

**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**

COMMERCE GROUP CORP,)
)
Claimant,)
)
vs.)
)
REPUBLIC OF EL SALVADOR,)
)
Respondent.)

NOTICE OF ARBITRATION

The claimants, Commerce Group Corp. and San Sebastian Gold Mines, Inc., by their attorneys, Machulak, Robertson & Sodos, S.C., hereby request arbitration of a dispute with the respondent, Republic of El Salvador, under the ICSID Convention and the ICSID Rules of Procedure for Arbitration Proceedings, as follows:

1. This is a request pursuant to Article 36 of the Convention on the Settlement of Investment Disputes Between States and Nationals of Other States (“ICSID Convention”), Articles 10.16(1)(a), 10.16(1)(b), and 10.16(3)(a) of the Central America - United States - Dominican Republic Free Trade Agreement (“CAFTA-DR”), and Article 15(a) of the Ley de Inversiones of El Salvador (“Investment Law”) for arbitration under the ICSID Convention and the ICSID Rules of Procedure for Arbitration Proceedings.

2. The underlying claim is a legal dispute arising directly out of the claimants’ investment. It is a dispute between a Contracting State, El Salvador, and nationals of another Contracting State, Commerce Group Corp. and San Sebastian Gold Mines, Inc.

3. The Republic of El Salvador is a Contracting Party to the ICSID Convention, which it signed on June 9, 1982. The ICSID Convention entered into force in El Salvador on April 5, 1984. The United States of America is a Contracting Party to the ICSID Convention. It signed the Convention on August 27, 1965 and the Convention entered into force in the United States of America on October 14, 1966. is a “national of another Contracting State” for purposes of the ICSID Convention.

4. Pursuant to Article 10.27 of CAFTA, service of this Notice of Arbitration may be made on El Salvador using the following address:

Republic of El Salvador
Dirección de Administración de Tratados Comerciales
Ministerio de Economía
Alameda Juan Pablo II y Calle Guadalupe, Edificio C 1-C2
Plan Maestro Centro de Gobierno
San Salvador — El Salvador

5. The claimant, Commerce Group Corp. (“Commerce”) is a United States corporation organized under the laws of the State of Wisconsin which has investments in the Republic of El Salvador. Commerce was organized in 1962 and its common shares have been publicly traded since 1968. Commerce’s address in the United States is 6001 North 91st Street, Milwaukee, Wisconsin 53225. Commerce is a “national of another Contracting State” for purposes of the ICSID Convention.

6. The claimant, San Sebastian Gold Mines, Inc. (“Sanseb”) is a United States corporation organized under the laws of the State of Nevada on September 4, 1968 which has investments in the Republic of El Salvador. Commerce owns 82 1/2% of the authorized and issued common shares of Sanseb. Sanseb’s address in the United States is 6001 North 91st Street, Milwaukee, Wisconsin 53225. Sanseb is a “national of another Contracting State” for purposes of the ICSID Convention.

7. On September 22, 1987, Commerce and Sanseb entered into a joint venture agreement (named the “Commerce/Sanseb Joint Venture”) to formalize the relationship between them. The Commerce/Sanseb Joint Venture is registered as an operating entity authorized to do business in the State of Wisconsin, U.S.A. and in the Republic of El Salvador, Central America. The joint venture agreement authorizes Commerce to execute agreements on behalf of the Commerce/ Sanseb Joint Venture. The Commerce/Sanseb Joint Venture is a “national of another Contracting State” for purposes of the ICSID Convention.

8. Mineral San Sebastian, S.A. de C.V. (“Misanse”) is an El Salvadoran corporation formed on May 8, 1960, reinstated on January 25, 1975 and reincorporated on October 22, 1993. Commerce owns 52% of the authorized and issued common shares of Misanse.

9. Starting in 1968, Commerce and Sanseb have been in the business of the exploration, development, mining, and production of precious metals in El Salvador at the San Sebastian Gold Mine near Santa Rosa de Lima and at other locations.

10. Commerce and Sanseb began producing gold at the San Sebastian Gold Mine site in 1968. In February, 1978, they suspended operations because of the war in El Salvador. The

mill which had been constructed on site at the San Sebastian Gold Mine was destroyed during the war. In 1985, Commerce and Sanseb returned to San Sebastian to resume operations and were able to re-hire many of their former employees.

11. On July 23, 1987, in a ceremony officiated by former Presidente Napoleon Duarte, Commerce and Sanseb were awarded the exploitation concession for the San Sebastian Gold Mine. At this time, the Commerce/Sanseb Joint Venture entered into an agreement with Misanse to lease the 304-acre site of the San Sebastian Gold Mine and develop the concession.

12. In 1993, Commerce/Sanseb acquired a mill for processing gold and silver, known as the San Cristóbal Mill and Plant. This facility is located on the Pan American Highway west of the city of El Divisadero. Commerce/Sanseb purchased the equipment on February 23, 1993 and signed a lease for the site with CORSAIN on November 12, 1993. The equipment required extensive retrofitting. Later, Commerce/Sanseb purchased a crushing system to be operated at the site of the San Sebastian Gold Mine.

13. In September 1993, Commerce/Sanseb expanded its mining interests when it acquired the El Modesto Mine located near the city of El Paisnal and about 19 miles north of San Salvador, with a view toward future exploration and exploitation concessions.

14. Commerce/Sanseb produced 22,710 ounces of bullion containing 13,305 ounces of gold and 4,667 ounces of silver at the San Cristóbal Mill and Plant from March 1995 through December 31, 1999. Commerce/Sanseb suspended production intending to expand the facility from its then existing 200-ton-per-day capacity to a 500-ton-per-day operation.

15. On September 6, 2002, at a meeting held with the El Salvadoran Minister of Economy and the Department of Hydrocarbons and Mines, Commerce/Sanseb agreed to cancel the concession for the exploitation of the San Sebastian Gold Mine obtained on July 23, 1987, in exchange for a new concession. On August 18, 2003 (delivered August 29, 2003) the Ministry of Economy issued a twenty-year concession. On May 20, 2004 (delivered June 4, 2004) the Government of El Salvador extended the exploitation concession for a period of thirty (30) years.

16. Commerce/Sanseb applied for and received environmental permits to mine gold ore at the San Sebastian Gold Mine site, and process ore at the San Cristóbal Mill and Plant. On October 15, 2002, the El Salvador Ministry of Environment and Natural Resources ("MARN") issued an environmental permit under Resolution 474-2002 for the San Cristóbal Mill and Plant. On October 20, 2002, MARN issued an environmental permit under Resolution 493-2002 for the new San Sebastian Gold Mine exploitation concession. Financial security bonds were submitted as required. This permit was later renewed for a three-year period with the issuance of Resolution No. 3026-003-2006 dated January 4, 2006.

17. In connection with the new San Sebastian Gold Mine concession, Commerce/Sanseb provided a bond to protect third parties against any damage caused from the mining

operations. Also, on January 14, 2003, the Company entered into an amended and renewed 30-year lease agreement with Misanse.

18. On March 3, 2003, the Government of El Salvador granted Commerce/Sanseb a new exploration license for a 41-square kilometer area (10,374 acres), which surrounded the site of the San Sebastian Gold Mine and included three other formerly-operated mines (the “New San Sebastian Exploration License”).

19. On May 25, 2004, the Government of El Salvador granted Commerce/Sanseb a new exploration license for an additional 45 square kilometers of area (11,115 acres) to the North of and abutting the New San Sebastian Exploration License area. This new license area encompassed eight formerly-operated gold and silver mines (the “Nueva Esparta Exploration License”).

20. After receiving the New San Sebastian Exploration License and the Nueva Esparta Exploration License, Commerce/Sanseb invested resources for the exploration of these areas for precious metals including explorations at the La Lola Mine, the Santa Lucia Mine, the Tabanco Mine, the Montemayor Mine, and the La Joya Mine. This was done with the expectation that Commerce/Sanseb would ultimately receive exploitation concessions for these sites.

21. Then, on or about September 13, 2006, MARN delivered to Commerce/Sanseb’s El Salvadoran legal counsel its revocation of the environmental permits issued for the San Sebastian Gold Mine exploitation concession and the San Cristóbal Mill and Plant, effectively terminating Commerce/Sanseb’s right to mine and process gold and silver. This was done without justification or any forewarning.

22. On December 6, 2006, Commerce/Sanseb’s legal counsel filed with the El Salvadoran Court of Administrative Litigation of the Supreme Court of Justice two complaints relating to this matter, one for the San Sebastian Gold Mine and the other for the San Cristobal Mill and Plant. These legal proceedings have not been resolved.

23. On October 10, 2006, Commerce/Sanseb applied to MARN for an environmental permit for its exploration in connection with the New San Sebastian Exploration License and the Nueva Esparta License. MARN did not respond to the request and on March 8, 2007, Commerce/Sanseb applied to the El Salvador Ministry of Economy for an extension of these exploration licenses, as was its right. On October 28, 2008, the Ministry of Economy denied Commerce/Sanseb’s application citing Commerce/Sanseb’s failure to secure an environment permit.

24. On January 20, 2009, Commerce/Sanseb’s legal counsel filed a challenge in the Courts to the government’s refusal to honor Commerce/Sanseb’s request to extend its exploration permits pursuant to the terms of the 2002 permits. These legal proceedings have not been resolved.

25. The actions of the El Salvadoran government, through its ministries, reflects an ongoing government policy since September 2006 to de facto deny foreign companies the right to develop mining interests in the country of El Salvador.

26. This policy, as applied, discriminates against foreign investment:

- a. While the government of El Salvador asserts that the current ban on gold and silver mining, and exploration connected with such mining, stems from the government's desire to protect the environment, the government permits, for example, the operation of coffee beneficios which dump liquid residue directly into rivers and other activities which are more intrusive on the environment.
- b. The government's ban on development of gold and silver mines applies in practice exclusively to foreign companies.
- c. The government does not enforce its stated policies against native El Salvadorans engaged in gold and silver production.

27. This policy, as applied, is arbitrary and irrational, and has denied Commerce/Sanseb of its property rights and investment in the country of El Salvador.

28. The government of El Salvador's continuing refusal to permit Commerce Group to engage in any exploration or mining activities despite proposals to ensure environmental protection and compliance with the laws of El Salvador, is unreasonable and is in violation of established international commerce law.

29. From 1969 forward, Commerce/Sanseb has provided substantially all of the capital required to develop the mining operation at the San Sebastian Gold Mine, to fund exploration, and to acquire, refurbish and operate the San Cristobal Mill and Plant. Commerce/Sanseb has continued to pay and incur expenses, has lost opportunities to secure investment capital, and has been denied the ability to develop and process an estimated 3.5 million ounces of gold, pending its legal efforts to secure the right to develop its investments in the Country of El Salvador. Commerce/Sanseb's damages exceed the sum of \$100,000,000.

30. By its conduct, the Republic of El Salvador has breached its obligations under Section A of CAFTA-DR, including Article 10.3 (National Treatment), Article 10.4 (Most-Favored Nation Treatment), Article 10.5 (Minimum Standard of Treatment), and Article 14.7 (Expropriation and Compensation).

31. Commerce and Sanseb are hereby seeking compensation from the government of El Salvador for its losses incurred as a result of the government of El Salvador's violation of its obligations under CAFTA-DR with respect to treatment of foreign investors, including:

1. Payment of compensation from the government of El Salvador to Commerce Group in an amount of not less than \$100,000,000 for its losses; and

2. Granting of permits allowing Commerce Group to resume its mining activities in the Country of El Salvador subject to reasonable and appropriate environmental protection conditions.
3. Such other relief as may be available, including payment for the costs of these proceedings.

32. Pursuant to CAFTA Article 10.16(2), on March 17, 2009, Commerce and Sansseb served a written notice of its intent to submit a claim to arbitration (the "Notice of Intent") on the respondent Republic of El Salvador. More than ninety (90) days have elapsed between the service of this Notice of Intent and the submission of this claim.

33. At least six (6) months have passed since the events giving rise to the claimants' claim, as required by Section B of CAFTA Chapter 10 (Article 10.16(3)).

34. The claimants consent to submit the present dispute to arbitration under the auspices of ICSID in accordance with the procedures set out in CAFTA. This Notice of Arbitration signifies the claimants' consent pursuant to Article 10.18.2(a) of CAFTA.

35. Pursuant to Article 10.18.4 of CAFTA, the claimants affirm that they have not previously submitted any of the breaches alleged in the present Notice of Arbitration to any other binding dispute resolution procedure for adjudication or resolution.

36. As required by Article 10.18.2(b)(ii) of CAFTA, the claimants hereby waive their rights to initiate or continue any domestic proceeding with respect to any measure alleged to constitute a breach for purposes of the present Notice of Arbitration. Notwithstanding the foregoing, pursuant to Article 10.18.3 of CAFTA, the claimants reserve the right to initiate or continue any proceedings for injunctive relief not involving the payment of damages before any administrative or judicial tribunal of the Republic of El Salvador, for the purposes of preserving their rights and interests during the pendency of this arbitration. Copies of the waivers are attached as Exhibit "A" and Exhibit "B".

37. The Republic of El Salvador's consent to submit the present dispute to arbitration under the auspices of ICSID is contained in Article 10.17 of CAFTA, as well as in Article 15 of the Investment Law.

38. The claimants are represented in this arbitration by their attorneys, Machulak, Robertson & Sodos, S.C., 1733 North Farwell Avenue, Milwaukee, Wisconsin 53202. Copies of letters authorizing the representation are attached as Exhibit "C" and Exhibit "D".

39. In accordance with CAFTA Article 10.16(6), the claimants hereby appoint Professor Christopher Greenwood, CMG QC, a national of Great Britain, to serve as arbitrator in this arbitration.

40. Mr. Greenwood's contact details are as follows:

Prof. Christopher Greenwood, CMG QC
Professor of International Law, London School of Economics

DATE OF ISSUE:

MACHULAK, ROBERTSON & SODOS, S.C.

July 2, 2009

By:


John E. Machulak

Machulak, Robertson & Sodos, S.C.
1733 North Farwell Avenue
Milwaukee, Wisconsin 53202
(414) 271-0760
machulak@lawmessage.com

SERVED ON:

Republic of El Salvador
Dirección de Administración de Tratados Comerciales
Ministerio de Economía
Alameda Juan Pablo II y Calle Guadalupe, Edificio C1-C2
Plan Maestro Centro de Gobierno
San Salvador - El Salvador

Ambassador René Antonio Leon Rodriguez
Embassy of El Salvador
1400 16th Street, NW., Suite 100
Washington, D.C. 22036



COMMERCE GROUP CORP.

6001 NORTH 91ST ST. • MILWAUKEE, WI • 53225-1795 • 414-462-5310 • FAX 414-462-5312
E-MAIL info@commercegroupcorp.com • WEBSITE www.commercegroupcorp.com

WAIVER

Commerce Group Corp., a United States corporation organized under the laws of the State of Wisconsin, in connection with its contemporaneous submission to arbitration of its disputes with the Republic of El Salvador 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, pursuant to Article 10.18.2(b)(ii) of CAFTA, waives any rights that it has to initiate or continue before any administrative tribunal or court under the laws of any country that is a party to the Central America Free Trade Agreement, or other dispute settlement procedures, any proceeding with respect to any measure alleged to constitute a breach under Article 10.16 of the CAFTA-DR Treaty.

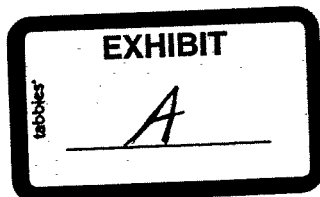
Notwithstanding the preceding paragraph, Commerce Group Corp., pursuant to Article 10.18.3 of CAFTA, does not waive, and affirmatively reserves the right to initiate or continue an action that seeks interim injunctive relief and does not involve the payment of monetary damages before a judicial or administrative tribunal of the Republic of El Salvador, provided that the action is brought for the sole purpose of preserving the rights and interests of the Commerce Group Corp. during the pendency of the arbitration proceedings brought under the provisions of CAFTA-DR and the ICSID.

Dated this 2nd day of July, 2009.

Commerce Group Corp.

By: 

Edward A. Machulak, President





San Sebastian Gold Mines, Inc.

6001 North 91st Street • ~~PO Box 25286~~ • Milwaukee, Wisconsin 53225 • (414) 462-5310

~~XXXXXXXXXX~~

Fax: (414) 462-5312

WAIVER

San Sebastian Gold Mines, Inc., a United States corporation organized under the laws of the State of Nevada, in connection with its contemporaneous submission to arbitration of its disputes with the Republic of El Salvador 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, pursuant to Article 10.18.2(b)(ii) of CAFTA, waives any rights that it has to initiate or continue before any administrative tribunal or court under the laws of any country that is a party to the Central America Free Trade Agreement, or other dispute settlement procedures, any proceeding with respect to any measure alleged to constitute a breach under Article 10.16 of the CAFTA-DR Treaty.

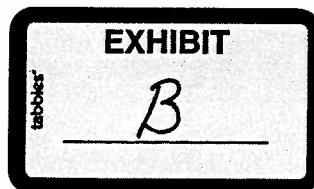
Notwithstanding the preceding paragraph, the San Sebastian Gold Mines, Inc., pursuant to Article 10.18.3 of CAFTA, does not waive, and affirmatively reserves the right to initiate or continue an action that seeks interim injunctive relief and does not involve the payment of monetary damages before a judicial or administrative tribunal of the Republic of El Salvador, provided that the action is brought for the sole purpose of preserving the rights and interests of the San Sebastian Gold Mines, Inc. during the pendency of the arbitration proceedings brought under the provisions of CAFTA-DR and the ICSID.

Dated this 2nd day of July, 2009.

San Sebastian Gold Mines, Inc.

By: 

Edward A. Machulak, President





COMMERCE GROUP CORP.

6001 NORTH 91ST ST. • MILWAUKEE, WI • 53225-1795 • 414-462-5310 • FAX 414-462-5312
E-MAIL info@commercegroupcorp.com • WEBSITE www.commercegroupcorp.com

July 2, 2009

Secretary General of ICSID
MSNIU3-3011
818 H Street NW
Washington D.C. 20433
United States of American

RE: Commerce Group, et al. vs. Republic of El Salvador, Notice of Arbitration

Dear Secretary General:

Please be advised that the Commerce Group Corp., a United States corporation organized under the laws of the State of Wisconsin, has retained the law firm of Machulak, Robertson & Sodos, S.C., and hereby authorizes said law firm to appear on its behalf and represent it in connection with the Commerce Group Corp.'s claims against the Republic of El Salvador brought under the provisions of CAFTA-DR and the ICSID arbitration procedures.

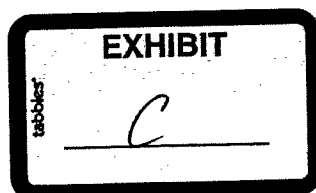
Thank you for your attention to this matter.

Sincerely,

COMMERCE GROUP CORP.

Edward A. Machulak
President

EAM/cw





San Sebastian Gold Mines, Inc.

6001 North 91st Street • ~~P.O. Box 25286~~ • Milwaukee, Wisconsin 53225 • (414) 462-5310

~~Circle X Service~~

Fax: (414) 462-5312

July 2, 2009

Secretary General of ICSID
MSNIU3-3011
818 H Street NW
Washington D.C. 20433
United States of American

RE: Commerce Group, et al. vs. Republic of El Salvador, Notice of Arbitration

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Thank you for your attention to this matter.

Sincerely,

SAN SEBASTIAN GOLD MINES, INC.

Edward A. Machulak
President

EAM/cw

