Companies prior to resolution, along with the corporate structure that the Board resolved to implement, is attached to the Resolution (C- 58). The pre-2007 reorganization structure, and the structure ordered by the Board's 4 December 2007 resolution, are Claimant's Exhibits 55 and 57, respectively.

pre-existing dispute, I must emphasize the following: As of 4 December 2007, when the Board approved the reorganization, neither I nor anyone on the Board believed that the Companies had a dispute with El Salvador, or even that a dispute was likely. There was frustration with the pace of the regulatory process, and a belief that the exploitation permits for El Dorado should have been granted previously. But there was also, as mentioned above, the desire to continue to cooperate with the Government, and the belief the Government's senior officials were dealing with us openly and in good faith. These senior Government officials repeatedly assured us that the permits for El Dorado would be issued. Moreover, we were making considerable exploration process at El Dorado and other sites, and continued to do so into 2008. We were advised that the proposed amendments to the Mining Law were likely to pass in 2008, meaning (among other things) that we would not have to revise our El Dorado application for a smaller concession area, or try to buy or acquire authorization to use all of the surface area overlaying the concession area included in our pending application. (Again, we would have reduced the concession size of our pending application if necessary.) In addition, MARN continued to communicate with DOREX on its EIA application into early 2008.

115. Accordingly, into 2008, the Companies did not commence any type of legal proceeding against El Salvador. PRES and DOREX continued their exploration activities under licenses issued by the Government, and we continued our efforts to work cooperatively with the Government in what we believed to be a constructive and positive matter. We continued to increase the size of our investment into El Salvador.

V. **PRESIDENT SACA'S 2008 ANNOUNCEMENT OF A MINING BAN**

116. For all of these reasons discussed above, I was stunned when, in March 2008, the press reported President Saca as announcing that he opposed granting any pending mining permits. His comments were widely interpreted as imposing a *de facto* ban on metallic mining throughout El Salvador. It cast an entirely new light on the delays we had been facing. Suddenly, in the midst of an election campaign, the Government's senior official was reported as saying that the existing mining laws did not matter – and that the repeated commitments and representations made to us by the Government had been false. We interpreted President Saca's March 2008 remarks as indicating that the Government was willing to abandon, and indeed was abandoning, its mining and environmental laws for the sake of political expedience.

117. As mentioned above, we had undertaken considerable exploration efforts in 2007 and into 2008, even as our operating profits from the Denton-Rawhide mine in Nevada were dwindling. The prospect that we might *never* receive the permits necessary to conduct exploitation at El Dorado threatened the Companies' very existence. On 14 April 2008, I wrote a letter to President Saca, which stated in part:

We have been unable to obtain a formal response from the government with respect to our proposed exploitation project for El Dorado. Similarly, our other exploration projects are awaiting receiving their respective permits, as well as our new applications for exploration licenses.

\* \* \* \*

Through the press, we have noticed that you have stated that you are opposed to awarding us our operating permits. In these public statements, you have stated that, 'In principle I do not agree with granting these permits.'

\* \* \* \*

I would also like to explain to you that the situation of Pacific Rim in El Salvador is extremely critical and precarious. Should we not receive a response on behalf of your government that addresses our rights as investors, our company would be in unavoidable situation of having to initiate the resolution of controversies procedure established in the Free Trade Agreement between Central America, the United States and the Dominican Republic (CAFTA-DR).<sup>20</sup>

118. In the meantime, I initiated meetings with various high-level Salvadoran officials, in an effort to arrange for a face-to-face meeting with President Saca himself. These meetings included a three-hour session in May 2008 in Washington, D.C. with El Salvador's Ambassador to the United States, René León Rodríguez. Ambassador León had always been (and continued to be) supportive of our project. At the May 2008 meeting, Ambassador León told me that President Saca's statement had been driven purely by domestic politics.

119. Finally, the U.S. Ambassador to El Salvador, Charles T. Glazer, arranged for me to meet with President Saca in San Salvador on 25 June 2008. The meeting was attended by President Saca; Ambassador Glazer; Mr. Donn-Allan Titus, the Economic Counselor at the U.S. Embassy to El Salvador; Mr. Carlos José Contreras Guerrero, who, as mentioned above, had become Minister of the Environment in January 2007; and Ms. Yolanda de Gavidia, the Minister of the Economy. At the meeting, President Saca said that he was not opposed to mining but was worried that issuing permits to PRES would cost his ARENA party votes in the upcoming elections. President Saca stated that his Administration would issue PRES both the environmental permit and exploitation concession for El Dorado in April 2009, after the national elections scheduled for the end of March 2009. President Saca then told me that I should meet

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<sup>20</sup> See Letter from Tom Shrake to President Saca (14 Apr. 2008) (Notice of Arbitration, Exhibit 8).

with Ministers Guerrero and de Gavidia to find a solution that would not hurt the ARENA party in the upcoming elections.

120. Later in the day on 25 June 2008, at President Saca's direction, I met with Minister Guerrero. Although President Saca had requested Minister de Gavidia to attend this meeting as well, she did not appear, and resigned her position as Minister of the Economy the next day. Minister Guerrero and I were not able to come to any sort of agreement at our meeting on 25 June 2008.

121. Despite President Saca's statement to me that he was in favor of mining – and his encouragement for me to work with his Ministers to find a satisfactory arrangement – he continued to make anti-mining statements in public. In a press interview dated 15 July 2008, President Saca stated:

[F]or now, I will not grant mining permit, until two requirements are satisfied.<sup>21</sup>

122. The first requirement, according to President Saca, was that new mining legislation had to be passed. As of the date of this Witness Statement, to the best of my knowledge, there have been no changes to El Salvador's Mining Law.

123. The second requirement, he said, was for MINEC and MARN to complete a "study" on the environmental effects of mining on the entire country. Nine months after the July 2008 press interview in which he reportedly made these statements, we filed Claimant's Notice

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<sup>21</sup> See *Saca afirma que no concederá permisos de extracción minera*, CADENAGLOBAL.COM (15 July 2008) (C-61).

of Arbitration. As of that date – 30 April 2009 – no nationwide environmental study had been commenced. Such a study was announced in the Salvadoran press in September 2010 – *i.e.*, about a year and a half after we commenced this arbitration, and about a month after this Tribunal rejected El Salvador’s first set of objections.

124. It is fair to say that following reports of President Saca’s statements to the press in July 2007, I no longer believed that the Government’s officials, and in particular, President Saca, were dealing with us in good faith. In the meantime, the Companies’ financial situation continued to deteriorate. On 29 February 2008 – just prior to President Saca’s reported comments in mid-March – the share price of Pacific Rim Mining Company’s stock was US\$1.21. By 30 June 2008, it had fallen to US\$0.80 – a decline of more than 30%. In addition, as stated above, the profits from the Denton-Rawhide facility in Nevada continued to dry up.

125. In July 2008, at my direction, PRES and DOREX suspended drilling activities in El Salvador. In one of the most painful and difficult decisions I have ever made, I directed PRES and DOREX to begin laying off its employees in El Salvador. By the end of July 2008, we had laid off over 200 employees in the country.

126. In September 2008, I personally travelled from Reno to Vancouver to conduct layoffs in that office. I met with Ms. Hashimoto and Mr. Neilans (who, as mentioned above, were our CFO and COO, respectively), as well as with our Controller, Ms. Minenko, and the receptionist in the Vancouver office, Ms. Morales, so that I could personally give them notice that we were terminating their employment. Also, in November 2008, Rim Mining Corp. vacated the offices it had previously leased in Vancouver, and moved into smaller office space in

Vancouver, which it shares with a number of other companies.<sup>22</sup> In 2009 and 2010, there have been further layoffs in El Salvador, Canada, and the United States. There is currently one full-time employee in the Vancouver office; there are currently three full-time employees in the United States; and there are currently five full-time employees in El Salvador.

127. Into December 2008, we continued our efforts to reach an amicable solution with the Government. At one point in early December 2008, MARN offered to issue the environmental permit for exploitation at El Dorado, but then conditioned the permit issuance on a whole new series of “milestones” that appeared designed only to delay the process further.

128. On 9 December 2008, Claimant submitted its Notice of Intent under CAFTA Article 10.16.

129. On 9 February 2009, President Saca was quoted in the press as stating:

While Elías Antonio Saca is in the Presidency, he will not grant a single permit [for mining exploration], not even environmental permits, which are issued prior to [the mining permits] being granted by the Ministry of the Economy.

\* \* \* \*

[Claimant is] about to file an international complaint, and I would like to reaffirm, I would prefer to pay the \$90 million than give them a permit.<sup>23</sup>

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<sup>22</sup> Pacific Rim Mining Corp. – Corporate Announcement “Pacific Rim is Moving” (26 Nov. 2008) (C-63).

<sup>23</sup> Notice of Arbitration, para. 79, (quoting *President of El Salvador asks for caution regarding mining exploitation projects*, INVERTIA, 11 Mar. 2008, (C-1)).

130. Also in February 2009, it was reported in the press that the newly installed Archbishop had stated his opposition to mining in El Salvador and wanted the leading presidential candidates to state their opinions. It was further reported that the FMLN's presidential candidate, Mr. Mauricio Funes, immediately stated that he agreed with the Archbishop and promised to ban mining in an open letter styled "*Bienvenido Buen Pastor*."<sup>24</sup>

131. On 15 March 2009, Mr. Funes won the presidential elections in El Salvador. Following the elections, the Companies' representatives again reached out to representatives of both President Saca and President-elect Funes to see if a negotiated solution could be reached. Unable to obtain such a solution, Claimant filed this arbitration 30 April 2009.

132. By 15 April 2009, just prior to the date Claimant filed its Notice of Arbitration, the share price of Pacific Rim Mining Corp. had fallen to just under US\$0.17. Again, on 30 April 2008 – one year earlier, and just before President Saca began making anti-mining statements to the press – the share price had been about US\$1.21. Within the year prior to Claimant's filing its Notice of Arbitration, the market value of Pacific Rim Mining Corp. had fallen dramatically from approximately US\$ 140 million to under US\$20 million.

133. Since his election, President Funes has been reported on several occasions as stating his opposition to all metallic mining in the country.<sup>25</sup>

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<sup>24</sup> *Un año de espera*, DiaroCoLatino.com (19 May 2010) (C-65).

<sup>25</sup> *Funes rules out authorization of mining explorations and exploitations in El Salvador*, by EFE AGENCY (27 Dec. 2009) (C-2); *No to Mining: Presidential Commitment*, PRENSA GRAPHICA (13 Jan. 2010) (C-3).

Being in full agreement with the statements contained in this document, I hereby sign it  
and acknowledge its contents on this 31 day of December 2010.



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Thomas C. Shrake