

**Metalclad Corporation v. United Mexican States**  
**ICSID Case No. ARB(AF)/97/1**

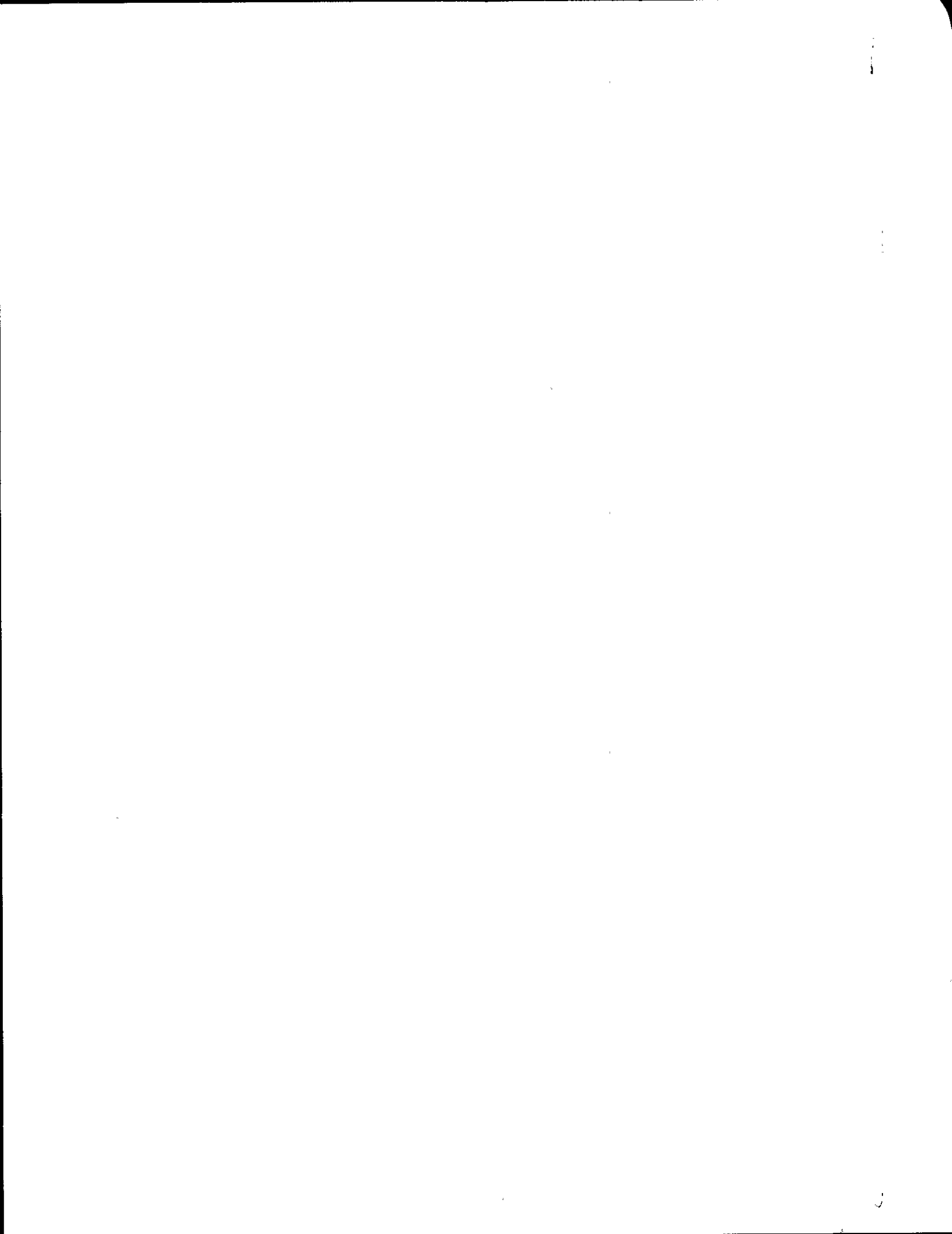
## **Annex Four**

**Expert Report**  
**of**  
**Mr. Kevin Dages**  
**The Chicago Partners**

**Metalclad Corporation v. United Mexican States**  
**ICSID Case No. ARB(AF)/97/1**

## **Annex Four**

**Expert Report**  
**of**  
**Mr. Kevin Dages**  
**The Chicago Partners**



**Metalclad Corporation, Claimant**  
**vs.**  
**United Mexican States, Respondent**

**Expert Report**

**of**

**Kevin Dages**

**February 14, 1998**

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**CHICAGO PARTNERS**  
A LIMITED LIABILITY COMPANY

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Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

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**CHICAGO PARTNERS**  
A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

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# Report Contents

1. Introduction
2. Qualifications
3. Summary of Opinions
4. Metalclad Before the Purchase of Stock by Kesler
5. Metalclad Since the Purchase of Stock by Kesler
6. Metalclad's Acquisitions, Start-Ups and Joint Ventures
7. How Metalclad Financed Its Losses, Mexican venture acquisitions, Insider payments, and Debt retirements
8. Composition, Compensation and Trading Activity of Metalclad's Insiders, Advisors and Institutional Shareholders
9. Incomplete, Misleading or Biased Metalclad Announcements
10. Claimant's \$20.5 million in "Landfill Development Costs"

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**CHICAGO PARTNERS**  
A LIMITED LIABILITY COMPANY

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Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

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## **1. Introduction**

1.1. I am Kevin Dages, Principal at Chicago Partners.

1.2. I have been engaged by counsel for the Respondent for the Metalclad Corporation, Claimant ("Metalclad") vs. United Mexican States, Respondent, to testify in the arbitration before The Honorable Tribunal of the International Centre for Settlement of Investment Disputes Pursuant to the North American Free Trade Agreement.

1.3. I have been asked by counsel for the Respondent to develop an understanding of Metalclad's corporate history with a view to informing the Tribunal of the nature of the Claimant's investments in Mexico (specifically, the La Pedrera hazardous waste landfill facility) and the actions Metalclad took in relation thereto that are material to both the Respondent's alleged liability and to Metalclad's claim for damages in this proceeding.

1.4. In order to do so, it was necessary to review all available data as a result of the Claimant's production of certain documents requested of it and such information as was accessible in the public marketplace to:

- Evaluate representations made in Metalclad's Memorial and other statements as to its business experience and financial condition.
- Summarize Metalclad's status and historical performance just prior to Grant Kesler's ("Kesler") stock purchase in 1991.
- Summarize Metalclad's performance in the period following Kesler's purchase of Metalclad stock and Daniel Neveau's ("Neveau") appointment as Chairman, including specific discussion of Metalclad's acquisitions, start-ups and joint ventures as well as Metalclad's financing of its losses, Mexican venture acquisitions, insider payments and debt retirements.

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### **CHICAGO PARTNERS**

A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

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- Address the composition, compensation and trading activity of Metalclad's insiders, advisors and institutional shareholders.
- Evaluate representations which have been made in the Memorial and the Claimant's expert report regarding the alleged \$20.5 million investment in La Pedrera.<sup>1</sup>

1.5. In the course of the review of the available data on the Claimant, it became apparent that there had been potentially incomplete, misleading, or biased information in Metalclad's disclosures via SEC filings, private offering memoranda, press releases or other articles or publications. Therefore, my report addresses this issue as well. In addition to illuminating the nature of Metalclad's La Pedrera investment and the Claimant's other Mexican ventures, this information provides a relevant factual basis for the expert report prepared by my colleague, Professor Mark Zmijewski.<sup>2</sup> Dr. Zmijewski analyzes and critiques the damages analyses prepared and offered by the Claimant's expert, American Appraisal Associates, from a market capitalization perspective.

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<sup>1</sup> Throughout my report, I will refer to La Pedrera, El Confín or COTERIN as the Metalclad landfill site that is the subject of this arbitration. There can be confusion in Metalclad disclosures between the La Pedrera site and the Santa María del Río site (acquired following the 1991 ETI acquisition and well prior to the 1993 acquisition of COTERIN), specifically when the disclosure references only to San Luis Potosí (the Mexican state in which both these sites are located.) In this report, I insert [Santa María del Río] wherever the San Luis Potosí reference risks becoming misleading.

<sup>2</sup> It should be noted that where this report refers to Exhibits C.A, etc., it is referring to certain exhibits annexed to Dr. Zmijewski's report.

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**CHICAGO PARTNERS**  
A LIMITED LIABILITY COMPANY

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Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

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## 2. Qualifications

2.1. I, Kevin Dages, am a Certified Public Accountant and Principal of Chicago Partners, a consulting firm that specializes in the application of accounting, economic and financial analyses to a variety of legal and regulatory issues we describe below. Prior to joining Chicago Partners, I was a co-founder and principal of Fort Dearborn Partners, a consulting firm that specialized in litigation, securities fraud, accounting and valuation. I have testified in or directed litigation matters regarding mergers and acquisitions and general damages issues. Previously, I was a Vice President and Director of Consulting for the Alcar Group, a financial consulting firm specializing in shareholder value issues. A detailed description of my credentials appears in my resume, attached to this statement as Appendix A.

2.2. Chicago Partners, LLC is an economic support and management consulting firm specializing in antitrust, damages, intellectual property, international trade, labor, regulatory, and securities analyses. Chicago Partners provides a multi-disciplinary approach to consulting on matters of economics, accounting, finance, and risk management. The analytical tools of each of these disciplines are distinct. The effective solutions to modern financial problems, however, may require that current research and professional experience are applied across disciplines. Chicago Partners' principals are leading scholars at institutions such as the University of Chicago, Northwestern University, the University of Minnesota and the University of Michigan; and respected industry professionals from major accounting, economics consulting, banking, trading, and investment firms. This diversity allows Chicago Partners to bring expertise to a wide range of issues including securities and investment matters; antitrust and regulation; labor economics; international trade; and intellectual property.

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### CHICAGO PARTNERS

A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

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2.3. Chicago Partners' experts have appeared in Federal District Court, United States Bankruptcy Court, and various State Court matters throughout the country. They have appeared before the National Association of Securities Dealers, National Futures Association, New York Stock Exchange, United States International Trade Commission, Chicago Board of Trade, Chicago Mercantile Exchange, and Commodity Futures Trading Commission. They have also served on the Illinois Commerce Commission, Federal Trade Commission, the Board of Directors of the Futures Industry Association (Chicago Division), the Supervision and Regulations Department of the Federal Reserve Bank System, and various interagency task forces of the Federal Reserve Bank responsible for market and credit risk measurement and management. They have also served as arbitrators before hearings of the National Association of Securities Dealers, the National Futures Association and the American Arbitration Association.

2.4. The securities practice of Chicago Partners covers a broad spectrum of client issues including the analysis of the following trading and investment consulting and litigation services such as complex derivative investment product and model review, securities fraud assessment, traditional "10b-5" securities fraud event study analysis, antitrust, market manipulation, and insider trading analysis, business and securities pricing and valuation, forensic accounting, financial risk management review, labor and employment dispute review, and banking, insurance, pension, and real estate finance consulting.

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**CHICAGO PARTNERS**  
A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

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### **3. Summary of Opinions**

**3.1.** The opinions and observations set out below represent my best professional judgement based upon the information available to me. I reserve the right to modify or expand my opinions and observations should the Claimant provide additional information, or should I become aware of other relevant information.

#### **3.2. Metalclad's status and historical performance just prior to Kesler's stock purchase in 1991:**

- Contrary to the Memorial's claims, until Kesler became involved with the company, it had never been involved in the development and operation of hazardous waste landfill facilities. Nor did Kesler (a lawyer who then worked in the securities industry) have any apparent experience in the area. Kesler financed his purchase of Metalclad shares with a \$2 million non-recourse loan from the Southern California & Arizona Glaziers, Architectural Metal & Glass workers pension plan. He became a Director of Metalclad in February 1991 and President and CEO in May 1991.
- Prior to Kesler, Metalclad was almost exclusively engaged in industrial insulation services, insulation material sales, and to a minor extent, asbestos abatement services prior to Kesler's purchase of shares. Revenues increased from 1987 to 1989, but declined 17% between 1989 and 1990 due to decreased industrial insulation contract revenues.

#### **3.3. Metalclad's performance in the period following Kesler's purchase of Metalclad stock and Neveau's involvement in the company:**

- Following Kesler's 1991 stock purchase, Metalclad promoted itself as an investment vehicle poised to reap what management saw as the opportunity in full service hazardous waste consulting, remediation, treatment and disposal in Mexico. In pursuit of this strategy Kesler and Neveau restructured and downsized Metalclad's only operating business during the 1990 to 1993 period – its industrial insulation business.
- Understanding the makeup of Metalclad's collection of Mexican hazardous waste ventures at any single point in time requires an examination of the

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## **CHICAGO PARTNERS**

A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

---

complicated, and at times confusing, layering of informational disclosures Metalclad released to the market about those ventures.

- Metalclad's 10-K descriptions of its business segments concentrate on the various projects in hazardous waste development, instead of operation, and therefore contrast markedly with companies in the 4950 SIC code - Sanitary Services.
- Operating revenues for the insulation business, as displayed in Exhibit 5.3, steadily declined from \$21 million in 1990 to \$12 million in 1996. Meanwhile, the company's "developing" hazardous waste business did not contribute to revenues until Quimica Omega was acquired in May 1994. Even after Quimica Omega's acquisition, the hazardous waste management business segment's significant operating losses mitigated all operating income that the insulation business generated.
- Metalclad identifies numerous Mexican hazardous waste ventures in its SEC filings, press releases, private offering memoranda, internal forecasts and "updates" and other disclosures to the public. Certain ventures disappear and reappear later. The list includes:
  1. Santa Maria del Rio
  2. Molten Metal Technology, Inc.
  3. Veracruz ("DIV")
  4. Tamaulipas ("ECI")
  5. CATSA
  6. COTERIN (also variously known as La Pedrera, El Huizache, and El Confin)
  7. QUIMICA OMEGA
  8. BFI-OMEGA
  9. The Incinerator/Rotary Slagging Kiln Project
  10. Guanajuato
  11. Jalisco
  12. Deter Saneamiento
  13. The Aqueous Waste Treatment Facility
  14. Seguridad Elctrica Mexicana ("SEM")
  15. PCB Exporting

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## CHICAGO PARTNERS

A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

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16. Potential Additional Sites
17. Laboratory, Transportation & Site Remediation Services
18. Other Potential Projects

- In Metalclad's June 1994 forecast, QUIMICA OMEGA, the Company's then only significant operating business in Mexico (the other was CATSA), accounted for nearly one-third (33%) of Metalclad's total forecasted revenues for 1995 to 1997, while only seven months later in a February 1995 forecast, QUIMICA OMEGA's revenues dropped to less than one-quarter (25%) of Metalclad's forecasted total revenues. Increases in forecasted revenue for El Confin appeared to cover the QUIMICA OMEGA revenue shortfall in the February 1995 forecast (despite El Confin's restricted operational and limited capacity status).
- Metalclad's accountant, KPMG Peat Marwick, tendered its resignation on April 20, 1993 and the company engaged Grant Thornton on May 28, 1993.<sup>1</sup> Grant Thornton LLP was the company's auditor until March 25, 1996, Metalclad then engaged Arthur Andersen LLP as its principal accountant on April 26, 1996.<sup>2</sup>
- Metalclad was not a trivial client for the public accounting firms. In 1994, for example, Metalclad's fees paid to its accounting firms (Grant Thornton, E&Y, KPMG and a local practitioner) totalled over \$300,000.<sup>3</sup>
- Grant Thornton was dismissed after issuing a "going concern" opinion about Metalclad's financial condition.

#### 3.4. Metalclad's acquisitions, start-ups and joint ventures:

- Metalclad paid sizeable premiums to acquire three entities: two non-operating landfill sites still in the permitting process and one operating company that was losing money at an even faster rate than Metalclad and had received a "going concern" opinion months before the acquisition.
- Consultoria Ambiental Total, S.A. de C.V. ("CATSA") is the only start-up initiated by Metalclad. Metalclad frequently announced expansion opportunities "into other ancillary activities such as laboratory, transportation and site remediation services."<sup>4</sup> However, as of its December 1996 10-K

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<sup>1</sup> Metalclad Corporation SEC Form 8-K dated April 21, 1993.

<sup>2</sup> Metalclad Corporation SEC Form 8-K/A3 dated May 6, 1996.

<sup>3</sup> Metalclad expense summaries reviewed as support for the \$20.5 million alleged landfill investment.

<sup>4</sup> Metalclad Corporation SEC Form 10-K for the fiscal year ended May 31, 1994, page 2.

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## CHICAGO PARTNERS

A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

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filing, those other start-ups did not materialize.

- Metalclad announces numerous potential joint ventures. Only two joint ventures are actually initiated: Curtom-Metalclad (in the U.S.) and BFI-OMEGA (in Mexico). BFI contributed assets and a general manager to the joint venture but exited in less than one year.<sup>5</sup>
- The Claimant's acquisition, start-up and joint venture activity began in earnest following Kesler's stock purchase with the acquisition of a company in which he owned a majority interest – Environ Technologies, Inc. (“ETI”).
- Given the voting control Kesler possessed over Metalclad, the acquirer, and his dominant shareholding in ETI, the target, the ETI acquisition could not reasonably be considered the product of arms-length negotiations. On the date of the acquisition ETI consisted of only two assets: cash of \$1,000 and advances and an investment in Eco Administracion (the Mexican entity) of \$1,003,463. In addition, as of November 15, 1991, Metalclad had already advanced ETI over \$400,000.<sup>6</sup>
- Kesler was appointed to Metalclad's board of directors only eight months prior to the ETI acquisition (February 1991) and engaged as President and CEO five months earlier (May 1991). Kesler acquired his interest in ETI only in July 1991, after his appointment as an officer and board member of Metalclad. This arranged sale of the ETI business to Metalclad propelled Kesler and, to a lesser extent, Ronald E. Robertson (“Robertson”) into positions as the dominant and controlling shareholders of the Claimant. Neveau also benefited from a consulting arrangement between Metalclad and the former shareholders of ETI, even though he was not a shareholder at the time of ETI's acquisition.
- In April 1993, Metalclad contracted with the shareholders of COTERIN for an option to acquire COTERIN. The agreement was amended to a 94% purchase agreement and the payment structure modified to incorporate certain contingencies on September 9, 1993.<sup>7</sup>
- In May, 1994, Metalclad acquired all the capital stock of QUIMICA OMEGA

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<sup>5</sup> Metalclad Corporation SEC Form 10-K for the transition period from June 1, 1996 to December 31, 1996, pages F-13 – F-14.

<sup>6</sup> Metalclad Corporation Form 10-K for the fiscal year ended December 31, 1991, EXHIBIT “10.2”.

<sup>7</sup> . One year later, on September 10, 1994, Bruce Haglund, who was secretary, a board member of, and legal counsel to Metalclad, wrote to the Grant Thornton audit partner confirming that Metalclad and the Mexican minority shareholders had determined “that full utilization of the COTERIN site will never occur.” As a result any contingent elements of the COTERIN acquisition agreement “will never become binding on the Company.” Metalclad Corporation Documents in production Response 1F –Letter from Haglund to Grant Thornton dated September 10, 1994.

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## CHICAGO PARTNERS

A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

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in return for 2,800,000 shares of Metalclad common stock. The issued stock was unregistered and Metalclad management estimated the fair value of the unregistered shares (and recorded the QUIMICA OMEGA purchase price) as \$6,300,000 (60% of the current market price.)

- Even at the reduced fair value estimate of the Metalclad stock issued, the QUIMICA OMEGA recorded purchase price was \$7,313,831 in excess of the net assets acquired. QUIMICA OMEGA's auditors had issued a "going concern" opinion at year-end 1993. Metalclad wrote off the remaining \$6,377,716 in goodwill relating to the acquisition as of May 31, 1995.
- A joint venture agreement between Browning-Ferris Industries, Inc. ("BFI") and QUIMICA OMEGA was negotiated on April 9, 1996. This joint venture was short-lived, however, dissolving later in 1996.
- A review of these transactions shows that the selling shareholders (i.e. those individuals who sold their interests in Mexican ventures to the Claimant in return for Metalclad stock) have almost universally sought to immediately dispose of the Metalclad stock.

**3.5. Metalclad's financing of its losses, Mexican venture acquisitions, insider payments and debt retirements:**

- The Claimant effectively financed all of its losses, Mexican venture acquisitions, insider payments and debt retirements through the issuance of its stock. Access to equity capital markets (particularly outside the United States) was a critical factor in the Metalclad insiders' strategies.
- Metalclad's debt financing history from 1992 through 1996 ranged from a highly touted \$250 million proposed, but never realized, facility with Chase Manhattan Bank to a \$2.5 million floating rate loan with CVD Financial Corp. that culminated in an effective rate of prime plus 45.5%.
- Metalclad issued approximately \$12 million principal amount of 12%, 8% and 9% Convertible Subordinated Debentures ("CSD's") from October 1991 through November 1993. The majority of these, almost \$8.6 million, were converted in common stock at \$2.50 per share, well below the original conversion rates between \$4.00 to \$5.50.
- The more than 25.5 million Metalclad common shares issued from December 1991 through September 1997 (almost a seven-fold increase in shares outstanding) served to fund the operating losses, pay for acquisitions, compensate insiders and advisors, and retire both the convertible and the CVD term debt.

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**CHICAGO PARTNERS**

A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

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- Metalclad's new shares were issued almost entirely in private placements of unregistered securities or via the issuance of unregistered securities in acquisitions. The bulk of the private placements were to non-US investors. As a result, the offering memoranda associated with these placements were not filed with the SEC.<sup>8</sup>
- Despite the lack of SEC-filed registration statements associated with its common stock offerings, Metalclad benefited from (and promoted) its status as a US publicly traded (and therefore SEC regulated) company.

**3.6. The composition, compensation and trading activity of Metalclad's insiders, advisors and institutional shareholders:**

- The Claimant's management insiders, primarily Kesler, Neveau, Robertson and, to a lesser extent, Javier Guerra Cisneros ("Guerra"), generated significant personal income from Metalclad. The insiders' gains are notable not only for their magnitude but more importantly for the scarcity of capital that they put at risk.
- Oakes Fitzwilliams & Co. Ltd. has served as the placement agent for numerous Metalclad private placements. In return for its services, Oakes received over \$1.35 million in cash fees<sup>9</sup> and realized over \$3.65 million in profits on Metalclad stock and warrants through December 31, 1996 (Exhibit 8.2). In addition, as of December 31, 1996 Oakes held 25,000 shares of Metalclad stock and 2,045,635 warrants to purchase Metalclad shares (in aggregate 6.64% of the common stock).<sup>10</sup>
- CVD earned some \$3.7 million from fees and stock transactions from its relationship with Metalclad. This figure does not include cash interest payments.

**3.7. Incomplete, misleading or biased information in Metalclad's disclosures via SEC filings, private offering memoranda, press releases or other articles or publications:**

<sup>8</sup> Metalclad Corporation Confidential Offering Memorandums dated September 14, 1994 and February 12, 1995 for a total of 4,900,000 units (one share plus one warrant).

<sup>9</sup> Metalclad Corporation Confidential Offering Memorandum dated February 12, 1996 page 37 ("cash fee equal to 10% of the gross proceeds...from the sale...by the Company [1.65 million units @ \$4.00]) and Metalclad Corporation Confidential Offering Memorandum dated September 14, 1994 page 33 ("cash fee equal to 10% of the gross proceeds" [2.3 million units @ \$3.00]).

<sup>10</sup> SEC Schedule 13D dated April 30, 1997 for Oakes, Fitzwilliams, et al. page 28 Item 5 (h).

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**CHICAGO PARTNERS**

A LIMITED LIABILITY COMPANY

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Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

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- As noted in the introduction, during the course of reviewing the Memorial's allegations of fact and the Claimant's public disclosures of its Mexican developments and operations through SEC filings, private offering memoranda, press releases and various other articles or publications, it became evident that certain significant pieces of information regarding Metalclad's Mexican ventures were not fully or accurately communicated to the market.

### **3.8. The Claimant's alleged \$20.5 million investment in La Pedrera:**

- Based upon our review of the Metalclad supporting documents (to the extent that they exist or have been produced), I conclude that any attempt to portray \$20.5 million as the investment in the La Pedrera landfill (the subject of this Claim) would be incorrect and grossly misleading.
- On their face, the Metalclad \$20.5 million schedules include patently inappropriate items such as expenditures made before La Pedrera was acquired. As a result, these schedules do not provide a reasonable estimate of the investment.
- As a result of the widespread nature of expenditures included, the lack of a comprehensive list, the lack of underlying invoices, and the lack of evidence of actual disbursement, the documents produced as support for Metalclad's \$20.5 million total fail to provide the basis for a reasonable estimate of the La Pedrera investment.
- The better, although most likely too high, estimate of Metalclad's investment in the La Pedrera landfill as of December 31, 1996 is \$3.225 million. This estimate is derived from the reported balance for all of Metalclad's hazardous waste treatment facilities property, plant and equipment balance as disclosed in its 10-K filings.

### **3.9. Documents Reviewed**

I have reviewed the Memorial (dated October 13, 1997) and relevant attachments and exhibits submitted to the Tribunal. I have also reviewed various Metalclad filings with the United States Securities and Exchange Commission ("SEC") and additional Metalclad documents submitted to the Respondent. Finally, I have reviewed press releases made by Metalclad and various disclosures and articles published in the financial press about Metalclad. Metalclad stock market data was collected from the Center for Research in Security Prices; specifically, daily stock prices, volume traded, stock returns,

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## **CHICAGO PARTNERS**

A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

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and other relevant information during the period May 1, 1990 through October 31, 1997.  
A list of the documents I have reviewed appears in Exhibit 3.1.

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**CHICAGO PARTNERS**  
A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

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#### 4. Metalclad Before the Purchase of Stock by Kesler

4.1. Pursuant to a stock purchase agreement dated February 28, 1991, Kesler purchased 1,000,000 shares of Metalclad common stock for \$1.42 per share and simultaneously was granted options to purchase 250,000 additional shares of common stock at specified prices (half exercisable at \$1.50 per share and half at \$2.00 per share).<sup>1</sup> Kesler purchased the shares expressly for the purpose of influencing the direction and management of the company.<sup>2</sup> He financed his purchase of Metalclad shares with a \$2 million non-recourse loan from the Southern California & Arizona Glaziers, Architectural Metal & Glass workers pension plan. Interest on the loan was prepaid through July 31, 1993. A contingent interest payment would be due (July 31, 1993) the pension fund equal to 15% of the excess of market value of the 1,000,000 shares at \$1.42 per share.<sup>3</sup>

4.2. Contemporaneous with that event, Metalclad experienced a "change in control". Metalclad described its "change in control" as follows: "In February 1991, Mr. Kesler and Leland E. Sweetser entered into a five-year Voting Trust Agreement pursuant to which Mr. Kesler deposited 1,000,000 shares of Common Stock into the Voting Trust and Mr. Sweetser deposited 356,068 shares of Common Stock into the Voting Trust."<sup>4</sup> This voting trust controlled more than 30% of the outstanding Metalclad's common stock. Kesler became a Director of Metalclad in February 1991 and President and CEO in May 1991.

4.3. To better understand and interpret Professor Zmijewski's analysis of Metalclad's

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<sup>1</sup> See Stock Purchase Agreement dated February 28, 1991 – Metalclad Corporation SEC Form 10-K for the fiscal year ended December 31, 1992, Exhibit 10.23.

<sup>2</sup> Metalclad Corporation Schedule 13D dated February 28, 1991, for Grant S. Kesler, page 9.

<sup>3</sup> Metalclad Corporation SEC Schedule 13D dated February 28, 1991 for Grant S. Kesler, Exhibit 1 – Secured Demand Promissory Note.

<sup>4</sup> Metalclad Corporation SEC Form 10-K for the fiscal year ended December 31, 1990, page 18, filed with the SEC on April 1, 1991.

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## CHICAGO PARTNERS

A LIMITED LIABILITY COMPANY

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Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

---

changes in its total capitalization, it is important to understand the company's history – the business in which the company was operating, how the company was performing in that business, what investments it was making, how it was financing its investments, and other decisions made by the company's management. In this section of the report, I describe Metalclad as it was before Kesler purchased his shares and in the following section, I describe Metalclad subsequent to the purchase of these shares; I also provide the history of Metalclad's acquisitions, start-ups and joint ventures and the financing of those activities as well as the mounting operating losses in sections 6 and 7 of this report.

4.4. I was also instructed by Respondent's counsel to examine the Claimant's financial and securities dealings as to shed light on the Claimant's activities in Mexico. This assists in explaining why it acted in certain ways (for example, holding a Grand Opening ceremony in demonstrate to investors that it had, as claimed, a fully permitted and approved operational hazardous waste landfill).

4.5. Metalclad was almost exclusively engaged in industrial insulation services, insulation material sales, and to a minor extent, asbestos abatement services, prior to Kesler's purchase of shares. The company was incorporated in Arizona in 1947, as Phoenix Gems, Inc. until 1973, then Bower Industries, Inc. until 1987, and was engaged in various activities unrelated to the insulation and asbestos abatement business.

4.6. On February 11, 1988, Metalclad's common stock, under the symbol ("MTLC"), was listed on the NASDAQ exchange. Prior that date, the company's common stock was traded in the over-the-counter market.<sup>5</sup>

4.7. Exhibit 4.1 shows selected items from Metalclad's results of operations and financial condition as depicted in the company's Form 10-K's filed with the SEC for the

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<sup>5</sup> Metalclad Form 10-K for the fiscal year ended December 31, 1989, pages 2-10.

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## CHICAGO PARTNERS

A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

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fiscal years ended December 31, 1987 through 1990. Revenues increased from 1987 to 1989, but declined 17% between 1989 and 1990 due to decreased industrial insulation contract revenues. Metalclad's net income for the years 1987 through 1990 fluctuated considerably from year to year and the company utilized tax loss carryforwards during 1987 – 1990. Net income for 1990 declined as a result of aforementioned lower industrial insulation contract revenues, a loss from joint venture operations, and increased selling, general and administrative costs.

4.8. Exhibit 4.1 also shows that total assets increased between 1987 and 1989, primarily as a result of increased receivables incurred during the normal course of business, and then decreased in 1990 as receivables were collected and as insulation contracts declined. During 1987-1990, Metalclad showed net investing expenditures (after sales of assets) at or below depreciation and amortization levels indicating that the company was not investing to grow its business during this period. Debt levels for the years 1987-1990 were maintained at between \$3 to \$4 million. Short-term debt consisted primarily of a note payable to a bank (in reality a revolving line of credit) at prime plus 1.625%. Metalclad made certain debt contract covenants to maintain stated minimum working capital, net worth, debt to net worth and current ratios. Long-term debt consisted primarily of another note payable to a bank and various notes payable to suppliers. These notes bore interest at roughly prime plus 2%.

4.9. Shareholder's equity steadily increased from 1987 to 1990, as Metalclad's net income from operations increased retained earnings, amounts due from affiliates were cancelled in exchange for common stock, and paid in capital increased from a public offering of common stock and warrants (February 1988)<sup>6</sup>. Metalclad experienced positive cash flow from operations in 1990, as it collected on its accounts receivable and decreased inventory, despite its net loss for the year.

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<sup>6</sup> Metalclad Corporation SEC Form 10-K for the fiscal year ended December 31, 1989, page 35 – Note D – Stock Offering.

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**CHICAGO PARTNERS**  
A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

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## 5. Metalclad After Kesler's and Neveau's Involvement

5.1. Following Kesler's 1991 stock purchase and Neveau's involvement in the company, Metalclad promoted itself as an investment vehicle poised to reap what was represented as the opportunity in full service hazardous waste consulting, remediation, treatment and disposal in Mexico.

- "The NAFTA treaty...contains an important side agreement that has opened an especially rich vein of opportunity for the norteamericanos...insistence of U.S. environmentalists and union leaders...requires Mexico to show progress in cleaning up its smoggy air and defiled rivers. This was a signal for Metalclad...began branching into the Mexican environmental services market in 1991, investing about \$5 million in an array of waste recycling and disposal operations before NAFTA took effect. That investment has since ballooned to more than \$30 million...And under NAFTA, Metalclad no longer has to pay a 20% tariff on environmental equipment it brings to Mexico. Kesler cites another reason NAFTA has made Mexico more inviting. The trade agreement's provisions for resolving contract disputes with Mexican companies, he says, "have brought a certitude that wasn't there before." This in turn has helped bolster the confidence his company needed to finance rapid expansion in Mexico."<sup>1</sup>

5.2. In pursuit of this strategy Kesler restructured and downsized Metalclad's only operating business during the 1990 to 1993 period – its industrial insulation business. Metalclad's 10K for the period ending December 31, 1991 describes the beginning of that restructuring.

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<sup>1</sup> Fortune Magazine, August 5, 1996.- Industrial Management & Technology Winning in Mexico Under NAFTA Despite A Battered Economy South of the Border, U.S. Companies with the Right Products have Gained from the Trade Agreement.

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### CHICAGO PARTNERS

A LIMITED LIABILITY COMPANY

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Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

- “During the fourth quarter of 1991, and effective December 31, 1991, the company adopted a plan to discontinue its commercial insulation services and commercial asbestos abatement activities, which included closing its operations in Seattle, Washington, due to the intense competition in those markets and the history of losses in such operations.”<sup>2</sup>

5.3. In fact, on September 21, 1993 Metalclad announced that it had entered into negotiations to sell the insulation business to EIF Holdings, Inc. for an undisclosed sum. The transaction was to close by to December 31, 1993, but never materialized.<sup>3</sup>

5.4. Interestingly, Metalclad has recently reversed course with respect the 1991 commercial insulation decision. Its mid-1997 10-Q discusses a re-entry to this market:

- “The company has taken steps to increase revenues by its recent re-entry into the commercial insulation market and has also reduced its cost structure in response to lesser revenues. These actions are anticipated to enhance the company’s ability to be profitable.”<sup>4</sup>

5.5. Metalclad’s own description of its business was inconsistent with representations made in its various disclosures indicating a 50 year and over \$1 Billion history in either environmental construction projects or asbestos abatement and removal. Through December 1996, Metalclad’s SIC (Standard Industrial Classification) code as listed on its SEC filings remained 1700 – Construction – Special Trade Contractors.<sup>5</sup> Metalclad’s 10-K descriptions of its business segments concentrate on the various projects in hazardous waste development, instead of operation, and therefore, contrast markedly with companies in the 4950 SIC code - Sanitary Services. WMX Technologies, Inc.

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<sup>2</sup> Metalclad Corporation SEC Form 10-K for the fiscal year ended December 31, 1991, page 1.

<sup>3</sup> PRN Newswire, September 21, 1993, 9:25 a.m.

<sup>4</sup> Metalclad Corporation SEC Form 10-Q for the quarterly period ended June 30, 1997, page 9.

<sup>5</sup> See “Company Data” for Metalclad Corporation’s SEC filings for the period December 31, 1989 – September 30, 1997.

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## CHICAGO PARTNERS

A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

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("WMX", also known as Waste Management), Safety-Kleen Corp. ("Safety-Kleen") and Browning Ferris Industries, Inc. ("BFI") are all listed under SIC code 4953 – Refuse Services.<sup>6</sup>

5.6. Understanding the makeup of Metalclad's collection of Mexican hazardous waste ventures at any single point in time requires an examination of the complicated, and at times confusing, layering of informational disclosures Metalclad released to the market about those ventures. The following section discusses in chronological order the various Metalclad Mexican hazardous waste ventures.

5.7. In November 1991, Metalclad commenced its development of a hazardous waste treatment business in Mexico when it acquired all of the outstanding shares of common stock of ECO-Metalclad, Inc. ("EMI", formerly known as Environ Technologies, Inc.).<sup>7</sup> (For a more complete discussion of the acquisition, see Section 6.)

- "The company is also engaged in the development of a hazardous waste treatment business in Mexico...In addition, the company is pursuing consulting opportunities through a wholly-owned Mexican subsidiary. Through its ownership interests in these Mexican corporations, the company intends to participate in the ownership, development, and operation of hazardous waste treatment facilities in Mexico."<sup>8</sup>

5.8. On May 5, 1994 (subsequent to its 1993 acquisition of COTERIN) Metalclad acquired its first operating hazardous waste company, Quimica Omega, S.A. de C.V. ("Quimica Omega"). (For a more complete discussion of the acquisition, see Section 6.) Thereafter, Metalclad's descriptions of its hazardous waste business change. In its internal forecasts Metalclad likens expectations for the Quimeca Omega subsidiary to a

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<sup>6</sup> Standard Industrial Classification Manual – 1987, pages 61 and 285.

<sup>7</sup> Metalclad Corporation SEC Form 10-K for the fiscal year ended December 31, 1992, page 1.

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**CHICAGO PARTNERS**  
A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

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sizeable U.S. hazardous waste player, Safety Kleen Corporation. However, the Metalclad descriptions stand in stark contrast to those of other hazardous waste players.

- **Metalclad 1994** - "Since November 1991, the company has pursued the development of integrated hazardous waste treatment and disposal facilities in the Mexican states of San Luis Potosi, Veracruz, and Tamaulipas. Recently, the company has expanded its activities to pursue development opportunities for additional facilities in the states of Jalisco and Guanajuato. The company believes that locating facilities in these states will give the company a significant business presence in the heart of industrial Mexico.

The company's current Mexican business consists of (i) the development and construction of operating facilities in San Luis Potosi for the treatment and disposal of industrial hazardous wastes, including a hazardous waste landfill and an inorganic treatment facility under construction and scheduled to open in the last quarter of calendar 1994, and a hazardous waste incinerator under development; (ii) the collection of waste oils and solvents for recycling or disposition in cement kilns; and (iii) environmental management consulting. The company anticipates expanding its business into other ancillary activities such as laboratory, transportation, and site remediation services.<sup>9</sup> [Emphasis added]

- **Metalclad 1996** - "Since November 1991, the company has been actively involved in the development of integrated hazardous waste treatment and disposal facilities in various states in the Republic of Mexico. The business is comprised of two major parts: operation and development.

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<sup>8</sup> Metalclad Corporation SEC Form 10-K for the transition period from January 1, 1993 to May 31, 1993, page 1.

<sup>9</sup> Metalclad Corporation SEC Form 10-K for the fiscal year ended May 31, 1994, page 1.

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## CHICAGO PARTNERS

A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

All operating activities associated with waste collection, transport, and disposal are conducted by BFI-Omega...All developmental activities are conducted by the company's subsidiary, ECONSA...ECONSA's primary business has been the development of a landfill and treatment facility located in the State of San Luis Potosi. Its other development activities include an additional hazardous waste landfill in another state, a facility for non-hazardous industrial waste in yet another state, the location of a hazardous waste incinerator, the development of an aqueous waste treatment facility, and in the exportation for the destruction of polychlorinated biphenyls (PCBs)."<sup>10</sup>

By stark contrast, actual waste management firms describe their operations during the same periods as...

- **WMX 1995** – “WMX Technologies, Inc. (Waste Management, Inc.) is a leading international provider of environmental and related services. The company provides integrated solid waste management services in North America. WMX also provides hazardous waste management services, chemical waste treatment, storage disposal and related services in North America. These services are provided to commercial and industrial customers. Waste Management International PLC provides comprehensive waste management and related services internationally.”<sup>11</sup>
  
- **WMX's scope of operations includes:**
  - Providing solid waste collection services to approximately 1.1 million commercial and industrial customers.
  - Providing collection services to approximately 12 million homes and apartment units.

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<sup>10</sup> Metalclad Corporation SEC Form 10-K for the fiscal year ended May 31, 1996, page 1.

<sup>11</sup> WMX Technologies, Inc. SEC Form 10-K for the fiscal year ended December 31, 1995, page 2.

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## CHICAGO PARTNERS

A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

- Operating 151 solid waste transfer stations.
  - Operating 133 solid waste sanitary landfill facilities, 103 of which are owned by Waste, the balance are under leases.
  - Engaging in methane gas recovery at 34 WMX owned or operated sanitary landfill facilities.
  - Operating 129 materials recovery facilities for the receipt and processing of recyclable materials.
  - Participating in joint ventures with Stone Container Corporation and American National Can Corporation to engage, respectively, in the businesses of marketing paper fiber and aluminum, steel, and glass containers for recycling.
  - Employing a total of approximately 73,200 persons in its worldwide operation.<sup>12</sup>
- **BFI 1995** – “Browning-Ferris Industries, Inc. (BFI) is one of the largest publicly-held companies that engages, through its subsidiaries and affiliates, in providing waste services. The company collects, transports, treats and/or processes, recycles and disposes of commercial, residential and municipal solid waste and industrial wastes. BFI is also involved in waste-to-energy conversion, medical waste services, portable restroom services, and municipal and commercial sweeping operations.”<sup>13</sup>
  - **BFI’s scope of operations includes:**
    - Operating in approximately 450 locations in North America and approximately 320 locations outside North America and employing approximately 43,000 persons.
    - Utilizing approximately 1.0 million containers and approximately 10,000 specially equipped collection trucks in its North American waste collection operations.

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<sup>12</sup> WMX Technologies, Inc. SEC Form 10-K for the fiscal year ended December 31, 1995, pages 2 – 25.

<sup>13</sup> Browning-Ferris Industries, Inc. SEC Form 10-K405 for the fiscal year ended September 30, 1995, page 1.

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## CHICAGO PARTNERS

A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

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- Operating 107 transfer stations.
  - Operating 104 solid waste landfill sites in North America.
  - Providing medical waste services with 32 sites offering either incineration or autoclaving (steam sterilization).
  - Providing recycling services at approximately 260 of BFI's operating locations.<sup>14</sup>
- **Safety-Kleen 1996** – “Safety-Kleen Corp. is a leader in servicing the recycling and waste needs of companies in the automotive/retail repair, industrial, imaging and other business sectors. Over 2,800 Safety-Kleen specialists service customers from a branch network that extends across North America and Western Europe.”<sup>15</sup>
- **Safety-Kleen's scope of operations includes:**
    - Operating 13 solvent recycling plants in the U.S., Canada, Puerto Rico, U.K. and Germany.
    - Operating 2 oil re-refining plants with combined annual re-refining capacity of 135 million gallons.
    - Employing approximately 7,300 employees at December 28, 1996.<sup>16</sup>

**5.9. Results of Operations December 31, 1990 – December 31, 1996**

**5.10.** Exhibit 5.3 shows selected items from Metalclad's results of operations and financial condition as depicted in its Form 10-K's for the fiscal years ended December 31, 1990 through December 31, 1996.

**5.11.** Operating revenues for the insulation business, as displayed in Exhibit 5.3,

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<sup>14</sup> Browning Ferris Industries, Inc. SEC Form 10-K for the fiscal year ended September 31, 1995, pages 1 – 10.

<sup>15</sup> Safety-Kleen Corp. SEC Form 10-K for the fiscal year ended December 28, 1996, page 1.

<sup>16</sup> Safety-Kleen Corp. SEC Form 10-K for the fiscal year ended December 28, 1996, pages 1 – 5.

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**CHICAGO PARTNERS**

A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

steadily declined from \$21 million in 1990 to \$12 million in 1996. Contract revenues and material sales experienced declines of up to 5% from year to year. Likewise, operating costs grew, reducing operating margins to below 2% of revenues. Very little capital was invested in the insulation business.

5.12. Meanwhile, the company's "developing" hazardous waste business did not contribute to revenues until Quimica Omega was acquired in May 1994. Quimica Omega contributed \$2 million and \$3 million in revenue during the fiscal year ended May 31, 1995 and May 31, 1994, respectively. Despite these revenues the company's waste management operations experienced significant operating losses from 1992 through 1996. Operating losses climbed as high as \$13 million for the fiscal year ended May 31, 1995, over \$6 million of which was due to the write-off of goodwill resulting from the Quimica Omega purchase.<sup>17</sup>

5.13. Even after Quimica Omega's acquisition, the hazardous waste management business segment's significant operating losses mitigated all operating income that the insulation business generated. Metalclad, on a consolidated basis, therefore, experienced net losses from 1991 through 1996 although, as discussed further in Section 10, not all of these losses have been deducted for U.S. tax purposes.

5.14. Exhibit 5.3 shows that total assets increased between 1990 and 1996, almost solely a result of the company's continued investment in the Mexican hazardous waste management business ventures.

5.15. Metalclad's debt level increased from its \$2 to \$3 million level prior to Kesler's and Neveau's involvement, to levels ranging from \$11 to \$12 million during 1994 and 1995. Metalclad's post-Kesler/Neveau debt consisted primarily of Convertible Subordinate Debentures (CSD's) (8% and 9% (stated rate) for terms of 12 months and 60

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<sup>17</sup> Metalclad Corporation SEC Form 10-K for the fiscal year ended May 31, 1995.

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## CHICAGO PARTNERS

A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

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months) and a \$2.5 - \$3.025 million privately placed loan.

5.16. Metalclad's CSD's tended to never approach their stated maturity dates, instead being quickly converted into the company's common stock at a significant discount to their original conversion rates. The 8% and 9% CSD's, originally issued with conversion rates between \$4.00 and \$5.50 per share, were converted into shares of Metalclad common stock at \$2.50 per share, under the company's August 1995 offer to all debenture holders (93% of whom accepted).

5.17. Metalclad's \$2.5 - \$3.025 million privately placed loan with CVD was also converted to common stock following several amendments. The amendments included extended maturity dates, an increased principal amount, and extended or expanded other terms and conditions including issuance of Metalclad common stock and options. The stated interest rate on the loan was prime plus 7%, considerably higher than the prime plus 2% Metalclad paid before Kesler's and Neveau's involvement and the Mexican development push.

5.18. Shareholders' equity declined in 1992 due to the initial entrance into the hazardous waste management business, which produced a \$4.5 million net loss for Metalclad. Thereafter, shareholders' equity steadily increased as a result of common stock issuances and conversion of the CSD's into common stock. From 1991 through 1996, Metalclad issued over 25 million shares of common stock (including shares issued in exchange for CSD's). As a result of significant net losses incurred by its investment in hazardous waste businesses, Metalclad cash flows before financing activities remained negative for the period 1991 to 1996.

#### 5.19. **Chronology of the Metalclad Mexican Hazardous Waste Ventures**

5.20. Metalclad identifies numerous Mexican hazardous waste ventures in its SEC filings, press releases, private offering memoranda, internal forecasts and "updates" and

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## CHICAGO PARTNERS

A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

---

other disclosures to the public. Listed below are brief descriptions of each of the various Mexican ventures and the annual citations based upon the materials I reviewed. Certain ventures disappear and reappear, thus inclusion on this list should not be interpreted as any independent verification or confirmation of the legitimacy of a particular venture's status or existence at any point in time.

**5.21. Metalclad's Mexican Hazardous Waste Ventures:**

**5.22. Santa Maria del Rio**

- "In November 1991, the Company [Metalclad] acquired all of the outstanding shares of common stock of ECO-Metalclad, Inc. ("EMI")...developing a toxic and hazardous waste treatment facility in the Mexican state of San Luis Potosi."<sup>18</sup>
- "ECO Administracion, S.A. de C.V. ("ECO") has received an unconditional permit to construct its facility in San Luis Potosi from SEDUE."<sup>19</sup>
- "In March 1993, the company received permission from the National Commission of Foreign Investments, an agency of the Mexican government, to increase its ownership interest in ECO to 75%."<sup>20</sup>
- ECO has received the Construction Permit for its first facility in San Luis Potosi from the National Institute of Ecology..."<sup>21</sup>
- "The company's current Mexican business consists of (i) the development and construction of operating facilities in San Luis Potosi...scheduled to open in

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<sup>18</sup> Metalclad Corporation SEC Form 10-K for the fiscal year ended December 31, 1991, page 1.

<sup>19</sup> Metalclad Corporation SEC Form 10-K for the fiscal year ended December 31, 1991, page 9.

<sup>20</sup> Metalclad Corporation SEC Form 10-K for the fiscal year ended December 31, 1992, page 1.

<sup>21</sup> Metalclad Corporation SEC Form 10-K for the fiscal year ended December 31, 1992, page 7.

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**CHICAGO PARTNERS**

A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

the last quarter of calendar 1994...<sup>22</sup>

- ...also been issued a construction permit for an integrated hazardous waste treatment facility, including a rotary slagging kiln, near Santa Maria del Rio, San Luis Potosi...<sup>23</sup>
- "...the Company has been encouraged by governmental authorities of the State of SLP to locate the hazardous treatment facilities originally planned for Santa Maria del Rio, including the rotary slagging kiln, at El Confin.<sup>24</sup>
- News announcements: Appendix C.5A at 10/18/91, 10/21/91, 5/19/92, 8/15/92, 7/16/93, 1/11/94, 2/15/94

#### **5.23. Molten Metal Technology, Inc. ("MMT")**

- "[Metalclad]...will participate in the ownership, development, and operation of toxic and hazardous waste treatment facilities in Mexico utilizing a patented waste treatment process pursuant to a license from Molten Metal Technology, Inc. ("MMT"),...ECO and MMT entered into an agreement in January 1992 pursuant to which MMT agreed to conduct conceptual design studies for the San Luis Potosi facility...<sup>25</sup>
- News announcements: Appendix C.4A at 1/14/92, 1/15/92

#### **5.24. Veracruz ("DIV")**

- After December 31, 1991, [EMI] formed two other corporations to develop

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<sup>22</sup> Metalclad Corporation SEC Form 10-K for the fiscal year ended May 31, 1994, page 1.

<sup>23</sup> Metalclad Corporation SEC Form 10-K for the fiscal year ended May 31, 1994, page 2.

<sup>24</sup> Metalclad Corporation SEC Form 10-K for the fiscal year ended May 31, 1994, page 5.

<sup>25</sup> Metalclad Corporation SEC Form 10-K for the fiscal year ended December 31, 1991, pages 1 & 7.

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## **CHICAGO PARTNERS**

A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

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toxic and hazardous waste treatment facilities in Veracruz and Tamaulipas. Metalclad used the words "EMI has since acquired a 49% ownership interest and 50% voting interest in two other Mexican corporations..."<sup>26</sup>

- "DIV and ECI have obtained applicable zoning and land use permits from city and state governmental authorities for the proposed facilities in Veracruz and Tamaulipas, have received permission from SEDUE to perform feasibility studies, risk analysis and environmental impact studies, and have applied for the construction permit."<sup>27</sup>
- "...is in the process of obtaining all applicable zoning and land use permits from local and state governmental authorities for the proposed facilities in Veracruz and Tamaulipas."<sup>28</sup>
- "CATSA is presently working on the selection and permitting of four additional sites in the states of Guanajuato, Jalisco, Tamaulipas, and Veracruz for facilities similar to those being developed by the company in the state of San Luis Potosi."<sup>29</sup>
- News announcements: Appendix C.4A at 3/2/92, 5/19/92, 7/20/92

#### 5.25. Tamaulipas ("ECI")

- After December 31, 1991, [EMI] formed two other corporations to develop toxic and hazardous waste treatment facilities in Veracruz and Tamaulipas. Metalclad used the words "EMI has since acquired a 49% ownership interest

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<sup>26</sup> Metalclad Corporation SEC Form 10-K for the fiscal year ended December 31, 1991, page 1.

<sup>27</sup> Metalclad Corporation SEC Form 10-K for the fiscal year ended December 31, 1991, page 9.

<sup>28</sup> Metalclad Corporation SEC Form 10-K for the fiscal year ended December 31, 1992, page 7.

<sup>29</sup> Metalclad Corporation SEC Form 10-K for the fiscal year ended May 31, 1994, page 3.

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## CHICAGO PARTNERS

A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

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and 50% voting interest in two other Mexican corporations...<sup>30</sup>

- “DIV and ECI have obtained applicable zoning and land use permits from city and state governmental authorities for the proposed facilities in Veracruz and Tamaulipas, have received permission from SEDUE to perform feasibility studies, risk analysis and environmental impact studies, and have applied for the construction permit.”<sup>31</sup>
- “...is in the process of obtaining all applicable zoning and land use permits from local and state governmental authorities for the proposed facilities in Veracruz and Tamaulipas.”<sup>32</sup>
- News announcements: Appendix C.4A at 3/2/92, 5/19/92, 7/20/92

#### **COTERIN**

- “In April 1993, the company entered into an agreement in principle to acquire 94% of Confinamiento Technico de Residuos Industriales, S.A. de C.V. (“COTERIN”), which owns a permitted hazardous waste landfill near Guadalucazar, San Luis Potosi.”<sup>33</sup>
- “ECOPSA is completing construction of a permitted hazardous waste landfill...in La Pedrera, in the Mexican state of San Luis Potosi (“El Confin”)...The La Pedrera site is owned by COTERIN, which was acquired by the company in October 1993...”<sup>34</sup>

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<sup>30</sup> Metalclad Corporation SEC Form 10-K for the fiscal year ended December 31, 1991, page 1.

<sup>31</sup> Metalclad Corporation SEC Form 10-K for the fiscal year ended December 31, 1991, page 9.

<sup>32</sup> Metalclad Corporation SEC Form 10-K for the fiscal year ended December 31, 1992, page 7.

<sup>33</sup> Metalclad Corporation SEC Form 10-K for the transition period from January 1, 1993 to May 31, 1993, page 9.

<sup>34</sup> Metalclad Corporation SEC Form 10-K for the fiscal year ended May 31, 1994, page 2.

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## **CHICAGO PARTNERS**

A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

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- "...and on the start-up phases one and two at El Confin...management believes that the landfill will operate at full capacity approximately 10 months after opening...The company is also engaged in pre-construction activities to plan the infrastructure and support requirements required for phase three of its facility at El Confin..."<sup>35</sup>
- "El Confin is presently not in operation because the governor of San Luis Potosi is actively opposed to its opening."<sup>36</sup>
- News announcements: Appendix C.6A at 7/16/93, 7/18/93, 10/13/93, 11/11/93, 1/11/94, 1/13/94, 1/21/94, 2/15/94, 3/29/94, 5/28/94, 5/31/94, 9/1/94, 1/19/95, 5/3/95, 6/12/95, 7/20/95, 8/10/95, 8/23/95, 9/25/95, 10/15/95, 11/13/95, 11/16/95, 11/27/95, 12/1/95, 1/1/96, 4/17/96

#### 5.26. CATSA

- "In June 1993, the company organized a consulting group to provide a multi-disciplined approach for environmental consulting services and in August 1993 incorporated CATSA."<sup>37</sup>
- "CATSA is presently working on the selection and permitting of four additional sites in the states of Guanajuato, Jalisco, Tamaulipas, and Veracruz for facilities similar to those being developed by the company in the state of San Luis Potosi."<sup>38</sup>
- News announcements: Appendix C.5A at 6/16/93

<sup>35</sup> Metalclad Corporation SEC Form 10-K for the fiscal year ended May 31, 1995, page 3.

<sup>36</sup> Metalclad Corporation SEC Form 10-K for the fiscal year ended May 31, 1996, page 4.

<sup>37</sup> Metalclad Corporation SEC Form 10-K for the transition period from January 1, 1993 to May 31, 1993, page 10.

<sup>38</sup> Metalclad Corporation SEC Form 10-K for the fiscal year ended May 31, 1994, page 3.

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## CHICAGO PARTNERS

A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

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## 5.27. QUIMICA OMEGA

- “In May 1994, the Company acquired all of the outstanding shares of QUIMICA OMEGA...”<sup>39</sup>
- “The company’s current Mexican business consists of ...the collection of waste oils and solvents for recycling and disposition in cement kilns...”<sup>40</sup>
- “The company is concentrating its efforts by optimizing expansion of QUIMICA OMEGA ...”<sup>41</sup>
- News announcements: Appendix C.7A at 4/26/94, 5/6/94, 6/7/94, 7/18/94, 9/6/94, 9/7/94, 9/29/94, 1/19/95, 2/1/95, 6/12/95, 11/13/95, 11/16/95, 12/1/95

## 5.28. BFI-OMEGA

- “On April 9, 1996, the company and BFI, through wholly-owned Mexican subsidiaries, formed BFI-OMEGA as a 50%-50% owned joint venture corporation to provide a full range of industrial waste collection, transportation, recycling, treatment, and disposal services in Mexico...Since the formation of BFI-OMEGA, additional branches have been added in Tampico, Puebla, and southwestern Mexico City. Additional branches are now being developed in Toluca, Veracruz and Coatzacoalcos..”<sup>42</sup>
- “Excluded from the joint venture [BFI-OMEGA] is the development and ownership of disposal facilities and international brokerage of PCB’s. Also

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<sup>39</sup> Metalclad Corporation SEC Form 10-K for the fiscal year ended May 31, 1994, page 2.

<sup>40</sup> Metalclad Corporation SEC Form 10-K for the fiscal year ended May 31, 1994, page 1.

<sup>41</sup> Metalclad Corporation SEC Form 10-K for the fiscal year ended May 31, 1994.

<sup>42</sup> Metalclad Corporation SEC Form 10-K for the fiscal year ended May 31, 1996, page 2.

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## CHICAGO PARTNERS

A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

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excluded is any municipal solid waste business.”<sup>43</sup>

- News announcements: Appendix C.4A at 3/8/96

### 5.29. The Incinerator/Rotary Slagging Kiln

- “...a hazardous waste incinerator under development...”<sup>44</sup>
- ...has also been issued a construction permit for an integrated hazardous waste treatment facility, including a rotary slagging kiln, near Santa Maria del Rio, San Luis Potosi...”<sup>45</sup>
- “...the Company has been encouraged by governmental authorities of the State of SLP to locate the hazardous treatment facilities originally planned for Santa Maria del Rio, including the rotary slagging kiln, at El Confin.”<sup>46</sup>
- News announcements: Appendix C.5A at 10/13/93, 11/11/93, 2/15/94

### 5.30. Guanajuato

- “CATSA is presently working on the selection and permitting of four additional sites in the states of Guanajuato, Jalisco, Tamaulipas, and Veracruz for facilities similar to those being developed by the company in the state of San Luis Potosi.”<sup>47</sup>

### 5.31. Jalisco

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<sup>43</sup> Metalclad Corporation SEC Form 10-K for the fiscal year ended May 31, 1996, page 3.

<sup>44</sup> Metalclad Corporation SEC Form 10-K for the fiscal year ended May 31, 1994, page 1.

<sup>45</sup> Metalclad Corporation SEC Form 10-K for the fiscal year ended May 31, 1994, page 2.

<sup>46</sup> Metalclad Corporation SEC Form 10-K for the fiscal year ended May 31, 1994, page 5.

<sup>47</sup> Metalclad Corporation SEC Form 10-K for the fiscal year ended May 31, 1994, page 3.

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## CHICAGO PARTNERS

A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

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- “CATSA is presently working on the selection and permitting of four additional sites in the states of Guanajuato, Jalisco, Tamaulipas, and Veracruz for facilities similar to those being developed by the company in the state of San Luis Potosi.”<sup>48</sup>

### **5.32. Deter Saneamiento**

- “Metalclad announced the execution of a definitive agreement to acquire Deter Saneamiento S.A. de C.V., a Mexican industrial environmental services business.” News announcements: Appendix C.4A at 5/17/94.

### **5.33. Aqueous Waste Treatment Facility**

- “In addition, a pilot plant for the treatment of aqueous waste is being developed at BFI-OMEGA’s Tenango plant, with future expansion contemplated.”<sup>49</sup>

### **5.34. Seguridad Elctrica Mexicana (“SEM”)**

- “Metalclad...acquired SEM, a 15-year old Mexican corporation which is the leader in the Mexican market for specialized repair and maintenance of electrical transformers.” News announcements: Appendix C.5A at 11/6/96.
- In Metalclad’s Form 10-K for the transition period from June 1, 1996 through December 31, 1996 SEM is described, “...a Mexican company exclusively engaged in the business of marketing PCB’s for export and destruction.”<sup>50</sup>

### **5.35. PCB Exporting**

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<sup>48</sup> Metalclad Corporation SEC Form 10-K for the fiscal year ended May 31, 1994, page 3.

<sup>49</sup> Metalclad Corporation SEC Form 10-K for the fiscal year ended May 31, 1996, page 2.

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## **CHICAGO PARTNERS**

A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

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- “Excluded from the joint venture is the development and ownership of disposal facilities and international brokerage of PCB’s. Also excluded is any municipal solid waste business.”<sup>51</sup>
- “...the Company...is exploring relationships in the United States for export...[and] has also acquired an option to purchase one other Mexican company also licensed in the same manner.”<sup>52</sup>
- “Metalclad...signed a letter of intent with Rollins Environmental, Inc. to enter into an exclusive environmental services agreement pursuant to which Metalclad’s Mexican subsidiary, ECONSA, would act as the exclusive agent for Rollins in the country of Mexico for the disposal of PCBs, which disposal will take place at Rollins’ disposal site in the U.S.” News announcements: Appendix C.5A at 11/6/96.

### 5.36. Potential Additional Sites

- ECONSA is active in developing additional projects in Mexico, including...an additional hazardous waste landfill and treatment facility near the heart of industrial Mexico....[Metalclad] believed that this project can proceed more rapidly than prior projects...<sup>53</sup>
- “The Company has responded to an invitation from a major industrialized state in Mexico to develop and install a facility for the treatment and disposal of non-hazardous industrial waste. A site...has been selected.”<sup>54</sup>

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<sup>50</sup> Metalclad Corporation SEC Form 10-K for the transition period June 1, 1996 through December 31, 1996, page 5.

<sup>51</sup> Metalclad Corporation SEC Form 10-K for the fiscal year ended May 31, 1996, page 3.

<sup>52</sup> Metalclad Corporation SEC Form 10-K for the fiscal year ended May 31, 1996, page 5.

<sup>53</sup> Metalclad Corporation SEC Form 10-K for the fiscal year ended May 31, 1996, page 4.

<sup>54</sup> Metalclad Corporation SEC Form 10-K for the fiscal year ended May 31, 1996, page 5.

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## CHICAGO PARTNERS

A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

### **5.37. Laboratory, Transportation & Site Remediation Services**

- “The company anticipates expanding its business into other ancillary activities such as laboratory, transportation, and site remediation services.”<sup>55</sup>

### **5.38. Other Potential Projects**

- “Metalclad Corp. ...and Hughes Environmental Systems Inc. ...have entered into a Memorandum of Understanding under which the parties will explore a possible alliance that could entail a joint venture for the development, construction and operation of multiple waste recycling and treatment facilities...contemplate the execution of a definitive agreement later this fall.”
- News announcements: Appendix C.5A at 7/20/92.

### **5.39. Metalclad’s 1991 Mexican Hazardous Waste Ventures:**

#### **Santa Maria del Rio:**

- Metalclad Corporation SEC Form 10-K for the fiscal year ended December 31, 1991, pages 1 & 9.
- News announcements: Appendix C.5A at 10/18/91, 10/21/91

#### **Molten Metal Technology (“MMT”)**

- Metalclad Corporation SEC Form 10-K for the fiscal year ended December 31, 1991, pages 1 & 7.
- News announcements: Appendix C.4A at 1/14/92, 1/15/92

#### **Veracruz (“DIV”)**

- Metalclad Corporation SEC Form 10-K for the fiscal year ended December 31, 1991, pages 1 & 9.

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<sup>55</sup> Metalclad Corporation SEC Form 10-K for the fiscal year ended May 31, 1994, page 2.

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## **CHICAGO PARTNERS**

A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

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- News announcements: Appendix C.4A at 3/2/92

#### **Tamaulipas ("ECI")**

- Metalclad Corporation SEC Form 10-K for the fiscal year ended December 31, 1991, pages 1 & 9.
- News announcements: Appendix C.4A at 4/20/92

#### **Potential Additional Sites**

- Metalclad Corporation SEC Form 10-K for the fiscal year ended December 31, 1991, page 9.

### **5.40. Metalclad's 1992 Mexican Hazardous Waste Ventures:**

#### **Santa Maria del Rio**

- Metalclad Corporation SEC Form 10-K for the fiscal year ended December 31, 1992, pages 1 & 7.
- News announcements: Appendix C.5A at 5/19/92, 8/15/92

#### **DIV**

- Metalclad Corporation SEC Form 10-K for the fiscal year ended December 31, 1992, page 7.
- News announcements: Appendix C.5A at 5/19/92, 7/20/92

#### **ECI**

- Metalclad Corporation SEC Form 10-K for the fiscal year ended December 31, 1992, page 7.
- News announcements: Appendix C.5A at 5/19/92, 7/20/92

#### **Other Potential Projects**

- Metalclad Corporation SEC Form 10-K for the fiscal year ended December 31, 1992, page 7.
- News announcements: Appendix C.5A at 7/20/92.

### **5.41. Metalclad's 1993 Mexican Hazardous Waste Ventures (Transition Period January 1, 1993 to May 31, 1993):**

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## **CHICAGO PARTNERS**

A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

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### **Santa Maria del Rio**

- Metalclad Corporation SEC Form 10-K for the transition period January 1, 1993 through May 31, 1993, page 7.

### **DIV**

- Metalclad Corporation SEC Form 10-K for the transition period January 1, 1993 through May 31, 1993, pages 6 - 7.

### **ECI**

- Metalclad Corporation SEC Form 10-K for the transition period January 1, 1993 through May 31, 1993, pages 6 - 7.

### **COTERIN**

- Metalclad Corporation SEC Form 10-K for the transition period January 1, 1993 through May 31, 1993, pages 9.

### **CATSA**

- Metalclad Corporation SEC Form 10-K for the transition period January 1, 1993 through May 31, 1993, pages 10.
- News announcements: Appendix C.5A at 6/16/93.

## **5.42. Metalclad's 1994 Mexican Hazardous Waste Ventures:**

### **Santa Maria del Rio**

- Metalclad Corporation SEC Form 10-K for the fiscal year ended May 31, 1994, pages 2 & 5.
- News announcements: Appendix C.5A at 7/16/93, 1/11/94, 2/15/94

### **COTERIN**

- Metalclad Corporation SEC Form 10-K for the fiscal year ended May 31, 1994, pages 1 & 2.
- News announcements: Appendix C.6A at 7/16/93, 7/18/93, 10/13/93, 11/11/93, 1/11/94, 1/13/94, 1/21/94, 2/15/94, 3/29/94, 5/28/94, 5/31/94, 9/1/94

### **Incinerator/Rotary Slagging Kiln (IRSK)**

- Metalclad Corporation SEC Form 10-K for the fiscal year ended May 31, 1994, pages 1, 2 & 5.

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## **CHICAGO PARTNERS**

A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

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- News announcements: Appendix C.5A at 10/13/93, 11/11/93, 2/15/94

#### **Laboratory, Transportation and Site Remediation Services**

- Metalclad Corporation SEC Form 10-K for the fiscal year ended May 31, 1994, page 2.

#### **Quimica Omega**

- Metalclad Corporation SEC Form 10-K for the fiscal year ended May 31, 1994, pages 1 & 3.
- News announcements: Appendix C.7A at 4/26/94, 5/6/94, 6/7/94, 7/18/94, 9/6/94, 9/7/94, 9/29/94

#### **DIV**

- Metalclad Corporation SEC Form 10-K for the fiscal year ended May 31, 1994, page 3.

#### **ECI**

- Metalclad Corporation SEC Form 10-K for the fiscal year ended May 31, 1994, page 3.

#### **Guanajuato**

- Metalclad Corporation SEC Form 10-K for the fiscal year ended May 31, 1994, page 3.

#### **Jalisco**

- Metalclad Corporation SEC Form 10-K for the fiscal year ended May 31, 1994, page 3.

#### **Deter Saneamiento**

- Appendix C.4A at 5/17/94.

### **5.43. Metalclad's 1995 Mexican Hazardous Waste Ventures:**

#### **Santa Marie del Rio**

- Metalclad Corporation SEC Form 10-K for the fiscal year ended May 31, 1995, page 1.

#### **CATSA**

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## **CHICAGO PARTNERS**

A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

---

- Metalclad Corporation SEC Form 10-K for the fiscal year ended May 31, 1995, pages 3 & 9.

**Quimica Omega**

- Metalclad Corporation SEC Form 10-K for the fiscal year ended May 31, 1995.
- News announcements: Appendix C.7A at 1/19/95, 2/1/95, 6/12/95, 11/13/95, 11/16/95, 12/1/95

**COTERIN**

- Metalclad Corporation SEC Form 10-K for the fiscal year ended May 31, 1995, page 3.
- News announcements: Appendix C.6A at 1/19/95, 5/3/95, 6/12/95, 7/20/95, 8/10/95, 8/23/95, 9/25/95, 10/15/95, 11/13/95, 11/16/95, 11/27/95, 12/1/95

**Incinerator/Rotary Slagging Kiln**

- Metalclad Corporation SEC Form 10-K for the fiscal year ended May 31, 1995, page 1.
- News announcements: Appendix C.5A at 6/12/95

**5.44. Metalclad's 1996 Mexican Hazardous Waste Ventures:**

**Incinerator/Rotary Slagging Kiln**

- Metalclad Corporation SEC Form 10-K for the fiscal year ended May 31, 1996, page 5.

**BFI-Omega**

- Metalclad Corporation SEC Form 10-K for the fiscal year ended May 31, 1996, pages 2 & 3.
- News announcements: Appendix C.4A at 3/8/96

**Aqueous Waste Treatment Facility**

- Metalclad Corporation SEC Form 10-K for the fiscal year ended May 31, 1996, page 2.

**COTERIN**

- Metalclad Corporation SEC Form 10-K for the fiscal year ended May 31, 1996, page 4.

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**CHICAGO PARTNERS**

A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

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- News announcements: Appendix C.6A at 1/1/96, 4/17/96

#### **Seguridad Electrica Mexicana ("SEM")**

- Metalclad Corporation SEC Form 10-K for the transition period June 1, 1996 through December 31, 1996, page 5.
- News announcements: Appendix C.5A at 11/6/96.

#### **PCB Exporting**

- Metalclad Corporation SEC Form 10-K for the fiscal year ended May 31, 1996, page 3 & 5.
- News announcements: Appendix C.5A at 11/6/96.

#### **Additional Sites**

- Metalclad Corporation SEC Form 10-K for the fiscal year ended May 31, 1996, pages 4 & 5.

#### **5.45. Metalclad's Mexican Ventures' Forecasts**

5.46. Metalclad Corporation produced various reports on the status and plans for its projects in Mexico. Two such reports, "Project Status, Mexico", dated June 15, 1994 (Claimant's answer to production request 7(c)A) (hereinafter "June 94 forecast") and "Project Status, Mexico", dated February 1, 1995 (Claimant's answer to production request 7(c)D) (hereinafter "February 95 forecast"), contained forecasts of revenues, operating expenses, selling, general and administrative costs ("SG&A") and earnings before interest and taxes ("EBIT") for three Metalclad businesses (El Confin, Quimica Omega & Insulation).

5.47. **EL CONFIN:** The June 94 forecast indicates that El Confin, having begun construction, was expected to begin operation September 1994. Ramp-up to full operation was expected by July 1995. The February 1, 1995 forecast, however, extended El Confin's start of operations to March 1995, with a resulting ramp-up to full operation

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### **CHICAGO PARTNERS**

A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

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by December 1995.<sup>56</sup>

5.48. The revenue forecasted for El Confin claimed to utilize pricing used by RIMSA, one of two operating commercial hazardous waste landfills in Mexico, located near Monterrey.<sup>57</sup> It is interesting to note that the price per ton in the February 1995 forecast for 1997 dramatically increased 20% to \$336/ton (with no accompanying explanation provided).<sup>58</sup> In addition, volume for El Confin in the February 1995 forecast for 1997 exceeded the capacity of 130,000 tons (even though at 130,000 tons, El Confin already would require additional approvals). As a result, annual revenues increase between forecasts, especially for periods after 1995.

5.49. El Confin's contribution to combined Metalclad revenues was forecasted at over 50% for 1996 and 1997 in the February 1995 report. EBIT for El Confin improves from forecast to forecast increasing from approximately 35% of revenues to over 40% of revenues. As a result, El Confin was predicted to contribute over 70% of Metalclad's EBIT in the 1995 forecast, while in the 1994 forecast it contributed 50% of Metalclad's EBIT.

5.50. **QUIMICA OMEGA:** Quimica Omega, the Company's then only operating business in Mexico, derived its income from two sources: 1) industrial services, which included the collection of waste fuels, recycling, sales to cement kilns and brokering, and 2) branch operation, which included placing and servicing of the parts washing equipment and the Omega tanks.

5.51. In the June 1994 forecast, QUIMICA OMEGA accounted for nearly one-third of

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<sup>56</sup> "Project Status, Mexico", dated June 15, 1994, pages 55-56 and "Project Status, Mexico", dated February 1, 1995, pages 64-65.

<sup>57</sup> "Project Status, Mexico", dated June 15, 1994, page 55 and "Project Status, Mexico", dated February 1, 1995, page 65.

<sup>58</sup> I understand that Mr. Butler criticizes AAA's reliance on Metalclad's estimates of revenues per ton of \$150.80 as being too high.

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## CHICAGO PARTNERS

A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

Metalclad's total-forecasted revenues for 1995 to 1997, while in the subsequent forecast, QUIMICA OMEGA's revenues made up less than one-quarter of Metalclad's total revenues. El Confin appeared to cover the forecasted revenue shortfall in the February 1995 forecast (despite its operational and capacity status).

5.52. In the June 15, 1994 forecast, Metalclad assumed the opening of at least three QUIMICA OMEGA branches per year, investing approximately \$7 million in new equipment. The additional required capital was forecasted to be generated mainly from the profits of the existing operations. Metalclad believed "precedence for the growth of Quimica Omega can be found by looking at the early years of the U.S. corporation Safety Kleen..."<sup>59</sup>

5.53. However, the February 1995 forecast did not assume any growth for QUIMICA OMEGA and called for only \$500,000 in capital improvements. An identical "Safety Kleen" reference remained in the February 1995 forecast.

5.54. As QUIMICA OMEGA's revenues declined from forecast to forecast, its EBIT contribution also declined. QUIMICA OMEGA was forecast to contribute less than 20% to Metalclad's EBIT in the February 1995 forecast, whereas it contributed almost 47% of Metalclad's EBIT in the June 1994 forecast.

5.55. **INSULATION:** Metalclad devoted little discussion to its insulation business in either forecast, claiming in both that insulation revenues and earnings had been forecasted using fairly conservative levels of operation. Annual insulation revenue levels did not change between forecasts, but it is interesting to note that the forecasted revenue levels were higher than those experienced by Metalclad in the prior two fiscal years. In addition, historical EBIT for insulation operations was approximately 2% of revenues for

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<sup>59</sup> "Project Status, Mexico", dated June 15, 1994, page 56 and "Project Status, Mexico", dated February 1, 1995, page 65.

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## CHICAGO PARTNERS

A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

the past three fiscal years, while the Metalclad forecasted levels of almost 5%.

**5.56. Metalclad's Auditor Changes and the 1995 "Going Concern" opinion**

**5.57.** Metalclad's accountant KPMG Peat Marwick, tendered its resignation on April 20, 1993 and the company engaged Grant Thornton on May 28, 1993.<sup>60</sup> Three years later Metalclad dismissed Grant Thornton LLP, effective March 25, 1996 and engaged Arthur Andersen LLP as its principal accountant on April 26, 1996.<sup>61</sup>

**5.58.** KPMG issued a letter to the SEC on April 27, 1993,

"We were previously principal accountants for Metalclad Corporation and, under the date of March 30, 1993, we reported on the consolidated financial statements of Metalclad Corporation and subsidiaries as of and for the years ended December 31, 1992 and 1991. On April 20, 1993, we resigned. We have read Metalclad Corporation's statements included under Item 4 of its Form 8-K dated April 27, 1993, and we agree with such statements."<sup>62</sup>

The paragraph that KPMG references - **Metalclad Form 8-K dated April 27, 1993 Item 4 -- "Changes in Registrant's Certifying Accountant"** - merely states that during KPMG's tenure with Metalclad, there were no disagreements with the accountant on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure, and no reportable events.

**5.59.** Metalclad was not a trivial client for the public accounting firms. In 1994, for example, Metalclad's fees paid to its accounting firms (Grant Thornton, E&Y, KPMG and a local practitioner) totalled over \$300,000.<sup>63</sup>

**5.60.** Current academic research indicates that restatements of prior period financial

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<sup>60</sup> Metalclad Corporation SEC Form 8-K dated April 21, 1993.

<sup>61</sup> Metalclad Corporation SEC Form 8-K/A3 dated May 6, 1996.

<sup>62</sup> Metalclad Corporation SEC Form 8-K dated April 21, 1993.

<sup>63</sup> Metalclad expense summaries reviewed as support for the \$20.5 million alleged landfill investment.

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**CHICAGO PARTNERS**

A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

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statements, disclaimed audit opinions, auditor-client disagreements and reportable events are significantly related to auditor resignations.<sup>64</sup>

**5.61. Metalclad's amendments and late notices in relation to its Many SEC filings,** Exhibit 5.4 details Metalclad's late notices and amendments to its SEC filings. Combined with two changes in fiscal year-end (from December 31<sup>st</sup> to May 31<sup>st</sup> and back again), the amendments and late filings complicate a reader's understanding and interpretation of the Metalclad story.

**5.62. Metalclad's "Going Concern" Opinion**

**5.63. Metalclad's second set of auditors, Grant Thornton, issued the Company a "going concern" audit opinion on August 31, 1995.**

"The Company has had substantial recurring losses from its operations and has been dependent upon external financing to sustain its operations. These factors, among others, as discussed in Note B to the consolidated financial statements, raise substantial doubt about the Company's ability to continue as a going concern."<sup>65</sup>

**Note B – "Realization of Assets" – Going Concern,** states that Metalclad's continued losses from its operations are "...attributable primarily to its hazardous waste business in Mexico and [the company] has been dependent on external financing to sustain its operations. At May 31, 1995, the Company had a working capital deficit of approximately \$1,800,000, and its liabilities exceeded its assets by approximately \$6,200,000..."<sup>66</sup>

"The Company has not been granted all necessary governmental authorizations to

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<sup>64</sup> Doctorate thesis entitled "Auditor Resignation Disclosures" by Keith Andrew Bockus, University of Chicago Graduate School of Business, January 1988.

<sup>65</sup> Metalclad Corporation SEC Form 10-K for the fiscal year ended May 31, 1995, page F-1.

<sup>66</sup> Metalclad Corporation SEC Form 10-K for the fiscal year ended May 31, 1995, pages F-13 – F-14.

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**CHICAGO PARTNERS**

A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

---

open and operate the facility. The financial statements do not include any adjustments relating to the recoverability of the carrying amount of this asset that might be necessary should the Company be unable to open and operate the facility.”<sup>67</sup>

5.64. Metalclad dismissed Grant Thornton LLP effective March 25, 1996 and engaged Arthur Andersen LLP as its principal accountant on April 26, 1996. Upon Grant Thornton’s dismissal a series of Form 8-K’s and amendments (5) thereto were issued by Metalclad describing Grant Thornton’s dismissal including Grant Thornton’s confirmation of the going concern and permit issues:

“...our report dated August 31, 1995 (except for Note G, as to which the date is September 12, 1995) on the consolidated financial statements of the registrant for the year ended May 31, 1995 contained explanatory paragraphs regarding uncertainties about the company’s ability to continue as a going concern and regarding the company not having been granted all necessary governmental authorizations to open and operate its hazardous waste facility in Mexico.”<sup>68</sup>

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<sup>67</sup> Metalclad Corporation SEC Form 10-K for the fiscal year ended May 31, 1995, pages F-13 – F-14.

<sup>68</sup> Metalclad Corporation SEC Form 8-K/A filed October 28, 1997, with attached Grant Thornton letter to SEC dated April 26, 1996.

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## CHICAGO PARTNERS

A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

## **6. Metalclad's Acquisitions, Start-Ups and Joint Ventures**

**6.1.** I examined Metalclad's acquisitions, start-ups and joint ventures (collectively the "Mexican ventures") to gain an understanding of

- The Claimant's development of its Mexican ventures,
- the significance of Metalclad's equity capital to its ability to pursue the Mexican ventures,
- the Sellers' (i.e. the former owners of the acquired entities) implied assessment of Metalclad equity values based upon their subsequent holding or disposition of their Metalclad stock consideration.

**6.2. Acquisitions:** In summary, Metalclad paid sizeable premiums to acquire three entities: two non-operating landfill sites still in the permitting process and one operating company that was losing money at an even faster rate than Metalclad and had received a "going concern" opinion months before the acquisition. Metalclad also spent at least \$550,000 in 1991 and 1992 acquiring land for the Santa Maria del Rio and Veracruz proposed landfill sites.<sup>1</sup>

**6.3. Startups:** In May and June 1993, the company organized Consultoria Ambiental Total, S.A. de C.V. ("CATSA"), as a wholly-owned subsidiary to pursue consulting opportunities in the Mexican environmental services industry.<sup>2</sup> CATSA is the only start-up initiated by Metalclad. Metalclad frequently announced expansion opportunities "into other ancillary activities such as laboratory, transportation and site remediation services,"<sup>3</sup> however, as of its December 1996 10-K filing those other start-ups had yet to materialize.

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<sup>1</sup> Metalclad Corporation SEC Form 10-K May 31, 1994 page 17 – 18 and various Metalclad documents reviewed in analysis of Claimant's alleged \$20.5 million landfill cost summary [See Section 10].

<sup>2</sup> Metalclad Corporation SEC Form 10-K for the transition period from January 1, 1993 to May 31, 1993, page 6.

<sup>3</sup> Metalclad Corporation SEC Form 10-K for the fiscal year ended May 31, 1994, page 2.

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### **CHICAGO PARTNERS** A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

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**6.4. Joint Ventures:** Metalclad announces numerous potential joint ventures. Only two joint ventures are actually initiated: Curtom-Metalclad and BFI-OMEGA. The joint venture partner (BFI) for the only Mexican venture, BFI-OMEGA, contributes assets and a general manager to the venture but exits in less than one year.<sup>4</sup>

**6.5.** The other Metalclad joint venture is unrelated to its Mexican hazardous waste business. Curtom-Metalclad was formed in 1989, apparently conceived and designed to win preferential minority contracts in the U.S. insulation business. In July 1996, this partnership received an estimated \$10 million contract from a long-term client. Contracts with Curtom-Metalclad accounted for more than 60% of the company's insulation contracting revenues during the 7 months ended December 31, 1996.<sup>5</sup> Metalclad performed the work as a subcontractor to the joint venture and in return shared 49% of the joint venture profit.

**6.6.** The Claimant's acquisition, start-up and joint venture activity began in earnest following Kesler's stock purchase with the acquisition of a company in which he owned a majority interest -- Environ Technologies, Inc. ("ETI"). ETI's name was subsequently changed to ECO-Metalclad, Inc. ("ECO"). The acquisition of ETI/ECO is described in the chronological summary presented below. Metalclad's current structure flows most directly from its status in 1993. The current structure will be described initially to assist in referencing the many name changes coincident to the acquisition history.

**6.7. 1993 – Current Metalclad Corporate Structure.**

On October 8, 1993, the Metalclad Board of Directors approved a change in the state of incorporation of Metalclad from Arizona to Delaware.<sup>6</sup> Metalclad's wholly-owned United States subsidiaries include Eco-Metalclad, Inc. ("EMI"), a Utah corporation;

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<sup>4</sup> Metalclad Corporation SEC Form 10-K for the transition period from June 1, 1996 to December 31, 1996, pages F-13 – F-14.

<sup>5</sup> Metalclad Corporation SEC Form 10-K for the transition period from June 1, 1996 to December 31, 1996, pages 3, 10, & F-15.

<sup>6</sup> Metalclad Corporation PRE 14-A, Filed October 8, 1993, page 28.

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**CHICAGO PARTNERS**  
A LIMITED LIABILITY COMPANY

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Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

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Metalclad Insulation Corporation ("MIC"), a California corporation; and Metalclad Environmental Contractors ("MEC"), a California corporation.<sup>7</sup>

6.8. Metalclad's Mexican subsidiaries include Ecosistemas Nacionales, S.A. de C.V. ("ECONSA"), Ecosistemas del Potosi, S.A. de C.V., formerly know as Eco Adminstracion, S.A. de C.V. ("ECOPSA"), QUIMICA OMEGA, S.A. de C.V. ("QUIMICA OMEGA"), Consultoria Ambiental Total, S.A. de C.V. ("CATSA"), Confinamiento Tecnico de Residues Industriales, S.A. de C.V. ("COTERIN") and Seguridad Electrica Mexicana, S.A. ("SEM"). The Company's intent, as stated in the December 1996 10-K, was to continue the process of restructuring the ownership of its Mexican subsidiaries so that ECONSA would hold the capital stock of all Mexican subsidiaries.<sup>8</sup>

#### 6.9. METALCLAD ACQUISITION CHRONOLOGY

#### 6.10. ECO-METALCLAD, INC.

6.11. In November 1991, Metalclad acquired all the outstanding shares of common stock of Environ Technologies, Inc. ("ETI") and subsequently changed ETI's name to Eco-Metalclad, Inc. ("EMI"). In exchange for 100% of the shares of ETI common stock, Metalclad issued 1,180,000 shares of Metalclad common stock to ETI's shareholders – Kesler, Robertson, Reed T. Warnick ("Warnick") and J. Terry Douglas ("Douglas"), in accordance with a November 20, 1991 Stock Exchange Agreement.<sup>9</sup>

6.12. At the November 20, 1991 market price of \$2.875 per Metalclad share and including the assumption of \$1,003,463 of ETI liabilities (per an unaudited November 15, 1991 balance sheet and not including the unquantified obligations and liabilities assumed

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<sup>7</sup> Metalclad Corporation Form 10-K for the fiscal year ended May 31, 1994, page 1.

<sup>8</sup> Metalclad Corporation Form 10-K for the transition period from June 1, 1996 to December 31, 1996, page 2.

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## CHICAGO PARTNERS

A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

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by Metalclad on behalf of ETI under a "certain Joint Venture Agreement dated July 26, 1991" relating to the Santa Maria del Rio project), the total ETI consideration under the Stock Exchange agreement was \$4,395,963.

6.13. On April 13, 1992, Metalclad, Kesler, Robertson, Warnick and Douglas, in settlement of all their disputes arising as a result of the ETI acquisition, effected a mutual release agreement ("ETI release"). The agreement provided for payments by Metalclad to (and full releases for Kesler and Robertson from) Warnick and Douglas in resolution of their "differences." Metalclad's payments to Warnick and Douglas consisted of approximately \$55,000 each for reimbursement of expenses; an additional \$250,000 each; and an additional 50,000 Metalclad shares each. Given Metalclad's market price of \$4.625 per share on April 13, 1992, the additional consideration paid under the ETI release amounted to \$1,072,500.

6.14. However, total consideration in the ETI acquisition (\$5,468,463 based on the Stock Exchange agreement and ETI release) included yet another component. While the Stock Exchange agreement (documenting the November 20, 1991 purchase) clearly indicated that the principal asset was not yet in operation (it was in the process of securing permits), an additional agreement was drafted with a significant impact on the future cash flows of ETI and therefore Metalclad. The additional agreement was a November 20, 1991 Memorandum of Understanding ("MOU") between the four ETI shareholders, Metalclad and a non-signatory, Neveau. Under the MOU (concluded on the same day as the ETI shares were sold to Metalclad), the five individuals agreed to form an S-Corp., which, with the explicit agreement of Metalclad, would be entitled to sizeable revenue flow from the Santa Maria del Rio project. These revenue flows were defined as 4% of the project costs, 5% of gross revenues of ECO (the operating company) plus 25% of the net operations profit of ECO. The S-Corp. would be tentatively named

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<sup>9</sup> See November 20, 1991 Stock Exchange Agreement and Mutual Release Agreement dated April 13, 1992 including all exhibits and schedules – Metalclad Corporation SEC Form 10-K for the fiscal year ended December 31, 1991, Exhibit 10.2.

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**CHICAGO PARTNERS**  
A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

US ECO and would be specifically designated to "not in any sense be an operating company."<sup>10</sup>

6.15. Given the voting control Kesler possessed over Metalclad, the acquirer, and his dominant shareholding in ETI, the target, the ETI acquisition could not reasonably be considered the product of arms-length negotiations. In fact, the only financial statement of ETI attached to the various acquisition agreements was an unaudited November 15, 1991 balance sheet indicating ETI consisted of only two assets: cash of \$1,000 and advances and investment in Eco Administracion (the Mexican entity) of \$1,003,463. In fact, that same balance sheet indicates that as of November 15, 1991 Metalclad had already advanced ETI over \$400,000.<sup>11</sup>

6.16. Examination of the 1991 and 1992 audited financial statements of Eco Administracion (the not-as-yet operating entity) indicates two additional liabilities assumed by Metalclad. First, the land on which Eco Administracion intended to build the Santa Maria del Rio facility was not held in clean title. The former owner had not, even as of April 1993 (over 18 months following the ETI acquisition), secured a release of the mortgage from the bank. In fact, Metalclad paid approximately \$250,000 during 1991 and 1992 to acquire the Santa Maria del Rio land.<sup>12</sup> Second, contingent payments totaling approximately \$347,000 were due to the Mexican stockholders of Eco Administracion upon receipt of the necessary authorizations to operate.<sup>13</sup>

6.17. Kesler had been appointed to Metalclad's board of directors only eight months prior to the ETI acquisition (February 1991) and engaged as President and CEO five months earlier (May 1991). As discussed below, Kesler acquired his interest in ETI in

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<sup>10</sup> Metalclad Corporation Form 10-K for the fiscal year ended December 31, 1991, EXHIBIT "10.2" - November 20, 1991 Stock Exchange Agreement and Mutual Release Agreement dated April 13, 1992 including all exhibits and schedules.

<sup>11</sup> Metalclad Corporation Form 10-K for the fiscal year ended December 31, 1991, EXHIBIT "10.2".

<sup>12</sup> Metalclad handwritten schedules, (\$130,000 in 1991) 1992 wire transfer listing (\$110,000 in 1992) and handwritten journal entry for 1991/1992 combined (\$550,000 including \$300,000 for Veracruz).

<sup>13</sup> Metalclad Corporation Form 10-K for the fiscal year ended December 31, 1991, EXHIBIT "10.2".

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## CHICAGO PARTNERS

A LIMITED LIABILITY COMPANY

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Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

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July 1991, after his appointment as an officer and board member of Metalclad. In exchange for his shares of ETI, Metalclad issued Kesler 840,000 shares of Metalclad common stock. Robertson, who had become a Metalclad officer and director in July 1991, received 140,000 shares of Metalclad stock in exchange for his ETI stock.<sup>14</sup> Thus, this arranged sale of their ETI business to Metalclad propelled Kesler and, to a lesser extent, Robertson into position as the dominant and controlling shareholders of the Claimant.

**6.18.** The underlying ETI deal documents indicate two very significant dates marking ETI's relationship with its sole asset, ECO-Administracion, S.A. de C.V. First, the ECO-Administracion by-laws, incorporation agreement, and registration are dated between August 14 and August 28, 1991. Second, the joint venture agreement between ETI and the Mexican individuals (apparently the same one referenced in the ETI Exchange agreement) was executed July 25 – 26, 1991. Thus, the sole ETI asset (and presumably the primary justification for Metalclad's acquisition of ETI) was itself only created (and acquired) within five months of the Metalclad ETI acquisition (and more than four months following Kesler's appointment to Metalclad's board).

**6.19. Eco Administracion becomes ECOPSA:** In February and April 1992 following the acquisition of ETI, ECO formed two companies apparently from the assets acquired in the ETI/ECO deal: Descontaminates Industrial de Veracruz ("DIV") and Eliminacion de Contaminates Industriales ("ECI"). DIV and ECI were formed to pursue development of two additional landfill facilities in Veracruz and Tamaulipas, respectively. Each was held by Metalclad as a 49% ownership interest and 50% voting interest. In May 1992, Metalclad reached an agreement in principle with Jorge Hermasillo Silva, Jaime de la Fuente and Jose Rodriguez for the acquisition by Metalclad of their remaining stock in ECO, DIV and ECI.<sup>15</sup>

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<sup>14</sup> Metalclad Corporation Form 10-K for fiscal year ended December 31, 1991, page 9.

<sup>15</sup> Metalclad Corporation Form 10-K for fiscal year ended December 31, 1991, page 8.

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**CHICAGO PARTNERS**  
A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

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6.20. Metalclad received permission from the National Commission on Foreign Investments ("NCFI") to increase its ownership of ECO/ETI to 75% (in March 1993) and later to 94% (in July 1993).<sup>16</sup> "Subject to final negotiations with the remaining Mexican shareholders of ECO, DIV and ECI and receiving approval from the Mexican government, the Company intends to acquire 100% of the outstanding shares of such companies."<sup>17</sup> During the 1994 fiscal year, Metalclad acquired 100% of the outstanding shares of ECO. Sometime during the 1994 fiscal year, Metalclad apparently changed the name of ECO and began referring to ECO as ECOPSA.<sup>18</sup> ECOPSA exists as a wholly owned subsidiary of ECONSA.

#### 6.21. COTERIN

6.22. In April 1993, Metalclad contracted with shareholders of Confinamiento Techico de Residuos Industriales, S.A. de C.V. ("COTERIN") for an option to acquire COTERIN. The original agreement, a \$50,000 option to purchase signed on April 23, 1993, was later amended to a 94% purchase agreement executed on September 9, 1993. Under the September 9, 1993 amendments Metalclad was required to:

- Pay \$450,000 at the execution of the agreement;
- Upon the occurrence of "certain contingencies" pay an additional \$1,500,000 and 5% of gross revenues for a 10-year period;
- Employ the two minority shareholders as general manager and marketing director, and
- Provide any required remediation services on the previously operated cells of the landfill, subject to an off-set against amounts due to the selling

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<sup>16</sup> Metalclad Corporation Form 10-K for fiscal year ended December 31, 1992, pages 1-7.

<sup>17</sup> Metalclad Corporation Form 10-K for fiscal year ended May 31, 1993, page 7.

<sup>18</sup> Metalclad Corporation Form 10-K for fiscal year ended May 31, 1994, pages 2-4.

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## CHICAGO PARTNERS

A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

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shareholders for remediation costs or fines exceeding \$500,000.<sup>19</sup>

**6.23.** The “certain contingencies” in the agreement stipulated that a first payment of \$500,000 would be paid within twenty days following the day the State of San Luis Potosi authorized Metalclad to proceed with the construction at La Pedrera and the Municipal permit for the building of the confinement had been obtained by COTERIN or definitive judgement in a writ of amparo was granted that allowed the building of the confinement. Two additional payments of \$500,000 would be paid within 60 days after the first payment.<sup>20</sup>

**6.24.** One year later on September 10, 1994, Bruce Haglund, secretary, board member, and legal counsel to Metalclad, wrote to the Grant Thornton audit partner confirming Kesler’s statement that Metalclad and the Mexican minority shareholders had determined “that “full utilization” of the COTERIN site will never occur.” He also stated that “the Company’s counsel have informally concurred in this conclusion.” As a result any contingent elements of the COTERIN acquisition agreement “will never become binding on the Company.”<sup>21</sup>

**6.25.** In its 1994 10-K filed September 13, 1994, Metalclad asserted that it “now believes that the contingencies upon which the additional payments are conditioned will not occur. Consequently, the company is negotiating an agreement with the minority shareholders of COTERIN to issue 100,000 shares of common stock of the company in consideration for the remaining 6% of the capital stock of COTERIN and the waiver of their rights to the contingent payments.”<sup>22</sup>

**6.26.** As a point of reference, a Metalclad forecast prepared five months later (February

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<sup>19</sup> Metalclad Corporation SEC Form 10-K for fiscal year ended May 31, 1994, page 5, EXHIBIT “10.17” – Agreement between COTERIN and ECO-METALCLAD dated April 23, 1993 and amendments dated September 9, 1993.

<sup>20</sup> From the translation of the amended agreement to the Unilateral Promise of Sale Agreement, September 9, 1993, production exhibit 1D.

<sup>21</sup> Metalclad Corporation Documents in production Response 1F –Letter from Haglund to Grant Thornton dated September 10, 1994.

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**CHICAGO PARTNERS**  
A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

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1995) for the El Confin landfill included forecasted royalty payments of \$113,046, \$1,527,437 and \$2,327,807 on revenues of \$2,203,929, \$31,448,747 and \$46,556,136 for 1995, 1996 and 1997, respectively.<sup>23</sup>

**6.27.** In January, 1996 the September 1993 COTERIN agreement was further amended whereby the company paid an additional \$200,000 in cash plus 125,000 shares of Metalclad common stock (issued at \$3.50 per share) in exchange for a reduction in certain future contingent payments based on the landfill opening to \$300,000 and a reduction in the royalty payment to 1% of gross revenues. In addition, the company acquired the remaining shares of COTERIN (6%) that it did not own for a cash payment of \$14,000.<sup>24</sup>

**6.28. CATSA**

**6.29.** In August, 1993, Metalclad incorporated Consultoria Ambiental Total, S.A. de C.V. (trade name, "CATSA") as a wholly-owned subsidiary "to provide a multi-disciplined approach for environmental consulting services."<sup>25</sup>

**6.30. QUIMICA OMEGA**

**6.31.** In May, 1994, Metalclad acquired all the capital stock of QUIMICA OMEGA in return for 2,800,000 shares of Metalclad common stock. QUIMICA OMEGA specialized in the handling of hazardous wastes for recycling, for disposition to either landfills or cement kilns.<sup>26</sup> At the May 5, 1994 market price of \$3.75 per Metalclad share, the extended value of the shares issued totaled \$10,500,000. The issued stock was unregistered and Metalclad management estimated the fair value of the unregistered shares (and recorded the QUIMICA OMEGA purchase price) as \$6,300,000 (60% of the current market price.)

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<sup>22</sup> Metalclad Corporation Form 10-K for fiscal year ended May 31, 1994, page 4.

<sup>23</sup> Production exhibit 7(c)D, Metalclad Corporation: Mexico Project Status, February 1, 1995, p.68.

<sup>24</sup> Metalclad Corporation SEC Form 10-K for the fiscal year ended May 31, 1996, pages F-8 & F-12.

<sup>25</sup> Metalclad Corporation Form 10-K for fiscal year ended May 31, 1993, page 10.

<sup>26</sup> Metalclad Corporation Form 10-K for fiscal year ended May 31, 1994, pages 4-9.

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**CHICAGO PARTNERS**

A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

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6.32. Even at the reduced fair value estimate of the Metalclad stock issued, the QUIMICA OMEGA recorded purchase price was \$7,313,831 in excess of the net assets acquired. QUIMICA OMEGA's auditors issued a "going concern" opinion at year-end 1993. Metalclad's Form 8-K/A-1, filed July 19, 1994, provided nine month comparative pro-forma income statements indicating that QUIMICA OMEGA's losses for the period ended February 28, 1994 exceeded those of Metalclad, despite the fact that QUIMICA OMEGA'S revenues were one quarter those of Metalclad (losses of \$1.282 million on sales of \$2.981 million vs. losses of \$1.041 million on sales of \$11.598 million).<sup>27</sup>

6.33. Under terms of the acquisition agreement, the former shareholders of QUIMICA OMEGA, many of whom had only invested in the company as recently as 1992, agreed to vote their stock in concert with Kesler.<sup>28</sup> Metalclad also agreed to register the shares within 90 days of closing. As of the issuance of the May 31, 1995 Metalclad 10K the shares had not been registered.<sup>29</sup>

6.34. Metalclad wrote off the remaining \$6,377,716 in goodwill relating to the QUIMICA OMEGA acquisition as of May 31, 1995. Three reasons were cited: the December 1994 devaluation of the Mexican Peso, a resulting adverse impact on the economy in Mexico and the recurring losses of the QUIMICA OMEGA business.<sup>30</sup>

#### 6.35. BFI-OMEGA JOINT VENTURE

6.36. Metalclad entered into a joint venture agreement involving QUIMICA OMEGA in 1996. BFI-OMEGA was a 50%-50% joint venture formed on April 9, 1996, between Metalclad and Browning-Ferris Industries, Inc. ("BFI") to be operated through subsidiaries of both companies. BFI's 50% interest in the joint venture was owned by BFI-Mexico, a subsidiary of BFI International, Inc. which in turn was a subsidiary of

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<sup>27</sup> Metalclad Corporation SEC Form 8-K/A-1 dated July 19, 1994, page 31.

<sup>28</sup> Quimica Omega, S.A. de C.V. audited financial statements, specifically the Consolidated Statements of Shareholders Equity.

<sup>29</sup> Metalclad Corporation SEC Form 10-K for the fiscal year ended May 31, 1995, Note C.

<sup>30</sup> Metalclad Corporation SEC Form 10-K for the fiscal year ended May 31, 1995, page F-11, Note A.

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## CHICAGO PARTNERS

A LIMITED LIABILITY COMPANY

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Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

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BFI, the parent corporation. Metalclad's 50% interest in the joint venture was owned by its wholly owned subsidiary QUIMICA OMEGA. Metalclad also stated that it had opened additional branches since the formation of BFI-OMEGA in Tampico, Puebla and Mexico City and that it planned to open more branches in Toluca, Veracruz and Coatzacoalcos. This joint venture was short-lived, however, dissolving later in 1996.

### **6.37. SEGURIDAD ELECTRICA MEXICANA**

**6.38.** According to a November 6, 1996 press release "...[Metalclad] acquired Seguridad Electrica Mexicana, S.A. de C.V. (SEM),...the leader in the Mexican market for specialized repair and maintenance of electrical transformers. ECONSA and SEM constitute two of five companies fully authorized to handle PCBs in Mexico. ...the acquisition of SEM and ECONSA's exclusive marketing agreement with Rollins, together with it's joint venture with Browning Ferris Industries de Mexico. S.A. de C.V...represents another important step in Metalclad's strategy to consolidate its position as a predominant participant in the Mexican hazardous waste business" (*PR Newswire*). The Metalclad 1996 10-K provides no detail on the purchase price or date of this acquisition.

### **6.39. Selling Shareholders' Subsequent Treatment Of Their Metalclad Stock Consideration.**

**6.40.** Based upon the chronologies described below, the selling shareholders (i.e. those individuals who sold their interests in Mexican ventures to the Claimant in return for Metalclad stock) have almost universally sought to immediately dispose of the Metalclad stock. Virtually all of the stock originally issued in these Metalclad acquisitions is unregistered and therefore subject to certain regulations regarding immediate resale (see the Quimica Omega acquisition discussion). In one instance Metalclad or its counsel appear to have assisted the selling shareholder to favorably define the shareholder's holding period such that the unregistered shares could be sold within a Rule 144 window.

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## **CHICAGO PARTNERS**

A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

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**6.41.** While this tendency for selling shareholders to quickly dispose of their Metalclad share consideration arguably could be driven by an individual's desire to diversify his or her investment portfolio (as in the case of Javier Guerra Cisneros ("Guerra")), such activity on the part of sophisticated, and already well diversified, professional investors and venture capitalists, such as First Analysis, its related funds and investors, is not so much a diversification but rather an explicit indication of their assessment of the overvalued nature of the Claimant's stock.

**6.42.** Each selling shareholder and the nature of their investment activity is briefly described below.

**6.43. ETI selling shareholders**

**6.44.** The following shares were issued to the selling shareholders of ETI in November 1991, including the additional shares issued to Warnick and Douglas (pursuant to the ETI release) in April 1992.

Grant S. Kesler -- 840,000 shares of Metalclad common stock  
Ronald E. Robertson -- 140,000 shares of Metalclad common stock  
Reed T. Warnick -- 150,000 shares of Metalclad common stock (including ETI release shares)  
J. Terry Douglas -- 150,000 shares of Metalclad common stock (including ETI release shares)  
T. Daniel Neveau -- not an ETI shareholder, but a party to the MOU (providing gross revenue and net profit participation)

**6.45.** Kesler sold 75,000 of his shares in June 1993 and 20,000 in September 1993. Robertson sold 50,000 shares in September 1993 and by February 1994 was completely divested of all Metalclad holdings.

**6.46.** Warnick and Douglas were not affiliated with Metalclad and therefore did not have to file the required SEC forms for insiders. As a result, there is no comprehensive public record of their trading activity. However, the Washington Service noted that on

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**CHICAGO PARTNERS**  
A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

---

November 19, 1993 both Warnick and Douglas filed to sell 81,000 shares each.<sup>31</sup>

**6.47. COTERIN selling shareholders**

**6.48.** The only Metalclad shares utilized in the COTERIN acquisition transactions (April, September, and October 1993, and January 1996) were 125,000 shares issued in January 1996. These shares were listed as part of the “amended” consideration paid to the original COTERIN shareholders, however, the shares were specifically designated to be delivered only to the two minority COTERIN shareholders (one of whom became a COTERIN minority shareholder following the September 1993 agreement.) The Metalclad shares distributed to the COTERIN minority shareholders in January 1996 were:

Salvador Aldrett Leon	75,000 shares
Guillermo Aldrett Leon	50,000 shares

**6.49.** On June 24, 1996 Bruce Haglund, Esq., Metalclad Secretary and board member, provided an opinion concerning the Rule 144 holding period and removal of the Regulation S legend on the Metalclad 50,000 share certificate registered in the name of Guillermo Aldrett Leon (one of the COTERIN minority shareholders following September 1993.) In the opinion letter, Haglund interprets the April, September, and October 1993 and January 1996 COTERIN agreements and amendments to state that Guillermo Aldrett Leon “tendered the COTERIN Shares to the Company” in April 1993 and that “the Company entered into an agreement with [Guillermo Aldrett Leon] in April 1993 pursuant to which the Company agreed to issue” Metalclad shares to Guillermo Aldrett Leon in return for his COTERIN shares.

**6.50.** As described previously, the COTERIN shareholders agreed to submit, on September 9, 1991, 94% of the shares to Metalclad in return for a cash payment and

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<sup>31</sup> The Washington Service reported on 11/24/93 that Warnick and Douglas had each filed Form 144 with the SEC to sell shares through Equico Securities.

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**CHICAGO PARTNERS**  
A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

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promise of future royalties. On January 10, 1996 the remaining 6% of COTERIN shares were exchanged for \$14,000.

6.51. Haglund concluded in the letter that "(A) the holding period for [Guillermo Aldrett Leon's] shares commenced in April 1993..." and "(B) the proposed sale of the [Metalclad] Shares by [Guillermo Aldrett Leon] meets all the conditions of Rule 144(k)..."<sup>32</sup>

6.52. Haglund's opinion letter contrasts in certain respects with the COTERIN acquisition agreements incorporated with Metalclad's SEC filings or produced in this arbitration.

- No Metalclad shares were issued until January 1996 – five months prior to Haglund's letter. In addition, the September 1993 and April 1993 COTERIN documents mention only cash payments for the COTERIN shares.
- Guillermo Aldrett Leon, the beneficiary of Haglund's opinion letter, was not a signatory to the April 1993 option agreement nor was he identified as a selling shareholder in any of the September or October 1993 or January 1996 amendments. Guillermo Aldrett Leon was, however, shown as a 0.025% shareholder (holding 5 of 20,000 outstanding shares) in Annex A to the April 1993 COTERIN option agreement.

There are no records available from Bloomberg Financial News indicating Guillermo Aldrett Leon's actual disposition of his Metalclad shares following issuance of the Haglund opinion letter.

6.53. On July 26, 1996, Salvador Aldrett Leon filed a Form 144 at the SEC, (publicly announced on July 30, 1996 by The Washington Service) to sell 5,000 shares through

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<sup>32</sup> Metalclad Corporation Documents in production Response IF –Letter from Haglund to the American Stock Transfer & Trust Company dated June 24, 1996.

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**CHICAGO PARTNERS**  
A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

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Paine Webber, Inc.<sup>33</sup> Metalclad's stock price was \$2.875 on July 26 and July 30, 1996.

**6.54. QUIMICA OMEGA selling shareholders**

**6.55.** QUIMICA OMEGA shareholders received Metalclad shares in the acquisition transaction May 5, 1994.<sup>34</sup> The chart below indicates Metalclad shares received by individual shareholder and each shareholder's subsequent Form 144 filings to sell those Metalclad shares (as published and tracked by Bloomberg Financial News.) Only Guerra's holdings are tracked in the Metalclad proxies by virtue of his position within the company.

**6.56.** Subsequent to Metalclad's acquisition of QUIMICA OMEGA, the shareholders listed above methodically liquidated their holdings of Metalclad's stock. Guerra is the only former QUIMICA OMEGA shareholder who becomes part of Metalclad's management team.

Name of Shareholder	Number of Metalclad Shares (incl. Escrow shares) <sup>(1)</sup>	Form 144 Filings to Sell Shares
Javier Guerra Cisneros	631,095	5/13/96: 150,000 shares 6/6/96: 350,000 shares
Javier Guerra Duran	96,743	5/13/96: 10,000 shares 9/10/96: 18,000 shares
Alba Duran Barbaray	630,772	
Manuel Duran Silva	647	
Luis Alberto Guerra Duran	96,743	10/28/96: 96,743 shares 2/6/97: 300,000 shares <sup>35</sup>
Environmental Venture Fund L.P.	566,048	5/17/96: 104,000 shares

<sup>33</sup> The Washington Service (WSA) announcement dated July 30, 1996.

<sup>34</sup> Metalclad Corporation SEC Form 8-K dated May 5, 1994, and EXHIBIT "2.1" - Agreement and Plan of Reorganization for the Acquisition of All of the Outstanding Shares of Common and Preferred Capital Stock of Quimica Omega, S.A. de C.V. by Metalclad Corporation

<sup>35</sup> According to The Washington Service report of filing to sell shares. We cannot ascertain how these shares were acquired.

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## CHICAGO PARTNERS

A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

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		6/10/96: 208,000 shares 9/3/96: 30,000 shares 9/18/96: 66,048 shares
The Productivity Fund L.P. II	252,200	5/17/96: 48,000 shares 6/10/96: 96,000 shares
Apex Investment Fund II, L.P.	252,200	5/17/96: 48,000 shares 5/24/96: 72,000 shares 6/10/96: 96,000 shares
Parvest US Partners II, C.V.	240,991	6/18/96: 50,000 shares 12/17/96: 230,991 shares
Multinvest Limited	11,209	
Brian E. Hand	11,209	
Robert Jones	10,143	6/17/96: 10,143 shares
<b>TOTALS</b>	<b>2,800,000</b>	<b>1,983,925</b>

- (1) 84,000 shares held in escrow until January 1995, at which time they will be transferred to the former shareholders of common stock of QUIMICA OMEGA if the closing sales price of the common stock of the Metalclad has been above \$5.75 for any period of 60 consecutive trading days prior to January 1, 1995 or returned to the former shareholders of Preferred Stock of Quimica Omega if such contingency does not occur. All shareholders indicated above were Preferred Stock shareholders. The first time Metalclad's stock price went above \$5.75 was March 1, 1996, therefore shares held in escrow returned to these shareholders. Source: Metalclad Form 8-K filed May 24, 1994, p.2.

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**CHICAGO PARTNERS**  
A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

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## **7. How Metalclad Financed Its Losses, Mexican Venture Acquisitions, Insider Payments, and Debt Retirements**

**7.1.** The Claimant has effectively financed all of its losses, Mexican venture acquisitions, insider payments and debt retirements through the issuance of its stock. As a result access to the equity capital market was a critical factor in the Metalclad insider's strategies.

**7.2.** The Metalclad insulation business was a minor positive cash flow generator expected to cover its own cash requirements.<sup>1</sup> Despite sizeable consolidated operating losses (see discussion in Section 5) Metalclad was almost debt-free at December 31, 1996. At that date Metalclad's balance sheet showed no long-term debt and only \$229,533 of convertible subordinated debentures.<sup>2</sup> As described in the financing chronology outlined below, what little debt Metalclad was able to issue over the 1991 to 1996 period was serviced and ultimately repaid by the issuance of Claimant's stock.

**7.3.** Lastly, a review of the returns (inclusive of stated rates, fees, stock and warrant consideration) required by Claimant's lenders, along with Claimant's inability to place their intended levels of debt financing, provides additional market based information regarding the credibility of Metalclad's management, forecasts and strategies. Especially telling is a brief comparison of the Metalclad financing activity to that of its purported hazardous waste industry competitors.

### **7.4. Debt Financing Chronology.**

**7.5.** Metalclad's debt financing chronology is best addressed in four phases: the pre-hazardous waste insulation business financing; the \$250 million Chase Manhattan Bank financing; the onerous CVD loans; and the convertible securities.

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<sup>1</sup> Metalclad Corporation SEC Form 10-K for December 31, 1996, Note O and page 22.

<sup>2</sup> Metalclad Corporation SEC Form 10-K for the transition period June 1, 1996 to December 31, 1996, page F-4.

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## **CHICAGO PARTNERS**

A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

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**7.6. Metalclad's pre-hazardous waste insulation business financing:** In June 1990, Metalclad entered into an accounts receivable loan agreement with City National Bank in the amount of \$3 million bearing interest at prime plus 1.625%. The line of credit was secured by the company's accounts receivable, inventory, and other assets. The agreement contained standard covenants requiring minimum working capital and net worth amounts, debt to net worth and current ratios. Any amount outstanding under the line of credit was scheduled to mature June 30, 1992.<sup>3</sup> In June 1992, Metalclad's loan agreement with City National Bank expired, was extended through December 30, 1992, paid off at that time, and allowed to expire.<sup>4</sup> The company announced in its Form 10-K for the fiscal year ended December 31, 1992 that it anticipated that a replacement line of credit would be obtained in 1993.<sup>5</sup>

**7.7. Metalclad's \$250 million Chase Manhattan Bank financing:** Apparently in anticipation of City National Bank's loan expiring, the company initiated discussions with Chase Manhattan Bank and other financial institutions based upon disclosures in three public announcements detailed below.

- **1/10/92** Metalclad Corp. announced Thursday that it has secured its permits and nearly has the financing to build an enormous hazardous waste recycling plant in central Mexico. Grant S. Kesler, Metalclad's president said the \$25 million plant is the first of 10 planned for Mexico. Kesler...said Chase Manhattan Bank is considering lending on the project...Alexander L. Cappello, an investment banker...(and) CEO of Beverly Hills-based Euro American Financial Corp., confirmed that a \$250 million proposal is in the final stages. (*Orange County Register*)
- **1/13/92** A U.S.-Mexican partnership has received the first permit under Mexico's new environmental regulations to build a hazardous waste processing facility. The group estimates it will cost up to \$25 million and is expected to generate annual gross revenues of \$150 million. Partnership members announced the venture at a Jan. 9 news conference in Washington, D.C. The group, ECO Administracion SA de CV, will build the 120,000 ton-

<sup>3</sup> Metalclad Corporation SEC Form 10-K for the fiscal year ended December 31, 1991, page 14.

<sup>4</sup> Metalclad Corporation SEC Form 10-K for the fiscal year ended December 31, 1992, page 19.

<sup>5</sup> Metalclad Corporation SEC Form 10-K for the fiscal year ended December 31, 1992, page 19.

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**CHICAGO PARTNERS**  
A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

---

per-year hazardous waste processing plant at a 250 acre site 35 miles outside of San Luis Potosi under a permit from Mexico's Secretaria del Desarrollo Urban y Ecoligia. SEDUE is the Mexican equivalent of the EPA...officials also said the partnership has received a proposal from Chase Manhattan Bank to provide \$250 million in financing for 10 hazardous waste processing facilities in Mexico. (*Hazardous Waste News*)

- 2/1/92 Metalclad Corp. CEO, Grant S. Kesler announced at the January 9 press conference that Eco Administracion has received a proposal from Chase Manhattan to provide \$250 million in financing to build 10 other hazardous waste processing facilities in Mexico...of four Mexican joint venture partners, Ing. Jorge Hermosillo...is joint owner, with Jaime de la Fuente, of an engineering and construction company in San Luis Potosi. The two other partners are Jose Rodriguez, currently residing in McCallen TX, and Javier Campos, an official of Nissan in Mexico. (*Mexico Business Monthly*)

7.8. The Company also made statements that it has "investigated financing sources with the International Finance Corporation, and affiliate of the World Bank, to provide project financing" for construction of its hazardous waste incinerator.<sup>6</sup>

7.9. The \$250 million Chase "proposal" never materialized into an actual financing.

7.10. **Metalclad's onerous CVD loans:** In September 1993, Metalclad signed a promissory note with CVD Financial for a \$2,500,000 principal loan. The note bore interest at the rate of prime plus 7 percent and came due on September 1, 1995. As security for the loan, Metalclad pledged all its assets, including all shares of all its wholly-owned US subsidiaries. Metalclad also issued the lender a five-year warrant to purchase 375,000 shares of common stock at \$4.50 per share at any time prior to September 1, 1998. Metalclad stock was trading at \$4.375 per share on September 27, 1993 (the date of the agreement).

7.11. Metalclad's SEC filings indicate that in January 1994, CVD agreed to forgive \$1,687,500 of the debt in return for the exercise of the warrant; however, that transaction

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<sup>6</sup> Metalclad Corporation SEC Form 10-K for the fiscal year ended May 31, 1994, page 8.

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**CHICAGO PARTNERS**  
A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

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was not consummated.<sup>7</sup> The reason was not disclosed.

7.12. In September 1994, Metalclad obtained an additional loan for \$525,000 from CVD Financial. The new loan bore interest at the same rate - prime plus 7 percent and was to come due in November, 1994. In return for this additional loan, Metalclad issued the lender a five-year warrant to purchase 75,000 shares of common stock at an exercise price of \$2.625. Metalclad's stock was trading at \$3.125 per share on September 7, 1994 (the date of the agreement).

7.13. Based upon recitals within its CVD loan modification agreement, Metalclad apparently defaulted on its CVD loans. Metalclad entered into a loan modification agreement with the financial institution in May, 1995, under which the loan repayment was extended to June 30, 1996. In return, Metalclad issued the lender 87,578 shares of common stock, reduced the exercise prices of previously granted warrants to \$1.59 (from \$4.00 and \$2.625 previously), extended the expiration date of the warrants to May 31, 2000 and granted the lender an additional five-year warrant to purchase 600,000 shares of common stock at an exercise price of \$1.908. Further, the new agreement gives the lender a right of first refusal for future debt and equity offerings, the right to convert the debt into shares of common stock at the rate of \$1.59 per share, and requires that 60% of the net proceeds from future financings be paid to the lender.<sup>8</sup> Metalclad's stock was trading at \$1.875 per share on May 31, 1995 (date of the agreement).

7.14. Notably, the loan agreement, as further amended on September 1, 1995, requires that "the Company's landfill be in operation by December 31, 1995."<sup>9</sup> Further, the September 1, 1995 amendment to the loan agreement provides that Metalclad shall pay an additional \$100,000 if the loan is not repaid in full by October 13, 1995.<sup>10</sup> Finally, of the \$2,583,000 net proceeds from the sale of common stock between May 31, 1995 and

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<sup>7</sup> Metalclad Corporation SEC Form 10-K May 31, 1994, page 23.

<sup>8</sup> Metalclad Corporation SEC Form 10-K May 31, 1995, page 24 & F-19.

<sup>9</sup> Metalclad Corporation SEC Form 10-K for the fiscal year ended May 31, 1995, page 24 & F-19.

<sup>10</sup> Metalclad Corporation SEC Form 10-K for the fiscal year ended May 31, 1995, page 24 & F-19.

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**CHICAGO PARTNERS**  
A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

---

June 1, 1995, approximately \$753,000 was used to repay a portion of Metalclad's principal balance of its debt to CVD Financial.<sup>11</sup>

7.15. In February 1996, CVD Financial exercised its option to convert 100% of the outstanding loan balance of \$1,924,797 into 1,210,564 shares of common stock at the conversion rate of \$1.59 per share (when Metalclad was trading at \$4.50 to \$5.50 per share).

7.16. As of May 31, 1996, Metalclad had no long term debt outstanding.<sup>12</sup>

7.17. **Summarizing CVD:** In addition to interest on its \$3.025 million principal loans, CVD Financial received: 87,578 shares of common stock; a 5-year warrant to purchase 375,000 shares of common stock at \$4.50 that expires September 1, 1998; a 5-year warrant to purchase 75,000 shares of common stock at \$2.625 that expires September 1, 1998; a reduction in both exercise price levels to \$1.59 and extended expiry to May 31, 2000; a 5-year warrant to purchase 600,000 shares of common stock at \$1.908 that expires May 31, 2000; and the right to convert debt into shares of common stock at the rate of \$1.59 per share (\$1,924,797 of debt was converted into 1,210,564 shares of common stock.)<sup>13</sup>

7.18. Exhibit 8.3 displays chronologically the CVD loan experience and calculates CVD's profit over and above interest on its two loans. In addition to interest at a rate of prime plus 7%, CVD collected another \$3.8 million in fees and profits on its \$3.025 million loans to Metalclad. Assuming that the full \$3.025 million was outstanding for the entire period September 1993 through February 1996, the effective annual interest rate on the CVD loan was prime plus 45.5%.<sup>14</sup>

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<sup>11</sup> Metalclad Corporation SEC Form 10-K for the fiscal year ended May 31, 1995, page F-13.

<sup>12</sup> Metalclad Corporation SEC Form 10-K for the fiscal year ended May 31, 1996, page F-4.

<sup>13</sup> Metalclad Corporation Form 10-K for the fiscal year ended May 31, 1996, page 24.

<sup>14</sup> Calculated as the stated prime plus 7% interest rate plus the effective annual rate realized on the additional fees and profits of \$3.8 million over the 30 month period assuming the full \$3.025 million

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**CHICAGO PARTNERS**  
A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

---

7.19. Lastly there was a finders fee associated with the CVD original \$2.5 million loan. In November 1993 Neveau agreed to pay Howard Falco of John Kinnard & Co. \$62,500 spread over two payments (November 1993 and January 1994.)<sup>15</sup>

7.20. Alternatively BFI's weighted average cost of borrowing ranged between 7.2% and 7.9% from fiscal 1993 through 1996. BFI was also able to access the commercial paper market with rates of 5%.<sup>16</sup>

7.21. WMX's financial statements did not provide weighted average costs of borrowing similar to those provided by BFI. WMX, however, was able to issue commercial paper with weighted average interest rates of 5.8% in 1994, 5.7% in 1995 and 5.8% in 1996.<sup>17</sup>

#### 7.22. Metalclad's Convertible Subordinate Debentures (CSD's)

Metalclad issued approximately \$12 million principal amount of 12%, 8% and 9% CSD's from October 1991 through November 1993. While some of the CSD's, approximately \$2.7 million, were converted prior to maturity at contracted conversion rates, almost \$8.6 million were converted at \$2.50 per share, well below the original conversion rates between \$4.00 to \$5.50.

#### 7.23. 12 month CSD's Bearing 12% Interest

Metalclad issued \$1,397,000 of 12%, 1-year, CSD's with a \$2.50 per share conversion rate. The outstanding principal of \$1,397,000 plus accrued interest of almost \$18,000 was converted into 589,530 shares of common stock by December 1992 at a conversion price of \$2.40. There was no explanation for the difference in conversion price. From November 1, 1991 through December 31, 1992, Metalclad's stock surpassed

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principal was outstanding for the full period (resulting in a effective annual rate on the additional fees and profits of 38.5%).

<sup>15</sup> Kinnard & Co. letter dated November 8, 1993 signed by Neveau (examined during review of Metalclad documents supporting the \$20.5 million landfill cost.

<sup>16</sup> Browning Ferris Industries, Inc. SEC Form 10-K for the fiscal year ended September 30, 1994, 1995, & 1996.

<sup>17</sup> WMX Technologies, Inc. SEC Form 10-K for the fiscal year ended December 31, 1995 & 1996.

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## CHICAGO PARTNERS

A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

---



the \$2.50 per share price, climbing to the mid-\$5.00 range.

#### **7.24. 5 year CSD's Bearing 8% Interest**

As originally mentioned in Metalclad's 1991 Form 10-K, the company planned to offer an additional \$7.5 million of 8%, 5-year, CSD's with a \$6.00 per share conversion feature. During 1992, Metalclad was able to issue \$4,662,999 of the CSD's but at a \$4.00 per share conversion rate. In December 1992 \$100,000 principal and accrued interest was converted into 25,216 shares of common stock. In February 1993, \$650,000 of principal was converted to 162,500 shares. By May 31, 1993, the company had issued a total of \$5,483,000 of which \$4,733,000 remained outstanding. During the year ended May 31, 1994, the company also issued an additional \$732,359 principal amount, \$434,000 of which was in the form of a private placement. \$71,044 of the CSD's were converted into 17,761 shares at \$4.00 per share.<sup>18</sup>

#### **7.25. 5 year CSD's Bearing 9% Interest**

In December 1993, Metalclad issued \$3,840,000 of 5-year CSD's bearing 9% interest in a private placement with a conversion rate of \$5.50. Oakes, Fitzwilliams & Co. Limited acted as placement agent in connection with the offering.<sup>19</sup>

**7.26.** In addition to paying commissions to brokers for the sale/placement of its CSD's (usually 9 – 10%)<sup>20</sup>, Metalclad employed consultants to "work with" the CSD holders. Elgin Williams, Metalclad's independent contractor spokesperson, authored the letters requesting payment for these "consultants." The largest single fee for working with an individual investor was \$20,000 paid in August 1993 to Bernard Woody.<sup>21</sup>

**7.27.** In August 1995, Metalclad offered to convert outstanding debentures into shares

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<sup>18</sup> Metalclad Corporation SEC Form 10-K for the fiscal year ended May 31, 1994, pages 23 & 28.

<sup>19</sup> Metalclad Corporation SEC Form 10-K for the fiscal year ended May 31, 1994, pages 27 – 28.

<sup>20</sup> Walford 10% commission request for raising \$117,000 in one week (September 24, 1993) (reviewed during analysis of support for Metalclad's \$20.5 million landfill cost.)

<sup>21</sup> Elgin Williams request for payment dated August 5, 1993 (reviewed during analysis of support for Metalclad's \$20.5 landfill cost.)

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## **CHICAGO PARTNERS**

A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

---

of common stock at \$2.50 per share, below the stated price on the debentures (original conversion rates ranged from \$4.00 to \$5.50 per share). As of August 31, 1995, the company had received commitments from approximately 93% of the CSD holders to convert.<sup>22</sup> Metalclad's stock price on August 31, 1995 was \$3.188.

7.28. During the fiscal year ended May 31, 1996, the company issued 3,525,000 shares in conversion of approximately \$8.6 million of its 8% and 9% CSD's. As of May 31, 1996, approximately \$239,533 of CSD's, all bearing 8% interest remained outstanding.<sup>23</sup>

#### 7.29. Metalclad Common Stock Financings

7.30. Excluding Metalclad shares issued to Kesler for his initial purchase (1,000,000 shares) and the shares issued in the ETI acquisition (1,180,000) Metalclad would have had 4,365,240 shares outstanding as of December 31, 1991.<sup>24</sup> As of September 30, 1997 Metalclad had 29,937,923 shares outstanding.<sup>25</sup> The minor amount of debt outstanding (slightly over \$225,000 at September 30, 1997) represented a fraction of Metalclad's \$1.2 million in cash and equivalents.

7.31. Clearly the more than 25.5 million shares issued during this period from December 1991 through September 1997 (almost a seven-fold increase in shares outstanding) served to fund the operating losses, pay for the acquisitions, compensate the insiders and advisors, and retire both the convertible and the CVD term debt.

7.32. Metalclad's new shares were issued almost entirely in private placements of unregistered securities or via the issuance of unregistered securities in acquisitions. The bulk of the private placements were to non-US investors. As a result the offering memoranda associated with these placements were not required to be filed with the

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<sup>22</sup> Metalclad Corporation SEC Form 10-K for the fiscal year ended May 31, 1995, page F-20.

<sup>23</sup> Metalclad Corporation SEC Form 10-K for the fiscal year ended May 31, 1996, page F-21 & F-18.

<sup>24</sup> Metalclad Corporation SEC Form 10-K December 31, 1991, page F-5.

<sup>25</sup> Metalclad Corporation SEC Form 10-Q September 30, 1997, page 2.

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## CHICAGO PARTNERS

A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

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SEC.<sup>26</sup> In addition, as Metalclad's attorney confirms, private placements to "sophisticated investors" require no offering memorandums.<sup>27</sup>

7.33. In fact Metalclad filed only a single S-3 registration statement since 1991 and that was for a contemplated 1993 stock offering almost exclusively for the benefit of selling shareholders.<sup>28</sup> The offering never materialized.

7.34. Despite the lack of SEC filed registration statements associated with its common stock offerings, Metalclad benefited from (and promoted) its status as a US publicly traded (and therefore SEC regulated) company. Certain professional investors and venture firms (such as First Analysis and Brian Hand) have the resources and professional analysts to perform their own independent investigations. Other institutional (and virtually all individual) investors rely upon the integrity of management, the company's advisors and their respective representations.<sup>29</sup>

7.35. Exhibit 8.4 details the reported institutional holders of Metalclad's common stock. As the changes in institutional holdings indicate, a number of institutional shareholders initiate or increase their holdings during period surrounding the Oakes-facilitated private offerings.

7.36. Over this same period Metalclad's authorized shares increased four-fold, from 20,000,000 in 1991 to 80,000,000 at September 1997.<sup>30</sup> The most recent increase was approved in May 1997 (from 40,000,000 shares to 80,000,000 shares). There are two primary applications for these additional shares based upon Metalclad's historical practice: stock for exercise of options and stock for issuance in acquisitions.

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<sup>26</sup> Metalclad Corporation Confidential Offering Memorandums dated September 14, 1994 and February 12, 1995 for a total of 4,900,000 units (one share plus one warrant).

<sup>27</sup> Letter from Clyde C. Pearce, Esq. dated February 12, 1998, carryover paragraph page 1 - 2.

<sup>28</sup> Metalclad Corporation Form S-3 Registration Statement August 27, 1993.

<sup>29</sup> See Herbert L. Oakes, Jr. letter dated May 15, 1995 to Kesler discussing 35 European institutional investors' reliance on representations that Metalclad had all necessary permits and that construction was complete.

<sup>30</sup> Increase in the authorized Metalclad shares to 80,000,000 approved at annual Meeting of the Shareholders on May 15, 1997. See Metalclad Corporation SEC Form 10-Q dated June 30, 1997 - Item 4.

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**CHICAGO PARTNERS**  
A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

---

7.37. At January 1997, Metalclad had 2,360,000 exercisable options outstanding, approximately 68%, or 1,595,000 of which, had been granted to Kesler. Neveau continued to hold 595,000 exercisable options or 25.2% of the total outstanding.<sup>31</sup> At the May 1997 Metalclad shareholders' meeting, shareholders rejected a proposal to grant Neveau (who had ostensibly left the company almost nine months before) 1.3 million additional options.<sup>32</sup>

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<sup>31</sup> See Metalclad Corporation Proxy Statement date April 17, 1997 pages 13 & 14.

<sup>32</sup> Metalclad Corporation SEC Form 10-Q dated June 30, 1997 – Item 4.

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**CHICAGO PARTNERS**  
A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

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## **8. Composition, Compensation and Trading Activity of Metalclad's Insiders, Advisors and Institutional Shareholders**

**8.1.** The Claimant's management insiders, primarily Kesler, Neveau, Robertson and, to a lesser extent, Guerra, have generated significant personal income from Metalclad. The insiders' gains are notable not only for their magnitude but more importantly for the scarcity of personal capital these insiders put at risk.

**8.2.** Kesler purchased his original Metalclad stake with a non-recourse loan, Neveau received his original shares as a transfer from Kesler, Robertson had not yet paid for his ETI shares before ETI was purchased with Metalclad stock, and Guerra's original investment in Quimica Omega (the eventual source of his Metalclad shares) was a fraction of the 1991 investment by the First Analysis-related shareholders. All four insiders increased their Metalclad holdings not through open market purchases, but via sizeable grants of options (and the re-pricing down of those options).

**8.3.** Exhibit 8.1 summarizes each management insider's stock and option trading activity, estimated realized and unrealized profits and disclosed salary, bonuses or other compensation. Reimbursed expenditures are not included in these totals except to the extent that any such reimbursements would have been included in insider earnings as reported on the Metalclad proxies.

**8.4.** Estimated gains on sales of stock or exercise of options are based on information included in the company's proxies, 10K's and 10Q's, Regulation 144 filings as tracked and reported by Bloomberg Financial News, and Form 3 & 4 filings as compiled by CDA Investment Technologies from microfiche files at the United States Securities and Exchange Commission. There are numerous inconsistencies and occasional mathematical errors in Metalclad's proxies and in those instances in which the discrepancy appeared sizeable, I noted it.

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### **CHICAGO PARTNERS** A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

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**8.5.** In October 1994, Metalclad loaned \$370,000 each to Kesler and Neveau. The loans bore interest at a rate equal to prime plus 7% (identical to the stated, but not the effective rate, of the CVD loan). According to the company's 10K for the period ended May 31, 1996, Kesler and Neveau repaid \$150,000 each in February 1996.<sup>1</sup> In March 1996 both the interest rate and the principal amounts were adjusted (upwards for Kesler to \$390,000 and downwards for Neveau to \$160,000.) The adjusted interest rate, effective March 1, 1997, was a variable rate based upon the company's "quarterly investment rate."

**8.6. Grant S. Kesler:** Kesler has collected over \$2.628 million in Metalclad salary, bonuses, fees, commissions and estimated realized profits on Metalclad stock options or purchases through December 31, 1996 (the last proxy reporting period available.) In addition Kesler gifted 45,000 shares (December 1, 1993), assigned 850,000 shares and 125,000 options to Neveau (December 1, 1993), and otherwise disposed of 489,000 shares (40,000 shares sometime prior to April 25, 1995 and 449,000 shares sometime between September 27, 1995 and August 31, 1996.) An aggregate market value estimate for the 534,000 shares gifted or otherwise disposed of is \$2,136,000.<sup>2</sup>

**8.7.** Approximately \$1.560 million represented the combination of salary, bonuses, fees and commissions during the period February 28, 1991 to December 31, 1996. This includes \$170,000 in commissions paid to Kesler's company Paradigm Securities as part of his original 1991 stock purchase. That stock purchase was financed by, and the shares pledged as security for a non-recourse loan to Kesler, due August 28, 1993, from the Southern California & Arizona Glaziers Architectural Metal & Glass Workers Pension Plan.

**8.8.** The \$1.560 million in salary, bonuses, etc. includes \$250,000 paid in 1993 and 1994 to Kesler (and Neveau) as consideration for their waiver of rights under the MOU

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<sup>1</sup> 12/31/96 10K, Item 13 page 24.

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**CHICAGO PARTNERS**  
A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

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(the 1991 Memorandum of Understanding between the four ETI shareholders, Metalclad and Neveau) [See discussion @ Section 6].<sup>3</sup> Generally the terms of the MOU provided for sizeable revenue and profit-sharing payments related to the Santa Maria del Rio facility (the only ETI/ECO asset).<sup>4</sup> However, the timing of the bulk of this payment coincides with the initiation of construction at La Pedrera, not Santa Maria del Rio. It is not clear if Metalclad's reported Kesler (or Robertson) compensation totals include the \$50,000 shareholder consulting payments (for each) accrued on the ETI books at the date of its November 1991 acquisition by Metalclad.

**8.9.** Kesler's cash compensation level doubled on an annualized basis between May and December 1996, the period immediately following Neveau's resignation. Kesler's fiscal 1996 annual compensation totaled \$287,587. Kesler's compensation for just the seven months ended December 1996 was \$328,982 (corresponding to annualized level of \$563,969 or 196% of the prior year.)<sup>5</sup> The 1996 increase does not appear to be a catch-up; Kesler's annual increases for fiscal 1995 and 1996 were 28.8% and 26%, respectively, excluding the \$250,000 one time payment in consideration of foregoing royalties on Santa Maria del Rio.

**8.10.** Approximately \$1.068 million represented estimated profits on various reported sales of Kesler's stock and options through December 1996.<sup>6</sup> Kesler transferred 850,000 shares and 125,000 options (a total of 1,020,000 share equivalents) to Neveau on December 1, 1993 with no disclosed consideration. The combined market value of the transfer was over \$3.68 million (\$4.00 per share net of the \$218,750 strike value of the options).

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<sup>2</sup> Estimate based upon the following daily prices: \$4.00 @ December 1, 1993, and \$4.00 around February 1, 1996.

<sup>3</sup> Metalclad Corporation Preliminary Proxy Statement September 27, 1995, page 6 footnote 3.

<sup>4</sup> See discussion in Section 6 and Metalclad Corporation SEC Form 10-K December 31, 1991 Exhibit 10.2.

<sup>5</sup> Metalclad Corporation Proxy Statement April 17, 1997, page 10.

<sup>6</sup> Unlike the other insiders, Kesler's stock trading profits are not calculated entirely on a FIFO basis. His trading activity clearly indicates that he exercised 425,000 options at prices ranging from \$1.50 - \$2.25 per share to sell the same shares in a private placement for \$4.00 each all on 2/1/96.

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**CHICAGO PARTNERS**  
A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

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**8.11.** On March 7, 1995, the strike price of 145,000 of Kesler's options (from the '92 & '93 Omnibus plans) was reduced from \$4.00 per share to \$2.25 per share. Metalclad's market price on March 7, 1995 was \$2.125, below the strike price.

**8.12.** As of December 31, 1996, Kesler's holdings of 850,000 shares and 1,245,000 options (745,000 at \$2.25 per share and 500,000 at \$1.625 per share) controlled approximately 7.2% of the outstanding Metalclad fully diluted shares (29,123,236). Metalclad's preliminary proxy statement dated April 8, 1997 indicates a lower level of Kesler holdings as of April 14, 1997 - 361,000 shares and 1,095,000 options (595,000 at \$2.25 per share and 500,000 at \$1.625 per share). Since February 1995, no Form 4's have been filed by Kesler indicating any sale, gift or transfer to explain the nature of his reduction in holdings. Assuming the shares and options have been sold or transferred to a party outside of Kesler's control, he controlled approximately 5.0% of the outstanding Metalclad fully diluted shares.

**8.13. T. Daniel Neveau:** Neveau, who served as a Director, Senior Vice President and Chairman of the Board for Metalclad, collected over \$2.0 million through December 31, 1996 (not including proceeds from his September 1996 post-resignation consulting agreement) and as of that same date held approximately 811,000 shares of Metalclad common stock and options to purchase up to 530,000 shares at an exercise price of \$2.25. Following Neveau's resignation, he continues to receive consulting fees for services provided to the Company until March 1998.

**8.14.** As a Director and Officer of the Company, Neveau received various options to purchase Company stock, and did not personally acquire Metalclad stock on the open market. At the end of 1993, pursuant to an ownership and financing agreement with Kesler, Neveau received 850,000 shares of common stock and options totaling 125,000 shares. In 1995, Neveau was the recipient of an option for 750,000 shares exercisable at \$2.25. Immediately following the grant of the 750,000 share option, Neveau exercised some of his options and sold 425,000 shares at \$4.00 in an off-shore private placement

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**CHICAGO PARTNERS**  
A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

---



organized by Oakes Fitzwilliams in February 1996, in conjunction with Kesler and Guerra, profiting from the issue by approximately \$877,000. As of December 31, 1996, Neveau earned almost \$1.2 million in the form of salary, bonus' and other fees.

**8.15. Ronald E. Robertson:** Robertson, who served as a Director, Senior Vice President and Chairman of the Board for Metalclad, collected approximately \$554,000 during his brief tenure with Metalclad (July 1991 to September 24, 1993).

**8.16.** Although at the time of ETI's acquisition, he had not paid for his shares, Robertson received 140,000 shares of Metalclad's common stock. Beginning in 1993, Robertson started to sell his shares of Metalclad. He realized a little over \$250,000 from his original 140,000 shares received from the ETI/ECO-Metalclad transaction. In addition, Robertson collected approximately \$303,000 in the form of salary, bonus and other income.

**8.17.** Robertson resigned from the Company on September 24, 1993, relinquishing his rights to any options under the Omnibus plan. Robertson's holdings in Metalclad were completely liquidated by February 14, 1994.

**8.18. Javier Guerra Cisneros:** On May 5, 1994, Metalclad acquired all of the issued and outstanding common and preferred stock of QUIMICA OMEGA, S.A. de C.V. in exchange for 2.8 million shares of Metalclad's restricted common stock. Of the 2.8 million shares, 84,000 shares were delivered to an escrow. The transaction was accounted for as a purchase at a price of \$6,300,000, based upon Metalclad management's estimate of the fair value of the Company's common stock issued to the QUIMICA OMEGA shareholders (approximately 60% of the then-current market price). Metalclad recorded costs in excess of net assets acquired of \$7,313,831. Subsequently, Metalclad wrote off the remaining goodwill of \$6,377,716 as of May 31, 1995.

**8.19.** Javier Guerra Cisneros ("Guerra") received 631,095 shares of Metalclad common stock in exchange for his 78,019 shares of QUIMICA OMEGA. Guerra's wife, Alba,

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**CHICAGO PARTNERS**  
A LIMITED LIABILITY COMPANY

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Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

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received 630,772 shares of Metalclad common stock for 77,880 shares of QUIMICA OMEGA, and his two sons, J. Guerra Duran and L.A. Guerra Duran, each received 96,743 shares of Metalclad common stock for their 11,860 shares (each) of QUIMICA OMEGA. Guerra maintained shared voting power in his family member shares. At the time of this transaction Metalclad's common stock was trading at \$3.75, which was \$1.50 greater than the \$2.25 price per share value assigned to the 2.8 million shares issued to purchase QUIMICA OMEGA (\$6,300,000 purchase price divided by 2,800,000 shares equals \$2.25 per share). As a result, Guerra and his family received almost \$2.2 million in additional value for their shares of QUIMICA OMEGA stock (\$1.50 multiplied by 1,455,353 shares).

**8.20.** On March 7, 1995, Guerra was issued a nonstatutory stock option for 250,000 shares of common stock with an exercise price of \$2.25. Only 150,000 shares were vested, the remaining 100,000 vest upon the achievement of certain performance standards associated with landfill operations. Metalclad's stock price of \$2.125 was below the exercise price of the option.

**8.21.** Beginning May 1996, Guerra and his family filed Form 144's to sell Metalclad stock. While full information is not available to determine exact selling dates and prices of the stock at the time of sale, I used the stock price at the date of filing of the Form 144's. Gains were determined by taking the trading stock price less the \$2.25 value of the Metalclad's stock at the time of QUIMICA OMEGA's acquisition. Assuming that all filings for the sale of stock occurred, Guerra and his family earned approximately \$350,000 from stock sales. Losses were incurred for the shares sold on October 28, 1996 and February 6, 1997, as Metalclad's stock price fell below the \$2.25 value assigned to Metalclad's stock from the QUIMICA OMEGA acquisition.

**8.22.** Guerra earned approximately \$439,000 in salary and bonus from the time QUIMICA OMEGA was acquired, May 5, 1994, through December 31, 1996, according to the Company's Preliminary Proxy filed on April 8, 1997. Due to incomplete

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**CHICAGO PARTNERS**  
A LIMITED LIABILITY COMPANY

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Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

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information I am unable to account for the reduction in option shares and difference in the level of common stock held, as Guerra fell below thresholds requiring disclosure.

**8.23. Advisor's Holdings:**

**8.24. Oakes Fitzwilliams & Co. Ltd.:** Oakes Fitzwilliams & Co. Ltd. has served as the placement agent for numerous Metalclad private placements. In return for their services, Oakes has received over \$1.35 million in cash fees<sup>7</sup> and realized over \$3.65 million in profits on Metalclad stock and warrants through December 31, 1996 (Exhibit 8.2). In addition, as of December 31, 1996 Oakes held 25,000 shares of Metalclad stock and 2,045,635 warrants to purchase Metalclad shares (in aggregate 6.64% of the common stock).<sup>8</sup>

**8.25.** In April 1997 Herbert L. Oakes ("HL Oakes") was nominated to serve on the Metalclad board of directors.<sup>9</sup> In May 1997 he declined to stand for election and was replaced by Juan B. Morales, a Monterrey, Mexico businessman and consultant.<sup>10</sup>

**8.26.** Oakes Fitzwilliams & Co., Ltd consists of several businesses: an investment and brokerage firm in the UK (Oakes Fitzwilliams & Co., Ltd), an investment and brokerage firm in Panama (Oakes Fitzwilliams & Co. S.A.), a holding and investment company in the Netherlands Antilles (Oaktree Productions, N.V.), an investment company in Panama (Purbrook Corp.) a brokerage business in the U.S. (Oakes Ftzwilliams & Co., L.P.). Information regarding the Metalclad related investment activity of these companies and Herbert L. Oakes, Jr.'s personal retirement fund is drawn from SEC Schedule 13D's filed by the Oakes entities.

**8.27.** On September 29, 1994, Oakes Fitzwilliams & Co. Ltd. ("OFCO") received

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<sup>7</sup> Metalclad Corporation Confidential Offering Memorandum dated February 12, 1996 page 37 ("cash fee equal to 10% of the gross proceeds... from the sale... by the Company [1.65 million units @ \$4.00]) and Metalclad Corporation Confidential Offering Memorandum dated September 14, 1994 page 33 ("cash fee equal to 10% of the gross proceeds" [2.3 million units @ \$3.00]).

<sup>8</sup> SEC Schedule 13D dated April 30, 1997 for Oakes, Fitzwilliams, etal. page 28 Item 5 (h).

<sup>9</sup> Metalclad Corporation Proxy Statement April 17, 1997 page 5.

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**CHICAGO PARTNERS**  
A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

---

warrants to purchase 230,000 Units of Metalclad stock (each unit consisting of one common share and one warrant to purchase one common share) as part of its compensation for services as the placement agent in a Regulation S offering.<sup>11</sup>

According to the 13D filing reporting this transaction, the warrants were exercisable from February 29, 1996. On February 22, 1995 OFCO sold the unit warrants to Oakes, Fitzwilliams & Co. S.A. ("OFSA"). By December 8, 1995 OFSA had exercised both the unit warrants and the underlying stock warrants and sold back the resulting 460,000 shares to OFCO at a profit of over \$1.13 million.

**8.28.** On December 8, 1995, Metalclad issued 1.57 million additional stock warrants to Oakes businesses "in replacement of and in conjunction with the exercise of certain unit warrants of the Issuer".<sup>12</sup> No exercise price or date was disclosed.

**8.29.** On February 29, 1996, OFSA received warrants to purchase 260,000 Units of Metalclad stock at \$4.40 as part of its compensation for services as the placement agent in a Regulation S offering.<sup>13</sup> Each unit consists of one common share and one warrant to purchase one common share with an exercise price of \$5.00.

**8.30.** On March 18, 1996, Howard Tisshaw of Oakes issued a twelve-page research report on Metalclad Corp. (dated 3/11/96). To our knowledge, this was the only analyst report ever issued for Metalclad. Although we were unable to obtain a copy of the report (Oakes declined to provide a copy to our agent in London), Nelson's provided the following quote from the report: "BFI joint venture confirms Metalclad as market leader in Mexico". Following the release of this favorable research report, several institutions purchased Metalclad stock, including National Westminster Bank PLC, Forstmann-Leff Associates and William Jones & Associates. In addition, several institutions substantially increased their holdings in the three months following the report, including BZW

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<sup>10</sup> Metalclad Corporation SEC Form 10-Q June 30, 1997 Item 4(A), page 12.

<sup>11</sup> SEC Schedule 13D filed October 14, 1994 by Oakes, Fitzwilliams & Co. Limited, page 11.

<sup>12</sup> SEC Schedule 13D filed June 21, 1996 by Oakes, Fitzwilliams & Co. Limited, pages 24 & 56.

<sup>13</sup> SEC Schedule 13D filed June 21, 1996 by Oakes, Fitzwilliams & Co. Limited, page 28.

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## CHICAGO PARTNERS

A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

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Barclays Global Investments, Richard L. Chilton, Jr., and Allied Irish Banks PLC. Institutional holdings of Metalclad stock, as reported to the SEC by fund managers on Form 13(f) increased by 1.373 million shares, or over 55%, from March 31, 1996 to June 30, 1996.

**8.31.** On May 12, 1995, Oakes sent a letter to Kesler noting that they had placed roughly \$14 million with approximately 35 European institutions, and were willing to contribute an additional \$10 million to support operations and provide expansion capital. The letter reminded Kesler that Metalclad had committed to a completion date for their SLP landfill project of September 6, 1994, and that they would be in default on approximately \$8 million in debentures if commercial operations did not begin by May 31, 1996. The Oakes letter implied that Metalclad had convinced Oakes (and through it the MTLIC investors who had subscribed to the shares issued through it as placement agent) that all necessary permits had been obtained and construction was complete.

**8.32. CVD Financial (see Exhibit 8.3)**

**8.33.** As Metalclad's financing quests for its Mexican hazardous waste ventures failed to materialize, the Company entered into various loan agreements with CVD Financial ("CVD"). On September 27, 1993, Metalclad signed a promissory note with CVD for a principal amount of \$2,500,000, bearing interest at the prime rate plus 7 points, due on September 1, 1995. As loan security, Metalclad pledged all of its assets, including all shares of several of its subsidiaries (MIC, MEC, and ECO-MTLC). In conjunction with this loan, Metalclad also issued two five-year warrants. The first warrant was issued on September 2, 1993 for 75,000 shares of the Company's common stock with an exercise price of \$4.50 and expiry of September 1, 1998. At that time the Company's stock price was \$4.875 (9/2/93), therefore, CVD was in-the-money by approximately \$28,125. The second warrant was issued on September 27, 1993 for 300,000 shares, with an exercise price of \$4.50 and expiry of September 1, 1998. The Company's stock price was \$4.375 (9/27/93), below the exercise price of the option. According to disclosed records, CVD

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## CHICAGO PARTNERS

A LIMITED LIABILITY COMPANY

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Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

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did not exercise any of its options prior to the additional loan made by CVD to Metalclad.

8.34. On September 7, 1994, Metalclad obtained an additional loan for \$525,000 from CVD with the same terms and conditions as the first and a maturity date of November 1, 1994. An additional warrant was issued to CVD for 75,000 shares of the Company's common stock with an exercise price of \$2.625 and expiry of September 1, 1998. The Company's stock was trading at \$3.125 (9/7/94), therefore, CVD was in-the-money by approximately \$37,500. According to disclosed records, CVD did not exercise any of its options prior to the amendments on December 30, 1994 and May 31, 1995.

8.35. The amendment dated December 30, 1994 merely consolidated the loans and the entire loan was due on April 15, 1995. The Loan Modification Agreement (dated as of May 31, 1995) was executed on June 1, 1995. This amendment followed an "event of default," which was not directly explained in Metalclad's SEC filings, but is included in the Agreement dated May 31, 1995, as follows:

"Each of the Borrowers acknowledge that they are in default under the Existing Loan Agreements by reason of, among other things, the failure to make a principal payment of \$100,000 due February 28, 1995 and to pay the entire unpaid balance of the Loan at Maturity on April 15, 1995, and for failure to pay scheduled interest payments due for February, March, and April 1995."<sup>14</sup>

8.36. The lender extended the maturity date of the loan to June 30, 1996. As a result CVD received 87,578 shares of common stock issued on June 7, 1995 when the Company's stock price was \$1.50, a \$131,367 benefit to CVD. The warrants previously issued (450,000 shares) were extended to May 31, 2000 and the exercise price was dropped to \$1.59 Metalclad's common stock price was \$1.875 on 5/31/95 and \$2.063 on 6/1/95, resulting in a potential benefit to CVD of between \$128,250 to \$212,850.

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**CHICAGO PARTNERS**  
A LIMITED LIABILITY COMPANY

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Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

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Metalclad also issued a warrant to CVD for 600,000 shares of common stock at an exercise price of \$1.908 and expiry of May 31, 2000. Metalclad's common stock price was \$1.875 on 5/31/95 and \$2.063 on 6/1/95, resulting in a potential benefit to CVD of \$93,000, if the 6/1/95 date is used. The new agreement gives the lender the right to convert the debt into shares of common stock at the rate of \$1.59 per share. On 6/1/95, Metalclad's common stock price was \$2.063; resulting in a potential in-the-money benefit to CVD of \$828,490.

**8.37.** Subsequently, a further amendment occurred on September 1, 1995, with the following requirements: the San Luis Potosi landfill site and related facilities be in full and unrestricted operations by December 31, 1995, the loan paid off in full before October 13, 1995 or pay to the lender a fee of \$100,000 on October 16, 1995, the final maturity date of the loan was June 30, 1996. Metalclad was not able to pay the loan in full by October 13, 1995 and incurred the \$100,000 fee.

**8.38.** On December 13, 1995, CVD exercised warrants for 150,000 shares of common stock at an exercise price of \$1.59. Instead of cash, CVD paid for this transaction by reducing the Company's loan by \$182,000 and forgiving \$56,000 in accrued interest. Metalclad's stock price was \$4.875 on December 13, 1995, giving CVD an in-the-money position of almost a \$500,000. CVD proceeded to liquidate its shares beginning on December 27, 1995 for stock prices ranging from \$3.98 to \$4.18. Sales in the month of December 1995 brought in over \$350,000 for CVD. On January 16, 1996, CVD sold its warrant for 600,000 shares of common stock at an exercise price of \$1.908 for \$960,000 (\$1.60 a share). Metalclad's stock was trading at \$4.625; CVD was forfeiting almost \$1.5 million by not exercising its warrant and selling the shares on January 16, 1996.

**8.39.** On January 2, 1996, CVD continued to sell shares and on February 27, 1996

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<sup>14</sup> Metalclad Corporation SEC Form 10-K for the fiscal year ended May 31, 1995, Exhibit "10.29" - LOAN MODIFICATION AGREEMENT.

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**CHICAGO PARTNERS**  
A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

exercised its option to convert all of its debt into Metalclad's common stock and sell off all of its remaining shares. CVD converted \$1,924,797 of debt into 1,210,564 shares of common stock at the conversion rate of \$1.59 per share (Metalclad's stock price was \$3.188). It immediately sold 1,000,000 shares for \$3.42 per share when Metalclad's stock price was \$4.875. CVD also sold 298,142 shares at \$3.25.

**8.40.** CVD earned some \$3.7 million from fees and stock transactions from its relationship with Metalclad. This figure does not include cash interest payments. At February 27, 1995, CVD held warrants for 225,000 shares exercisable at \$1.59. We are unable to balance to CVD's last 13G dated February 27, 1996, missing a warrant for 75,000 shares transaction, and sale of 56,200 shares.

**8.41. Institutional Shareholdings in Metalclad.**

**8.42.** Institutional shareholders are required to report their shareholdings in all companies as of the end of each calendar quarter (March 31, June 30, September 30 and December 31). These reports are filed on form 13(f). Exhibit 8.4 summarizes the reported institutional holdings of Metalclad at each quarter end from January 19 through September 1997.

**8.43.** As indicated in the table there were multiple significant periods in which institutional ownership in Metalclad either significantly increased or shifted among various institutions. These periods coincide with periods of increased share trading volume and with periods of significant run-up in the Metalclad total capitalization.

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**CHICAGO PARTNERS**  
A LIMITED LIABILITY COMPANY

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Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

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## 9. Metalclad Announcements

This section highlights certain significant pieces of information regarding Metalclad's Mexican ventures which are not fully or accurately communicated to the market through Metalclad's SEC filings, private offering memoranda, press releases and various other articles or publications.

### 9.1. COTERIN's Permit and Approval Status

**ISSUE:** COTERIN applied for and obtained two Federal permits. It applied for and obtained the State Land Use license on May 13, 1993. COTERIN applied and failed on two occasions, on September 30, 1991, and December 5, 1995, to obtain the Municipal construction permit. In addition to these legal permits, Metalclad recognized that it required the approval of the State government and of the local community. The State made its approval conditional on the Municipality giving its approval. The Municipality refused to approve the landfill project. There is no evidence that COTERIN applied for or obtained a Municipal operating permit.<sup>1</sup>

### 9.2. References to COTERIN's Permit and Approval Status in Metalclad Corporation SEC Filings (Emphasis Added)

- "COTERIN has received the construction permit from SEDESOL and anticipates the state and municipal land use authorizations by September 1993."<sup>2</sup>
- "On October 7, 1993, Metalclad...completed the acquisition of 94% of the outstanding shares of...[COTERIN]...which owns a permitted hazardous waste treatment landfill near Guadalucazar, in the Mexican state of San Luis

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<sup>1</sup> THE FACTS – Page 5

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**CHICAGO PARTNERS**  
A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

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Potosi.”<sup>3</sup>

- “The company anticipates commencement of operations at the landfill in the first quarter of calendar 1994.”<sup>4</sup>
- “ECOPSA is completing construction of a permitted hazardous waste landfill on a 2,200 acre site in La Pedrera, in the Mexican state of San Luis Potosi (“El Confin”), which site has been approved for the development of a fully-integrated hazardous waste treatment facility.”<sup>5</sup>
- “Although the INE has granted unconditional permits to construct and operate El Confin, there can be no assurance that construction or operating permits will be granted for additional sites.”<sup>6</sup>
- “ECOPSA has completed construction of a permitted hazardous waste landfill on a 2,200 acre site in La Pedrera, in the Mexican state of San Luis Potosi (“El Confin”), which site has been approved for the development of a fully-integrated hazardous waste treatment facility.”<sup>7</sup>
- “ECONSA, through a subsidiary, owns a completed hazardous waste landfill and treatment facility in the state of San Luis Potosi. The landfill is located in the remote area of La Pedrera, Guadalcasar and is know by its trade name, El Confin. It comprises 2,200 acres of land, has a permitted capacity of 360,000 tons of waste per year and is designed presently to handle approximately

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<sup>2</sup> Metalclad Corporation Form 10-K for the transition period from January 1, 1993 to May 31, 1993, p. 9.

<sup>3</sup> Metalclad Corporation Form 8-K dated October 7, 1993

<sup>4</sup> Metalclad Corporation Form 8-K dated October 7, 1993

<sup>5</sup> Metalclad Corporation Form 10-K for the fiscal year ended May 31, 1994, p. 2.

<sup>6</sup> Metalclad Corporation Form S-3 filed November 30, 1994, p. 6.

<sup>7</sup> Metalclad Corporation Form 10-K for the fiscal year ended May 31, 1995, p. 2.

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## CHICAGO PARTNERS

A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

160,000 tons per year when fully operational.”<sup>8</sup>

- “El Confin is presently not in operation because the governor of San Luis Potosi is actively opposed to its opening.”<sup>9</sup>
- “ECONSA, through a subsidiary, owns a completed hazardous waste landfill and treatment facility in the state of San Luis Potosi. The landfill is located in the remote area of La Pedrera, Guadalupe and is known by its trade name, El Confin. It comprises 2,200 acres of land, has a permitted capacity of 360,000 tons of waste per year and is designed presently to handle approximately 160,000 tons per year when fully operational.”<sup>10</sup>
- “El Confin is presently not in operation because of political opposition to its opening...[Metalclad has] not been able to overcome this opposition...[and has] file [d a] claim under the North American Free Trade Agreement (“NAFTA”).”<sup>11</sup>

**9.3. References to COTERIN’s Permit and Approval Status in Metalclad’s Private Offering Memoranda (Emphasis Added)<sup>12</sup>**

- “ECOPSA is completing construction of a permitted hazardous waste landfill on a 2,200 acre site in La Pedrera...which site has been approved for the development of a fully-integrated hazardous waste treatment facility...ECOPSA has also been issued a construction permit for an integrated hazardous waste treatment facility, including a rotary slagging kiln,

<sup>8</sup> Metalclad Corporation Form 10-K for the fiscal year ended May 31, 1996, p. 4.

<sup>9</sup> Metalclad Corporation Form 10-K for the fiscal year ended May 31, 1996, p. 4.

<sup>10</sup> Metalclad Corporation Form 10-K for the transition period from June 1, 1996 to December 31, 1996, p. 4.

<sup>11</sup> Metalclad Corporation Form 10-K for the transition period from June 1, 1996 to December 31, 1996, p. 4.

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**CHICAGO PARTNERS**  
A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

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near Santa Maria del Rio...however, San Luis Potosi governmental officials have encouraged the Company to incorporate the kiln into its plans for El Confin and have indicated that the permit could be transferred to El Confin.”<sup>13</sup>

- “The company believes that it has obtained the support of state and local government agencies to operate the facility and has conducted an extensive public awareness and social development plan.”<sup>14</sup>
- “The Company believes it has secured the necessary permits to construct and operate the landfill at El Confin...However, the governor of the State of San Luis Potosi has recently asserted that the Company did not have the necessary permits to construct and operate the landfill.”<sup>15</sup>
- “Unfortunately, I must also ask you to recall that the original completion date was September 9, 1994. We have heard all the reasons for delay, but our investors no longer understand what is preventing the opening since you have all necessary permits and the construction is now fully complete.”<sup>16</sup>

#### **9.4. References to COTERIN’s Permit and Approval Status in Metalclad News Announcements (Emphasis Added)**

- We expect to be able to announce the acquisition of an existing and operational hazardous waste landfill in the near future. *PR Newswire, 4/20/92, 3:37pm*

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<sup>12</sup> And Mr. Oakes’ letter in response thereto.

<sup>13</sup> Metalclad Corporation Confidential Offering Memorandum (Oakes, Fitzwilliams & Co. Ltd, Placement Agent) dated September 14, 1994, p. 2.

<sup>14</sup> Metalclad Corporation Confidential Offering Memorandum (Oakes, Fitzwilliams & Co. Ltd, Placement Agent) dated September 14, 1994, p. 5.

<sup>15</sup> Metalclad Corporation Confidential Offering Memorandum (Oakes, Fitzwilliams & Co. S.A, Placement Agent) dated February 12, 1996, p. 6.

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## **CHICAGO PARTNERS**

A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

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- Metalclad Corp. announced today that it has completed the acquisition of a hazardous waste landfill in the state of San Luis Potosi, Mexico. An option on this 2,200 acre facility, La Pedrera, was acquired on April 23, 1993...The operating permit was issued by the INE on Aug. 10, 1993 and last Thursday, Oct. 7, 1993, representatives from the INE were in San Luis Potosi to meet with the Governor...The La Pedrera facility includes an inorganic treatment and neutralization unit, a solidification unit and landfill cells with double liners, leachate detection and collection systems...Fully developed, the facility is expected to cost \$6.2 million and will be capable of handling in excess of 10,000 tons of hazardous waste per month. Financing for the facility was obtained from CVD financial, an affiliate of Conversion Industries Inc., Pasadena, Calif. *PR Newswire, 10/13/93, 1:32pm*
- Metalclad Corp. said a hazardous waste treatment and secure landfill project near Guadalcazar, San Luis Potosi has been delayed because the governor of San Luis Potosi lacked "critical" information about the project...*Bloomberg News, 1/21/94, 2:12pm*
- The green light previously signaled by Metalclad Corp. for a proposed hazardous waste treatment facility and landfill in Mexico has changed to yellow. Metalclad has "made the decision not to go forward with construction, development of operation until we have the full public support" of San Luis Potosi Gov. Horatio Sanches Unzueta and communities around Guadalcazar...In an agreement announced last year, Metalclad unveiled a plan to build an incinerator capable of processing 120,000 tons per year of wastes...62 miles separate the proposed project in Santa Maria del Rio from

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<sup>16</sup> This quote is not from an offering memorandum, but rather from a letter dated May 12, 1995 from Oakes, Fitzwilliams & Co. to Kesler.

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**CHICAGO PARTNERS**  
A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

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the landfill...The company later announced that a subsidiary had received final approval for the hazardous waste treatment project from Mexico's federal government and that the facility would be two-thirds operational before the end of the year. *American Metal Market, 02/15/94*

- Metalclad Corp. announced the completion of all requirements requested by the governor of San Luis Potosi for the development of a hazardous waste treatment facility in that state. At a meeting held Jan 28, 1994 between the governor and Metalclad reps, it was agreed that a commission...would be formed to validate the safety and adequacy of the site...The Environmental Committee of the State Legislature of San Luis Potosi has also reviewed the design and operational plan for Metalclad's hazardous waste treatment facility and given their approval and support. *PR Newswire, 3/29/94, 12:30pm*
- Metalclad Corp. announced today that an announcement has been made by the Mexican Government in conjunction with the opening of Metalclad's hazardous waste landfill in the State of San Luis Potosi, Mexico...Licenciado Miguel Limon Rojas (PROFEPA) announced the opening of the landfill...this follows an announcement by Dr. Pedro Medellin Milan that an agreement had been reached between the Governor of San Luis Potosi and Metalclad for the construction and operation of the facility. The current announcement reaffirms both federal and state governmental support for both Metalclad's projects. *PR Newswire, 9/6/94, 12:52pm*
- A delegation of US Department of Commerce (DOC) officials told last week's Environmental Industry Association (EIA) annual conference...Success Stories: Metalclad Corp. of California won a permit to build and operate Mexico's first integrated hazardous waste treatment plant. The investment for

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**CHICAGO PARTNERS**  
A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

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this first and only commercial treatment plant for hazardous waste to date is \$100 million. *Environmental Remediation Technology*, 5/3/95

- Metalclad...announced today the following...National Council of Ecological Industrialists in Mexico City (CONIECO)...called for the immediate opening of the facility. *PR Newswire*, 8/10/95, 3:28 pm
- Metalclad Corporation Letter to Shareholders: "...Our hazardous waste treatment facility in San Luis Potosi was substantially complete and ready to open in March. However, because of local expressions of opposition and in spite of the fact that we had all the necessary permits to operate, the federal authorities suggested further scientific tests be undertaken. ...two changes suggested were the creation of an emergency storage area and the lengthening of a drainage canal. Both...have now been completed. ...Having met all state and federal technical requirements and addressed local concerns, we are now awaiting a public announcement...that we can open. There is no way we can accurately forecast when they will take this step..." *PR Newswire*, 11/16/95 2:06pm
- On Friday November 24 at 5 pm Mexico City time...PROFEPA called a news conference to witness the signing of a historic agreement between the federal government of Mexico and one of Metalclad's Mexican subsidiaries...Signatories...included both PROFEPA and El Instituto de Ecologia (INE)...the agreement insures operations of Metalclad's hazardous waste treatment facility completed in March 1995 for a period of five years...remediation of the old transfer station...be completed within three years. *PR Newswire*, 11/27/95, 9:18am

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**CHICAGO PARTNERS**  
A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

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- Metalclad Corp. has reported to shareholders that although its hazardous waste treatment facility and landfill in San Luis Potosi, Mexico, was substantially complete and ready to open in March, local expressions of opposition caused...further scientific tests...Metalclad had already received the necessary permits to operate the facility...Metalclad is now awaiting a public announcement by both federal and state officials that the facility may open...  
*Waste Treatment Technology News, 12/01/95*

#### **9.5. Santa Maria del Rio Permit and Approval Status**

**ISSUE:** We understand that Metalclad did not to obtain all necessary permits and approvals to construct and operate the proposed hazardous waste facility at Santa Maria del Rio.

#### **9.6. References to Santa Maria del Rio Permit and Approval Status in Metalclad Corporation SEC Filings (Emphasis Added)**

- “In November 1991, the Company acquired all of the outstanding shares of common stock of ECO-Metalclad, formerly known as Environ Technologies, Inc. a privately held corporation, in exchange for 1,180,000 shares of the Common Stock of the Company. At the time of acquisition, EMI owned a 49% ownership interest and a 50% voting interest in a Mexican corporation engaged in the business of developing a toxic and hazardous waste treatment facility in the Mexican state of San Luis Potosi.”<sup>17</sup>
- ECO owns a site for the development of a hazardous waste processing facility in San Luis Potosi and has received all necessary local, state, and federal

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<sup>17</sup> Metalclad Corporation Form 10-K for the fiscal year ended December 31, 1991, p. 3

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**CHICAGO PARTNERS**  
A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent



permits to construct the facility.<sup>18</sup>

- “ECO has received an unconditional permit to construct its facility in San Luis Potosi from SEDUE [Secretary of Urban Development and Ecology].”<sup>19</sup>
- “ECO has received the Construction Permit for its first facility in San Luis Potosi [Santa Maria del Rio] from the National Institute of Ecology, after completing the various applications with the local, state, and federal agencies in Mexico which were commenced in early 1991 by ECO. ... The Company anticipates that ECO will break ground for the San Luis Potosi [Santa Maria del Rio] facility as soon as joint venture or other project financing is arranged.”<sup>20</sup>

#### **9.7. References to Santa Maria del Rio Permit and Approval Status in Metalclad News Announcements (Emphasis Added)**

- A U.S.-Mexican partnership has received the first permit under Mexico's new environmental regulations to build a hazardous waste processing facility. The group estimates it will cost up to \$25 million and is expected to generate annual gross revenues of \$150 million. Partnership members announced the venture at a Jan. 9 news conference in Washington, D.C. The group, ECO Administracion SA de CV, will build the 120,000 ton-per-year waste processing plant at a 250 acre site 35 miles outside of San Luis Potosi [Santa Maria del Rio] under a permit from Mexico's Secretaria del Desarrollo Urban y Ecoligia *Hazardous Waste News 1/13/92*
- The site in San Luis Potosi [Santa Maria del Rio] is the first newly permitted

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<sup>18</sup> 5/19/92 2:52 p.m. See Appendix D of Dr. Zmijewski's report, Event Study Analysis at p. 15.

<sup>19</sup> Metalclad Corporation Form 10-K for the fiscal year ended December 31, 1991, p. 9

<sup>20</sup> Metalclad Corporation Form 10-K for the fiscal year ended December 31, 1992, p. 7

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## **CHICAGO PARTNERS**

A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

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central site in Mexico since Mexico adopted US environmental standards, which establishes ECO as the premier new environmental firm in Mexico. *PR Newswire 1/15/92 4:31pm*

- Kesler also announced that on Feb. 26, 1993, Metalclad's subsidiary was issued a final permit from the Ministry of Social Development (SEDESOL) to build a fully integrated hazardous waste treatment facility in the State of San Luis Potosi [Santa Maria del Rio]....[I]ssuance of this permit has not been previously made public in order to allow the company time to benefit from the recently announced State Development Plan implemented by the new governor... The permit as issued is comparable to a permit issued in the United States under Part B of the Resource Conservation and Recovery Act (RCRA). ...Kesler concluded, "... We'll now be able to go forward with the operational portion of our plan. ... [W]e will be the first company in Mexico to create such a commercial hazardous waste treatment facility. ... We expect to be fully operational with two technologies this year and with a third beginning the first quarter of next year." *PR Newswire 7/16/93 9:22am*

#### **9.8. The COTERIN Landfill's Need for Remediation**

**ISSUE:** The La Pedrera site was contaminated by the previous owners of COTERIN. On January 11, 1994 Metalclad placed a public advertisement in the San Luis Potosi newspaper *El Pulso* which stated:

"...we recognize that a serious danger exists in the event that the facility... cannot be operated given that the number of containers existing on the site may reach up to 120,000 in number representing close to 30,000 tonnes of dangerous and toxic waste... without complying with the minimum safety conditions and standards and which may pose a great danger to the

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**CHICAGO PARTNERS**  
A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

---

health of the inhabitants of the communities. Given this grave danger METALCLAD CORPORATION is ready to treat and confine these wastes investing the amount of \$5,000,000 to meet these ends..."

**9.9. References to the COTERIN Remediation in Metalclad Corporation SEC Filings (Emphasis Added)**

- "In 1991, COTERIN operated the landfill for a three-month period as a transfer station (temporary storage facility) prior to a change in the General Ecology Law which required it to close the facility and obtain new permits from SEDESOL...the company expects to perform an environmental audit...during the next 12 months to determine if any remediation needs to be accomplished...the company believes that the new landfill being constructed adjacent to the closed transfer station will enable the company to handle the vast majority of any remedial work...site remediation will consist primarily of moving drums of hazardous waste to an adjacent cell meeting current governmental regulations." <sup>21</sup>
- In 1991, COTERIN operated the landfill for a three-month period prior to a change in the General Ecology Law which required it to obtain a permit from SEDESOL...the cells of the landfill...have been closed...remediation...[costs...are] not expected to be significant." <sup>22</sup>

**9.10. References to COTERIN Remediation in Metalclad's private offering memoranda (Emphasis Added)**

- ...the company expects to perform an environmental audit...during the next 12 months to determine if any remediation needs to be accomplished...the

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<sup>21</sup> Metalclad Corporation Form 10-K for the fiscal year ended May 31, 1994, p. 5.

<sup>22</sup> Metalclad Corporation Form 10-K for the transition period from January 1, 1993 to May 31, 1993, p. 10.

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**CHICAGO PARTNERS**  
A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

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company believes that the new landfill being constructed adjacent to the closed transfer station will enable the company to handle the vast majority of any remedial work...site remediation will consist primarily of moving drums of hazardous waste to an adjacent cell meeting current governmental regulations.”<sup>23</sup>

- “In November 1995 the Company entered into an agreement with PROFEPA which provides for site remediation over a period of three years...It is anticipated that site remediation will begin when full-scale operations have commenced at the site and will consist primarily in treating and moving drums of hazardous waste to an adjacent cell which meets current government regulations. The Company believes that the amounts involved will represent only a small portion of the wastes process by El Confin.”<sup>24</sup>

**9.11. References to COTERIN Remediation in Metalclad News Announcements (Emphasis Added)**

- Metalclad would characterize and remediate the prior Aldrett transfer station. *PR Newswire, 5/31/94, 2:57pm*
- Metalclad Corp...is proposing a hazardous waste landfill in the central Mexican state of San Luis Potosi. It’s already sunk \$22 million into studying and preparing the site to open... *Press-Enterprise, 9/25/95*

**9.12. “Full Utilization” of COTERIN**

**ISSUE:** On September 19, 1994, Bruce Haglund, legal counsel, secretary and a board

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<sup>23</sup> Metalclad Corporation Confidential Offering Memorandum (Oakes, Fitzwilliams & Co. Ltd, Placement Agent) dated September 14, 1994, p.15.

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**CHICAGO PARTNERS**  
A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

---

member of Metalclad, writes to the Grant Thornton audit partner confirming that Metalclad and the Mexican minority shareholders have determined "that 'full utilization' of the COTERIN site will never occur." He also states that "the Company's counsel have informally concurred in this conclusion." As a result any contingent elements of the COTERIN acquisition agreement "will never become binding on the Company."<sup>25</sup>

**9.13. References to COTERIN's "full utilization" in Metalclad Corporation SEC Filings (Emphasis Added)**

- "The company believes that the completion of El Confin will enable it to commence hazardous waste treatment and disposal in the fourth quarter of calendar 1994, and be the first firm in Mexico to provide integrated solutions to hazardous waste treatment and disposal."<sup>26</sup>
- "ECOPSA has completed construction of the landfill and expects to commence landfill operations in the near future."<sup>27</sup>
- "The company now believes that the contingencies upon which the additional payments are conditioned will not occur. Consequently, the company is negotiating an agreement with the minority shareholders of COTERIN to issue 100,000 shares of common stock of the company to them in consideration for the remaining 6% of the capital stock of COTERIN and the waiver of their rights to the contingent payments."<sup>28</sup>
- "The company is concentrating its efforts by optimizing expansion of

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<sup>24</sup> Metalclad Corporation Confidential Offering Memorandum (Oakes, Fitzwilliams & Co. S.A., Placement Agent) dated February 12, 1996, p.16.

<sup>25</sup> Metalclad Corporation Documents in production Response 1F – Letter from Haglund to the American Stock Transfer & Trust Company dated June 24, 1996.

<sup>26</sup> Metalclad Corporation Form 10-K for the fiscal year ended May 31, 1994, p. 3.

<sup>27</sup> Metalclad Corporation Form 10-K for the fiscal year ended May 31, 1995, p. 5.

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**CHICAGO PARTNERS**  
A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

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QUIMICA OMEGA and on start-up of phases one and two at El Confin...Because of market knowledge and existing customer contracts included in the acquisitions of COTERIN and QUIMICA OMEGA, management believes that the landfill will operate at full capacity approximately 10 months after opening."<sup>29</sup>

- "Construction for phases one and two have been completed and, in December 1995, the Company commenced intensive employee training and limited landfill operations. Landfill activities will be expanded to full-scale operations as employee training is complete."<sup>30</sup>

**9.14. References to COTERIN's "full utilization" in Metalclad's private offering memoranda (Emphasis Added)**

- "Because of market knowledge and existing customer contracts included in the acquisitions of COTERIN and Quimica Omega, management believes that the landfill will operate at full capacity upon completion."<sup>31</sup>
- "Because of market knowledge and existing customer contracts included in the acquisitions of COTERIN and QUIMICA OMEGA, management believes that the landfill will operate at full capacity approximately in the last calendar quarter of 1996."<sup>32</sup>
- "Each of the Company's proposed landfill facilities, with an estimated

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<sup>28</sup> Metalclad Corporation Form 10-K for the fiscal year ended May 31, 1994, pp. 4-5.

<sup>29</sup> Metalclad Corporation Form 10-K for the fiscal year ended May 31, 1995, p. 3.

<sup>30</sup> Metalclad Corporation Confidential Offering Memorandum (Oakes, Fitzwilliams & Co. S.A, Placement Agent) dated February 12, 1996, p. 3.

<sup>31</sup> Metalclad Corporation Confidential Offering Memorandum (Oakes, Fitzwilliams & Co. Ltd, Placement Agent) dated September 14, 1994, p. 3.

<sup>32</sup> Metalclad Corporation Confidential Offering Memorandum (Oakes, Fitzwilliams & Co. S.A., Placement Agent) dated February 12, 1996, p. 3.

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**CHICAGO PARTNERS**  
A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

processing capacity of 300,000 tons per year, will be able to process approximately 5% of the estimated 6.2 million tons of hazardous waste generated in Mexico annually.”<sup>33</sup>

**9.15. References to COTERIN’s “full utilization” in Metalclad forecasts from “Project Status, Mexico” Reports Dated June 15, 1994 and February 1, 1995 (Emphasis Added)**

- “ECOPSA expects to open its hazardous waste landfill in September 1994. Its design capacity is 130,000 tons per year. Reaching this design capacity is a function of training and organization. ECOPSA already has approximately 250 customer service agreements, which are more than sufficient to ensure operation at full capacity.”<sup>34</sup>
- “ECOPSA expects to open its hazardous waste landfill in March 1995. Its design capacity is 130,000 tons per year. Reaching this design capacity is a function of training and organization. ECOPSA already has approximately 250 customer service agreements, which are more than sufficient to ensure operation at full capacity.”<sup>35</sup>
- Financial Forecast (February 1, 1995) information revealed “El Confin, while presently under construction, is not yet in operation. It is not expected to begin operation until March 1995. The facility is being built in such a way that it can be almost immediately expanded after operation begins. Ultimate design capacity is expected to be approximately 130,000 tons per year of

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<sup>33</sup> Metalclad Corporation Confidential Offering Memorandum (Oakes, Fitzwilliams & Co. S.A., Placement Agent) dated February 12, 1996, p. 20.

<sup>34</sup> Metalclad Corporation Documents in Production response 7(c)A “Project Status, Mexico” report dated June 15, 1994, page 26.

<sup>35</sup> Metalclad Corporation Documents in Production response 7(c)D “Project Status, Mexico” report dated February 1, 1995, page 31.

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**CHICAGO PARTNERS**  
A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

---

processed and confined waste.” By May 31, 1997 the company expects that El Confin will operate at 138,548 tons, above capacity.<sup>36</sup>

**9.16. References to COTERIN’s “full utilization” in Metalclad News Announcements**

- Metalclad expects to generate \$40 million in revenue annually from the plant...the plant will be able to treat 300,000 tons of waste a year. *BBN*, 11/27/95, 2:46pm
- Metalclad said it could handle about 160,000 tons per year with revenues of about \$325 per ton...El Confin currently has one landfill cell completed with a second under construction... The company says it hopes to have the site open to waste shipment at the start of 1996 and that it will take 4-6 months to build up the volume...Metalclad says it has over 250 customers ready to begin waste deliveries to El Confin. *Haznews*, 1/1/96

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<sup>36</sup> Metalclad Corporation Documents in Production response 7(c)D “Project Status, Mexico” report dated February 1, 1995, page 64.

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**CHICAGO PARTNERS**  
A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

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## **10. Claimant's \$20.5 million in "Landfill Development Costs"**

**10.1.** I have been asked to express an opinion with regard to the \$20.5 million total alleged by the Claimant to be alternatively the "direct investment", their "expenditure ...into the Mexican economy for the labor, equipment and materials to construct the landfill", or simply, "the \$20.5 million landfill."<sup>1</sup>

**10.2.** Metalclad's experts, American Appraisal Associates ("AAA"), conclude, or adopt as true, that \$20.5 million represents the purchase price for COTERIN plus the "expenditures for the analysis of the site and the development and construction of the La Pedrera facility as it exists today."<sup>2</sup> AAA goes on to state that "These costs are only the out-of-pocket expenditures by Metalclad incurred in the acquisition, permitting, construction, and subsequent validation of the La Pedrera property's ability to meet or exceed all federal environmental regulations."<sup>3</sup>

**10.3.** Metalclad provided additional schedules supporting the \$20.5 million number in response to requests from the Respondent. These schedules are titled "Landfill Development – Costs Incurred" (totaling \$20.474 million) and "Landfill Losses – 10K Filings" (totaling \$25.531 million.)<sup>4</sup> Metalclad also provided copies of its Mexican and US tax returns for the consolidated entity as well as for COTERIN and ECOPSA.

**10.4.** In addition, Metalclad afforded an associate and myself the opportunity to review documents supporting the \$20.5 million in its offices on February 9, 1998. Metalclad's CFO, Anthony Dabbene, allowed us to freely review the universe of supporting documents contained in a single 12x18 inch banker's box. He also attempted to answer any questions we had regarding the documents or other available support. At the time of

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<sup>1</sup> Metalclad Corporation Memorial dated October 13, 1997 pages 49, 38 and 29.

<sup>2</sup> Report of American Appraisal Associates dated September 26, 1997 pages 74 – 77.

<sup>3</sup> Report of American Appraisal Associates dated September 26, 1997 page 77.

<sup>4</sup> Metalclad Corporation supplemental production labeled 7(a)A and 7(a)B.

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### **CHICAGO PARTNERS**

A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

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this report filing there remain a few outstanding requests to Mr. Dabbene.

**10.5.** Based upon our review of the Metalclad supporting documents (to the extent they exist or have been produced), I conclude that any attempt to portray \$20.5 million as the investment in the La Pedrera landfill (the subject of this Claim) would be incorrect and grossly misleading.

**10.6. Other Firm's Landfill Accounting Difficulties**

**10.7.** While determining the exact investment in a single landfill site would appear a simple task on its face – especially for a very small company like Metalclad – the task is not always so straightforward. Indeed, much larger companies with extensive hazardous waste management experience have encountered difficulties in recording landfill investments.

- In March 1992 Chambers Development Corp. announced that it was revising its 1991 financial results to reflect a change in its accounting with respect to its capitalization of certain costs and expenses. The financial statements were restated to reflect a \$362 million adjustment to both earnings reported since its inception and cumulative retained earnings at December 31, 1991. Operating costs and interest expense, which should have been expensed, had been inappropriately capitalized on landfill projects. Net income previously recorded for 1991, 1990 and 1989 of \$50 million, \$34 million, and \$27 million, respectively was restated to losses of \$(72) million, \$(41) million, and \$(16), respectively. In total over \$1.7 billion of equity market capitalization was lost. Numerous securities class action suits were filed and eventually settled for over \$85 million. Grant Thornton, the auditor eventually dismissed by Metalclad in March 1996 was the Chambers auditor during the relevant period.

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**CHICAGO PARTNERS**  
A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

---

- Following announcements in the fall that it was conducting ongoing reviews of its business operations, Waste Management (WMX) indicated on December 22, 1997 that it expected to record a material fourth quarter 1997 charge against earnings. On January 29, 1998, WMX further announced that it will restate prior period financial results for 1992 through 1997 to reflect previously announced revisions as well as changes in various expenses items related to its accounting for fixed asset and landfill costs. Arthur Anderson was the Waste Management auditor during the apparently relevant period. Various class action law suits have been filed against the company.

#### **10.8. Errors and Inconsistencies in Metalclad's Schedules**

**10.9.** On their face the Metalclad \$20.5 million schedules include patently inappropriate items such as expenditures made before La Pedrera was acquired. As a result these schedules fail to provide a reasonable estimate of the La Pedrera investment.

**10.10.** The COTERIN acquisition closed on October 7, 1993.<sup>5</sup> Prior to October 7, 1993, Metalclad's Mexican hazardous waste treatment business consisted of ECO, DIV, ECI—all formed to pursue the ownership, development, and operation of hazardous waste treatment facilities in Santa Maria del Rio, Veracruz and Tamaulipas. All of Metalclad's expenditures prior to the 1993 acquisition of COTERIN, therefore, would be associated with ECO, DIV, and ECI and their sites rather than COTERIN or its landfill. Claimant incorrectly includes more than \$7 million in expenditures in its calculations for fiscal period prior to October 1993.

**10.11.** Claimant's schedule 7(a)B is not consistent with its "restated" Form 10-Ks for the years ended May 1995 and May 1994. As a result, schedule 7(a)B overstates "landfill loss" by more than \$5 million. Metalclad reclassified some costs to "Corporate Expense"

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<sup>5</sup> Metalclad Corporation Form 8-K dated October 7, 1993.

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## **CHICAGO PARTNERS**

A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

---

which it previously classified as "Landfill" for fiscal years ending May 1996, May 1995, and May 1994. The "Landfill" operating losses were restated substantially downward from \$5,449,289, and \$3,832,294 to \$675,997 and \$2,899,589 for 1995 and 1994 respectively.

**10.12.** In addition, the restated losses for "Landfill" reported in Metalclad's Form 10-K filings include all landfill related costs – "Landfill costs are those costs associated with the development and general and maintenance of facilities in Mexico, including the opening of the landfill in San Luis Potosi."<sup>6</sup> Costs associated with landfill activities other than COTERIN have been significant as is evidenced by the more than \$7 million for time periods before Metalclad purchased COTERIN.

**10.13. Support for the \$20.5 million in Metalclad's bankers box of documents**

**10.14.** The Metalclad bankers box consisted of 11 manila file folders containing copies of handwritten or computer spreadsheet schedules summarizing certain individual disbursements or wire transfers. Certain handwritten schedules tied to the 7(a)A and AAA exhibits. However, there was no complete detail listing of all the expenditures included in the \$20.5 million total. Also missing were any proofs of disbursement (check or wire transfer copies) as well as the majority of the related invoices. Certain invoice copies were included – apparently produced a number of years ago at the request of an Arthur Andersen auditor.

**10.15.** As discussed in this section and referenced in numerous other footnotes throughout this report, the nature of expenditures included in the \$20.5 million total extend well beyond the La Pedrera landfill including (as a sample and in no specific order):

- Reimbursement of Kesler's car phone,

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**CHICAGO PARTNERS**  
A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

---

- Extensive travel & entertainment expenses of all Metalclad officers,
- Gross wire transfers (some totalling \$100,000) to Mexican law firms or the Mexican affiliates often with no detail explanation (primarily the affiliate transfers) beyond monthly draw amounts,
- A Renaissance Partners Inc invoice (October 24, 1994) for a fairness opinion related to the Quimica Omega acquisition,
- Commission to Dickinson & Company for CSD sales,
- Donations to Mississippi State University Center for International Security,
- Full allocation (through 1993) and, thereafter, partial allocation of Metalclad's officer's compensation,
- Extensive consulting and legal fees (although legal fees are allocated between the Mexican operations and Metalclad corporate in later years),
- Expense reimbursement for Chesapeake travel expenses (a related party paid a success fee for arranging the short-lived BFI-Omega joint venture),
- Payments ( one noted for \$20,000) to personal consultants "working with" the Metalclad convertible securities holders at the behest of Elgin Williams,
- Oakes Fitzwilliams' expense reimbursement related to Metalclad's December 1993 private placement,
- A finders fee for the CVD loan (see extended discussion in Section 7),
- Consulting fees to Elgin Williams apparently for daily service as a

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<sup>6</sup> Metalclad Corporation Form 10-K for the fiscal year ended December 31, 1996, page 20.

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**CHICAGO PARTNERS**  
A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

---

spokesperson, and

- Allocated portions of Metalclad's accounting firms fees.

**10.16. Metalclad's Schedule M Items:** The primary purpose of the schedules contained in the Metalclad \$20.5 million bankers box appears to have been the yearly review and allocation of expenses which would be deducted (as expenses) on the company's financial statements but which for one reason or another would not qualify for deduction on the company's tax return. Such items (expenses or income recorded on a firm's financial statements, but not allowed for tax purposes) constitute Schedule M items on the firms Form 1120 tax return. Cumulatively for the period 1991 through 1996 (the returns provided by Metalclad), Metalclad's Schedule M expense items (expenses on the books, but not on the return) total \$12.5 million.<sup>7</sup>

**10.17.** As a result of the widespread nature of expenditures included, the lack of a comprehensive list, the lack of underlying invoices, and the lack of evidence of actual disbursement, the Metalclad \$20.5 million bankers box of documents fails to provide the basis for a reasonable estimate of the La Pedrera investment.

**10.18.** The best estimate of Metalclad's investment in the La Pedrera landfill would be the audited property, plant and equipment balance for all Metalclad's hazardous waste treatment facilities as disclosed in its 10-K filings (\$3.875 million) LESS amounts in that total attributable to Metalclad's other non-La Pedrera developmental sites (including Santa Maria del Rio, Veracruz, Tamaulipas and the Tarango water treatment pilot). Metalclad's SEC filings and the \$20.5 million banker's box indicated at least \$650,000 had been invested in the acquisition of land at Santa Maria del Rio and Veracruz.<sup>8</sup> Subtracting only these known non-La Pedrera expenditures from the December 1996

<sup>7</sup> Metalclad Corporation IRS Form 1120 Schedule M-1's for 1991 (\$409,259); 1992 (\$3,398,550), 1993 (\$57,837), 1994 (\$710,929), 1995 (\$6,899,809), and 1996 (\$1,012,018).

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**CHICAGO PARTNERS**  
A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

---

balance of \$3.875 million<sup>9</sup> yields an estimate of the La Pedrera investment of \$3.225 million.

10.19. The \$3.225 million estimate is most likely too high given (1) the number of other developmental projects Metalclad cites in its public filings and news announcements as well as (2) the IRS examination results disallowing (and capitalizing) \$1.227 million in Metalclad expenditures.<sup>10</sup> To the extent any of the \$1.227 million 1993 IRS adjustment is included in the \$3.875 million audited hazardous waste treatment facility balance AND to the extent that it relates to non-La Pedrera (acquired September 1993) expenditures, then that portion should also be subtracted from the \$3.225 million estimate.

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<sup>8</sup> Metalclad Corporation SEC Form 10-K December 31, 1991 page 10 (\$650,000) and Metalclad documents produced in support of \$20.5 million alleged landfill costs (\$550,000 – 1991 & 1992 payments).

<sup>9</sup> Metalclad Corporation SEC Form 10-K December 31, 1996 Footnote E page F-16.

<sup>10</sup> Internal Revenue Service Income Tax Examination Changes Form 4549-CS provided as support for the \$20.5 million alleged landfill costs.

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**CHICAGO PARTNERS**  
A LIMITED LIABILITY COMPANY

---

Expert Report of Kevin Dages  
Metalclad Corporation, Claimant vs. United Mexican States, Respondent

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