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Xethanol Corp.

by Christopher Carey

Xethanol Corp. bills itself as a biotechnology-driven ethanol company that can turn wood chips, corn stalks and paper sludge into cheap alternative fuel.

But a Sharesleuth.com investigation found no evidence that Xethanol (XNL: AMEX) has produced significant quantities of ethanol from those raw materials. Combine that with Xethanol's [announcement](#) that it's poised to become one of the first companies to commercialize that technology – a sort of Holy Grail in the renewable-energy world – and you've got the type of inconsistency that Sharesleuth seeks to uncover with its stories.

When Sharesleuth identifies what might be considered corporate misdirection, we take a deeper look at the company, its history, its business and the people behind it.

At Xethanol, we discovered that the shareholders whose names appeared in the company's SEC filings over the past year and a half included no fewer than eight current or former stock brokers who have been the subjects of disciplinary actions by the Securities and Exchange Commission, the National Association of Securities Dealers or other regulatory bodies.

One of the five biggest shareholders in Xethanol when it went public last year was William Scott Smith, who was [charged by the SEC in 1995](#) with defrauding investors in a Denver-based shell company called Melbourne Capital Corp. The SEC said that Smith installed his nephew and two friends as officers and directors of Melbourne Capital, and that the group -- at Smith's direction -- misused or misappropriated 70 percent of the \$246,000 that the company raised from investors. The onetime stockbroker settled the charges in 1996, without admitting or denying guilt. The SEC assessed \$256,000 in financial penalties and barred Smith from serving as an officer or director of any public company.

Xethanol's SEC filings refer to him as W. Scott Smith and do not mention his past. We confirmed that he was the same person by comparing address records, birthdates, Social Security numbers and other identifying information.

Sharesleuth noted in its investigation that Christopher d'Arnaud-Taylor, Xethanol's chairman and chief executive officer, claims to have gained "global senior corporate executive experience with multinationals including Unilever, Reed Elsevier, Northrop Grumman and TKM Trading." Two of those companies -- Reed Elsevier and Northrop Grumman -- said they could find no information confirming his employment, in any capacity.

Sharesleuth also learned that one of Xethanol's two conventional ethanol plants, a facility it once called its Biomass Technology Center, has been idle for more than a year and no longer has water or sewer service -- two prerequisites for testing or production.

Other things that caught our attention include:

- The company's minimal spending on research and development.
- An absence of scientists on its staff.
- The relatively low price it paid for the outside technology upon which its waste-to-ethanol dreams are based.
- Key alliances with two companies founded by the same person -- a former stock broker who now functions as a financial consultant and promotor.

## A SHARED HISTORY

Smith's ownership stake in Xethanol was not happenstance.

[Florida corporation filings](#) list D'Arnaud-Taylor and Smith as officers of London Manhattan Limited Inc., the company that provided executive-management services to Xethanol from September 2001 to January 2005. The filings list d'Arnaud-Taylor as president of London Manhattan They list Smith as vice president and Franz A. Skryanz, another Xethanol officer, as secretary and treasurer.

Sharesleuth uncovered a second connection between d'Arnaud-Taylor and Smith dating back to 1996. Their names appeared together in a suit filed by a New York doctor who claimed he was defrauded of \$30,000. The doctor alleged that d'Arnaud-Taylor and Smith participated in a scheme to extract an up-front fee for business financing that was promised but never materialized. The doctor dropped his suit in favor of settlement negotiations. But d'Arnaud-Taylor's three co-defendants later wound up in prison -- two for advance-fee loan frauds and one for laundering money for a drug ring.

Sharesleuth found that d'Arnaud-Taylor was more recently a partner in two business ventures with Andrew Kimmins, a former British brokerage executive who served prison time for fraud in the 1990s. One of those companies, or its shareholders, had an early stake in Xethanol.

It's possible that d'Arnaud-Taylor just bragged a little on his resume and has picked the wrong people to do business with. Sharesleuth readers should use their own judgment.

## A SLOW START AND A FAST RISE

Xethanol entered the ethanol business in 2003, buying a small plant in Hopkinton, Iowa, that was using waste water from candy companies as the source of sugars it fermented into ethanol. It bought a second plant, in Blairstown, Iowa, out of bankruptcy in October 2004. The two operations have a combined capacity of 7.1 million gallons a year and are designed to make fuel from corn and other high-starch or high-sugar feedstocks.

Xethanol went public in February 2005 through a reverse merger with a moribund pottery business whose shares traded on the Over-the-Counter market. Its stock performance was unremarkable until early this year, when its shares rose sevenfold. Xethanol climbed from a low of \$2.30 in January to a high of \$16.18 in April, riding a surge of investor interest in ethanol producers and a steady wave of press releases about new deals and developments.

Xethanol's trading volume was amplified by a financing deal that called for Fusion Capital Fund II of Chicago to buy \$40,000 of stock a day, provided that the company's shares remained at or above certain price levels. The deal also allowed Fusion to quickly sell the shares it purchased.

According to Xethanol's SEC filings, Fusion Capital bought 1.89 million shares between Jan. 3 and April 30. Fusion paid \$9.85 million, or an average of \$5.20 a share. Xethanol's stock hit its peak of \$16.18 in interday trading on April 18, which also was the highest volume day.

While Fusion Capital was buying, D'Arnaud-Taylor and his wife were selling. He filed SEC disclosure forms covering 125,000 shares of Xethanol stock held by his spouse. The filings listed sales between Feb. 21 and April 12 and estimated proceeds of \$1.37 million. D'Arnaud-Taylor and his wife still control roughly 1.5 million shares, excluding options, with a current market value of \$10.4 million

Jeffrey S. Langberg, described by Xethanol as an independent investment banker who has advised d'Arnaud-Taylor since 1999, reported the sale of \$1.41 million in stock from February through April.. His filings said the shares were held by his spouse. Langberg has been a Xethanol consultant and, until June 12, a member of its board of directors

Xethanol's stock has skidded over the past three months, and closed at \$6.95 a share on Friday. Trading volume also has declined, despite a move in June to the American Stock Exchange. Xethanol still has a market capitalization of more than \$180 million.

*(Disclosure: Mark Cuban, the majority member of Sharesleuth.com LLC, sold short 10,000 shares of Xethanol's stock at a time when the price was around \$12.65. Cuban also has sold short about 25,000 shares of UTEK Corp.(UTK: AMEX), a Florida company that is a large Xethanol shareholder.)*

## XETHANOL'S STRATEGY

Xethanol says its long-term strategy is built around the promise of producing ethanol from cellulosic "biomass." Advocates of that approach say it is less expensive and less energy-intensive than using corn and other grain products as a feedstock.

Detractors say cellulosic ethanol has yet to prove economically feasible, despite three decades of trying.

"Sometimes I compare the difference between ethanol from corn and ethanol from cellulose as the difference between traveling to the moon and traveling to Mars," said Robert Rapier, a chemical engineer who works in the petroleum industry and has done research on alternative fuels. "We have traveled to the moon several times, and while not cheap, the feasibility has been demonstrated. There is no doubt that we could travel to Mars, just like we can make cellulosic ethanol, but the costs of both are prohibitive, and the barriers to commercialization are huge."

Xethanol said July 20 it would proceed with plans to convert a former pharmaceutical plant in Augusta, Ga., to produce ethanol from biomass. It said the operation would open in mid-2007 and have a capacity of 50 million gallons a year.

That announcement came as a surprise to officials at Iogen Corp. The Canadian company operates the only plant in North America that produces large quantities of ethanol from cellulose, and that operation still is in the demonstration phase. Iogen does not expect to complete its first commercial plant, a 50-million-gallon facility with a projected cost of \$300 million, until 2008.

Iogen has major financial backing from Royal Dutch/Shell Group, Petro-Canada, the Canadian government and Goldman Sachs & Co. It has spent tens of millions of dollars on research and development to move its project forward.

Xethanol did not say how much it expects its plant to cost, or how it would finance the project.

Xethanol's plan to open a commercial cellulosic ethanol plant within a year seems overly ambitious to Spencer Kelly, ethanol analyst for the Oil Price Information in Rockville, Md.

"Nobody else does it," Kelly said. "It's still basically experimental."

Xethanol has also announced that it will expand its operation in Blairstown, adding a corn-to-ethanol plant with an annual capacity of 35 million gallons. It plans to convert the original plant to produce cellulosic ethanol.

Xethanol is not without resources in its bid to diversify and grow. It raised roughly \$34 million in equity capital in April, including \$4 million from Goldman Sachs, which has been investing in ethanol ventures. And Xethanol says it has enlisted PRAJ Industries Ltd., an Indian company that designs and builds distilleries and ethanol plants, to work on its new projects in Georgia and Iowa. Although PRAJ has begun exploring the cellulosic ethanol business, it has no demonstrated expertise.

## TRICKY SCIENCE

Although the vision of biomass as an abundant, low-cost source of alternative energy is alluring, scientists have struggled for years to find an efficient and economical way to break down its cellulose fibers into usable components.

"The proponents always downplay the challenges, and just presume they will be solved," said Rapier, who writes about ethanol issues on his blog, [R-Squared](#). "They seem to think they can just legislate their way to commercial viability. That hasn't worked with hydrogen, and I don't believe it will work with cellulosic ethanol."

It is not Sharesleuth's job to evaluate whether the technology that Xethanol has chosen will work. In the scientific debate over ethanol, just as in all debates, it's easy to find "experts" on both sides. But it *is* our job to find examples of activity that could lead Xethanol to success. The aforementioned logen has published and demonstrated its progress. We have been unable to find any comparable announcements by Xethanol, or any outside individuals aware of the progress that Xethanol has made towards producing cellulosic ethanol.

Sharesleuth asked the company whether it had created any test batches and, if so, where the tests were conducted and what the company used as a feedstock. Xethanol declined to answer.

"All of the information that you requested is confidential and proprietary information relating to our research and development," the company said in a written response.

Xethanol does not have a chemist or scientist among its top executives, nor has it been granted patents on any internally developed technology for processing cellulosic feedstocks or converting them into ethanol. The company's SEC filings say that the company spent less than \$240,000 on research and development in the two years that ended Dec. 31. The company has augmented that work by licensing a variety of technological applications developed mainly by government and university laboratories. Here is how the company described its approach in its most recent annual filing with the SEC:

"Our objectives are to access a continual stream of diverse advanced technologies from academic and other research organizations, on a worldwide basis, rather than be captive to any one particular technology platform."

Xethanol did five such deals with UTEK Corp., a Florida company that specializes in identifying potentially useful technologies, licensing them, and then placing them with potential users -- typically in exchange for stock in the company. Xethanol issued 1.34 million shares to UTEK between June 2004 and June 2006 to acquire the rights to the technologies.

The value of that stock amounts to a fraction of the money spent by logen in its bid to discover an economically viable way to produce cellulosic ethanol.

UTEK filed forms with the SEC last month covering the planned sale of 786,123 of its Xethanol shares, with an estimated value of \$6.23 million.

## TESTING?

Many of Xethanol's recent press releases say that the company's biotechnology is "currently deployed" at its two Iowa facilities. The company has characterized its plant in Hopkinton, Iowa as a testbed for evaluating potential feedstocks and technologies.

But that statement directly contradicts the company's SEC filings, which note that the plant in Hopkinton suspended production in April 2005. When we paid a visit to the operation June 30, we found the doors locked, the building dark and no employees present. A large filtration unit sat on a grassy patch outside the plant, and an air system serving the building was in obvious disrepair

D'arnaud-Taylor said in an interview with The Wall Street Transcript in March that the Hopkinton plant was being refurbished "as we speak." But we saw no signs of improvements, and Xethanol's SEC filings show that capital expenditures in the first quarter were just \$38,000.

Last week, a Hopkinton city official said plans to make the plant a test facility apparently had fallen by the wayside, adding that no public utility services were being provided to the building and no Xethanol employees worked there on a regular basis.

## PREVIOUS QUESTIONS

Xethanol says the ability to turn waste from factories and farms into ethanol has multiple benefits. First, the company can locate its plants close to the sources of waste, saving on transportation costs. Second, the waste producers might be willing to offer Xethanol an attractive price, or even pay the company to take the material off their hands. Third, by targeting locations in the Southeast, Northeast and, eventually, the West – it will have plants where ethanol demand is greatest.

D'arnaud-Taylor has projected that Xethanol will be producing 300 million to 400 million gallons of cellulosic ethanol a year by the spring of 2009.

For the moment, however, Xethanol is a conventional ethanol producer. And even at full output, its Blairstown plant produces just 6.6 million gallons of ethanol a year from corn. The company had \$4.3 million in revenue in 2005, and posted an \$11.4 million loss.

## A MEDIA QUESTION GETS A QUESTIONABLE RESPONSE

A financial analyst writing for MotleyFool.com suggested last month that Xethanol went public in a bid to exploit investor excitement about ethanol. The writer cited the company's unusual history, which included a flurry of name and business changes (from FreeReal-TimeQuote.com to LondonManhattan.com Inc. to Xethanol) in the five years before the reverse merger.

Xethanol responded with a press release calling the article inaccurate and misleading. D'Arnaud-Taylor said that the company had been focused on the ethanol business since 2001. He defended the reverse merger, with Denver-based Zen Pottery Equipment Inc., as a legitimate means to get its stock on the public market.

"None of Xethanol's management were involved with Zen or its businesses and none of Zen's management or owners are involved with Xethanol," he said in the release.

SEC filings, however, show that Zen's treasurer and chief financial officer, Walter C. Nathan, wound up with 383,333 Xethanol shares immediately after the reverse merger.

Another group of Zen shareholders, headed by Lawrence M. Underwood, emerged with 138,974 Xethanol shares.

Nathan was described in Zen's SEC filings as a Denver insurance salesman and former real estate developer. Sharesleuth has looked deeper into his past and identified him as an ex-stockbroker, who was charged by the NASD in 1987 after two of his clients said they were guaranteed against loss as an inducement to invest \$100,000 in two penny stocks. When the value of the shares fell and the men asked for the return of their money, they were rebuffed. The NASD fined Nathan \$5,000 and suspended from association with any member firm for 60 days.

Underwood, too, is a former Denver stockbroker. He was charged by the NASD in 1986 with violating the rules of fair practice by charging excessive markups. He was censured, fined and ordered to disgorge \$10,000; however, the SEC set aside the order after Underwood appealed.

Other early Xethanol shareholders with past regulatory actions include:

**Stanley C. Brooks**, chairman of Brookstreet Securities Corp. in Irvine, Calif. Brooks has a long history of fines and disciplinary actions by the NASD and state regulators.

In January, he settled compliance-related charges the NASD brought against him and an affiliated brokerage, First Securities USA Inc. Brooks did not admit or deny guilt, but agreed to a two-year ban on serving in any supervisory capacity with any member firm.

Xethanol filed a registration statement with the SEC last year listing Brookstreet with 100,000 shares. The filing said Brooks had voting and disposition power over the shares. Brooks' personal website says he and his wife are the sole owners of Brookstreet.

**Russell W. Newton**, chief financial officer of Source Capital Group Inc. in Westport, Conn.

The NASD imposed a \$180,000 fine against Newton and a previous firm, Merit Capital Associates Inc., in 1999 for using brokers known to have been barred from the industry. The industry group also suspended Newton for 30 days and ordered him to retake a qualifying exam.

Newton was Merit's chairman. A joint investigation by the NASD and the State of Connecticut found that Newton, on behalf of Merit, paid \$167,500 to people who were disqualified from working as registered brokers. The investigation also found that Merit representatives in one branch office used sales scripts that were materially misleading and made exaggerated and unwarranted claims.

The Utah Division of Securities brought additional charges against Newton and Merit Capital in 2001, alleging the sale of unregistered securities, sales by unlicensed agents, failure to supervise and securities fraud. Newton settled the charges without admitting or denying guilt. He and Merit were assessed a joint fine of \$25,000.

According to Xethanol's SEC filings after the reverse merger, Newton owned 94,639 shares and had options on an additional 12,187 shares.

**Marc K. Swickle** and **Howard B. Berger**, co-founders of Professional Traders Fund LLC.

The Washington Division of Securities filed a complaint in February against Swickle, Berger and Professional Traders Fund, alleging that they sold unregistered securities to residents of that state. The agency said it intended to issue a cease and desist order against the men and the firm. Swickle and Berger have asked for a hearing, so the order remains pending.

Berger settled NASD charges in 2000 related to the alleged "flipping" of shares in the initial public offering of a penny-stock company.

The complaint charged that he and at least one other person at his brokerage placed more than 15 percent of the IPO shares with clients, with the understanding that the firm would buy them back immediately after the offering. The NASD also charged that Berger failed to take steps to prevent unregistered individuals from selling securities for his firm, or failed to register them.

Berger agreed to pay a \$20,000 fine. He was suspended from working in a supervisory capacity for any NASD member firm for two years and suspended from working in any capacity for 120 days.

According to Xethanol's SEC filings after the reverse merger, Professional Traders Fund held 46,153 shares.

Xethanol declined to say how it raised money from investors when it was a private company, or whether a particular company or individual acted as placement agent for the shares.

"The information concerning its initial funding is confidential information of both the Company and its initial investors and not relevant to those who now invest or own shares in the Company today," it said. "We have

provided, and continue to provide, complete and accurate financial information as required by applicable SEC regulations.”

Nor would the company say how William Scott Smith, who is 76, wound up as one of Xethanol’s largest shareholders.

“Mr. Smith’s transactions and relationship with the Company (other than as a shareholder) predated our becoming a publicly traded company,” Xethanol said. “The relevant information regarding his relationship with the Company is disclosed in our filings with the SEC.”

It was impossible to tell from Xethanol’s filings which early shareholders invested in the company before it went public, and which bought shares in a private placement that accompanied the reverse merger.

Smith reported owning 972,414 shares of Xethanol in an SEC filing in February 2005. At the time, that stake amounted to 7.3 percent of the company. Those shares would be worth \$6.76 million at Friday’s closing price.

Smith’s holdings excluded 338,115 additional shares held in the name of Therese Roos, with whom he has shared addresses in Delray Beach, Fla., and Westhampton, N.Y.

One of Smith’s co-defendants in the old SEC fraud case also appeared on the list of early Xethanol shareholders. A registration statement in October 2005 shows Anthony Skulski holding 2,648 shares. An additional 1,766 shares were held in the names of Skulski’s two young children. Like Smith, Skulski settled the SEC charges without admitting or denying guilt. He agreed to pay \$4,402 and commit no future violations of securities laws.

Xethanol declined to discuss d’Arnaud-Taylor’s relationship with Smith.

## **INTERNATIONAL MAN OF MYSTERY**

D’arnaud-Taylor’s biography describes him as an international merchant banker, entrepreneur and turnaround specialist who has managed the strategy, operations and financial affairs of companies on four continents.

But a string of lawsuits stretching from Washington, D.C. to New York and Phoenix paint a somewhat different picture of Xethanol’s 60-year-old CEO, whose father was a British diplomat.

In 1992, two of d’Arnaud-Taylor’s partners in a financial-services firm called London Manhattan Co. sued him in federal court in Washington. The partners claimed that he and another member of the firm, James V. Hackney, were soliciting money for a private investment fund without their knowledge. The suit also said d’Arnaud-Taylor and Hackney engaged in other activities that were beyond the scope of London Manhattan’s business. The court file included complaint letters from companies that said they paid d’Arnaud-Taylor a retainer to secure capital but had not received funding nor collected a refund.

The partners in London Manhattan settled their litigation and parted ways. The two who sued kept the company’s original name, while d’Arnaud-Taylor and Hackney operated under several variations, including London Manhattan Ltd. and London Manhattan Communications.

The original London Manhattan Co., now based in South Carolina, has no connection to Xethanol or d’Arnaud-Taylor.

Hackney was indicted on four counts of mail fraud in 1998. Authorities said he solicited investment capital from friends and relatives, including his father-in-law, but used the money for his personal use. He was convicted and sentenced to 41 months in prison. Hackney committed his crimes in late 1995 and early 1996, a time when he was still a partner in London Manhattan Communications, according to descriptions of that firm contained in a pair of SEC filings from that period.

The New York doctor who sued d'Arnaud-Taylor and three other men alleged that, in late 1996, d'Arnaud-Taylor posed as someone who was interested in backing him in a medical-management business. The doctor claimed that the people who were supposed to be arranging the financing – Bruce W. Kitchen and Brian Cook – held out d'Arnaud Taylor and another man, Franco Nocito, as verified sources of funding simply to beat a deadline that would have triggered a refund of the doctor's \$30,000 retainer. The suit said that William Scott Smith attended the same meeting and misrepresented himself as a willing source of money.

At the time, Kitchen was already facing charges in Florida in connection with an advance-free loan scheme, and was on probation in New York for running a fraudulent car-leasing operation. Nocito had been caught delivering drug cash in 1992 and agreed to cooperate with authorities. He was indicted on under seal on money-laundering charges in 1994, and was arrested and arraigned in August 1996. Smith had just settled his case with the SEC.

Kitchen eventually struck a plea bargain in the Florida case. He also pleaded guilty in a federal fraud case in New York in 2000. Those charges grew out of his activities at the financial-services company that was the focus of the doctor's suit. Kitchen was sentenced to 50 months in prison and was ordered to pay \$4.27 million in restitution. Cook also pleaded guilty in the New York case. He was sentenced to 18 months in prison and was ordered to pay \$2.18 million in restitution.

Nocito pleaded guilty in his money-laundering case, acknowledging in his plea agreement that he had delivered \$4.6 million in drug cash.

## RESUME QUESTIONS

D'Arnaud-Taylor's biography says he worked as an executive for several large corporations. Sharesleuth searched old newspaper and magazine articles, Who's Who guides and other archived material and was unable to find any references to him serving in those positions.

An article in Inc. magazine in 1983 identified him as president of Boles & Co., a trading company in San Francisco. It made no mention of previous executive positions at Unilever, Reed Elsevier or Northrop Grumman. Nor did his marriage announcement in the New York Times that same year.

Sharesleuth has accounted for d'Arnaud-Taylor's career moves since then, and none took him to any of those companies. So, for the claims in Xethanol's SEC filings to be true, d'Arnaud-Taylor's would have needed to make his way through the executive ranks of all of those companies by age 37.

Reed Elsevier said its pension and payroll records turned up no trace of d'Arnaud-Taylor or Christopher Taylor, as he sometimes called himself. Northrop Grumman said its human-resources department was unable to verify that d'Arnaud-Taylor had worked for the defense contractor or any of the "heritage" companies it acquired through mergers and acquisitions. Northrop Grumman noted, however, that it could not say with absolute certainty that d'Arnaud-Taylor never worked for the company.

Xethanol declined to provide d'Arnaud-Taylor's titles or dates of service at the firms.

The first mention of d'Arnaud-Taylor's purported positions with those companies appears in a 1996 SEC filing for Continental Orinoco Co., a penny-stock company that was pursuing a minerals venture in Venezuela. D'Arnaud-Taylor was the firm's chairman and investor relations contact.

SEC filings show that in July 1996, Continental Orinoco hired a onetime broker named Cary Cimino as a management consultant. D'Arnaud-Taylor signed the agreement, which called for Cimino to receive 1 million shares of Continental Orinoco stock to advise the company on everything from management and marketing to strategic planning, international activities and shareholder relations.

Less than three months later, Cimino was one of 45 people arrested as part of a nationwide sting aimed at cracking down on bribes to stockbrokers. The FBI, which set up a mock brokerage firm as a front for its investigation, alleged that Cimino offered payoffs to its brokers as an inducement to sell 45,000 shares of

Continental Orinoco's stock. The FBI, which taped the conversations, said Cimino offered to pay brokers 40 percent of the transaction price in stock, or 35 percent in cash. Authorities said he followed through on the offer by transferring shares to an account controlled by undercover agents. Although others involved in the scheme were indicted by a federal grand jury, the charges against Cimino were dismissed with little explanation. He was arrested in an even bigger crackdown in 2000, and was charged with offenses that included bribing brokers and soliciting the murder of a person he thought was cooperating with authorities. He pleaded guilty and was sentenced to 10 years in prison.

## **SMALL WORLD**

SEC filings, corporate records and other documents reviewed by Sharesleuth show that d'Arnaud-Taylor has a pattern of doing business deals with a familiar circle of associates.

D'Arnaud-Taylor's biography says he was president of Findex.com, a developer of religious software, when it went public through a reverse merger in 2000. The person who took over as that company's chairman after the deal was Benjamin Marcovitch.

In August 2003, Xethanol signed a partnership agreement with DDS Technologies USA Inc., a small, publicly traded company in Boca Raton, Fla. The joint-venture deal called for Xethanol's plant in Hopkinton, Iowa, to install DDS Technologies' "revolutionary" equipment for separating agricultural products and biomass into substances that can be converted into ethanol and other byproducts.

SEC filings for DDS show that the company's chairman and chief executive at the time of the deal was none other than Benjamin Marcovitch. The filings also identify another of the company's co-founders as Lee S. Rosen, a former stock broker whose license was suspended by the NASD from October 1998 to April 2001 because of his failure to pay an arbitration award to a former employer.

Xethanol and DDS said in a press release that they expected to process 40 tons of biomass a day at the Hopkinton plant, starting in early 2004, and that the sale of end products would generate \$5 million in annual operating profits. By October 2004, the deal between Xethanol and DDS had devolved into a federal lawsuit, with DDS claiming in its filings that Xethanol refused to pay for the first of four units and refused to give it back. Xethanol claimed the equipment did not work as advertised.

The two companies announced last fall that they had settled their differences. DDS got its system back, while Xethanol agreed to buy a new and improved version for its Blairstown plant. The companies also agreed that Xethanol would be the exclusive marketer of the equipment to the U.S. ethanol industry.

Xethanol said the original units did not perform as well as expected because of calibration issues. The company added that it entered into a new deal with DDS because it thought the improved version would give it a competitive advantage, and because it wanted to preclude rivals from getting the systems.

## **HELLO AGAIN**

In April, Xethanol entered into a partnership with H2Diesel Inc., a new company headed by Rosen.

H2Diesel had been incorporated seven weeks earlier. It says it has the North American, Latin American, Caribbean and African license for a proprietary additive used in making biodiesel fuel. In a convoluted deal, two investment funds with stakes in Xethanol bought 3.25 million shares of H2Diesel's stock for \$2 million. H2Diesel issued an additional 2.6 million shares to Xethanol, which in turn agreed to manage H2Diesel's business.

The deal gave the investment funds, Crestview Capital Master LLC and Toibb Investment LLC, the right to sell their H2Diesel shares to Xethanol in exchange for 500,000 shares of Xethanol stock. They exercised that right in April, shortly after the agreement was signed. In the end, the investment funds put in \$2 million and got Xethanol stock that Xethanol valued at \$5.4 million. Those shares were still worth \$3.47 million at the end of last week.

Xethanol said in a recent SEC filing that the additional shares it received in the swap brought its ownership stake in H2Diesel to 45 percent.

Xethanol said it did the deal with Rosen and H2Diesel to gain access to potentially valuable technology.

"While Mr. Rosen is involved in H2Diesel, our transaction was not with him individually," the company said. "Rather, it involved our obtaining a license to certain technology to which H2Diesel, which was founded by Mr. Rosen, had procured certain rights and our making an investment in H2Diesel. We believe that technology will be valuable to us in our ongoing business."

## NEW PARTNERS

Xethanol has a joint venture agreement with Coastal Energy Development Inc., a newly formed company in Savannah, Ga., to develop its ethanol plant in Augusta, as well as additional plants. The agreement calls for Coastal to locate sites and secure funding for the plants.

Coastal Energy's president is Chandler Hadlock, a 30-year-old West Point graduate who has spent most of his adult life in the military. According to a story that appeared in January in the Atlanta Business Chronicle, Coastal Energy and Xethanol are getting help in the funding search from Epiphany Partners Inc., described as a Savannah-based merchant bank.

[Florida corporation records](#) show that two of the founders of Epiphany Partners were previously involved in a separate venture with d'Arnaud-Taylor and Kimmins, the former British brokerage boss. The records, for a company called Trafalgar Resources Inc., listed Taylor as chairman and Kimmins as chief operating officer.

Delaware franchise tax records also link d'Arnaud-Taylor and Kimmins at a company called Xeminex Inc. Kimmins was listed as Xeminex's president in a filing on Feb. 25, 2005, just a few weeks after Xethanol completed its reverse merger. Although he did not claim them at that time, d'Arnaud-Taylor later reported beneficial ownership of 426,588 Xethanol shares held by Xeminex. He said in an SEC filing that the shares were contributed through a settlement among the shareholders of Xeminex.

One of the founders of Epiphany Partners, John J. Murphy Jr., appears in the Florida corporation filings for London Manhattan Limited Inc., the company that provided management services to Xethanol. A document in April 2002 lists him as a director of the company, with William Scott Smith as president.

Xethanol has also created a joint venture to pursue ethanol plants in New England. The company it is working with there is run by a longtime gambling promoter, a political lobbyist and a former executive with an independent electricity producer.

Xethanol is counting on its joint venture partners to raise the money needed for its new plants. Here's how d'Arnaud-Taylor described Xethanol's approach to local alliances in his interview with the Wall Street Transcript:

"Especially down in southeast Georgia, Florida and in the Carolinas we are developing a regional alliance platform with people who have local political access, local real estate knowledge and expertise, and who basically can access the local capital market. We see this business as a very local business. It's not a national business, it is local; for example, is it only people who live in Savannah who understand how to get things done in Savannah."

Xethanol announced today that it has entered into a purchase agreement for the plant in Georgia. Whether that deal works out for the company and its shareholders, we won't presume to say.

These are simply the facts as we know them.

*D'Na Hankins did field research for this report; Julie Armstrong Editing LLC provided fact-checking services*

## AFTERWORD FROM MARK CUBAN

Based on the information that Sharesleuth has uncovered, I have chosen to short shares of this company. My personal approach to investing, and in this case shorting, is very consistent. When there are a lot of individuals with pasts that include sanctions from the SEC, there is a good chance they are up to their old tricks again. Which leads me to want to short the stock.

When a company says they are operating a plant to produce a product, and that plant has no utilities, I want to short that stock.

So I am short 10,000 shares of Xethanol. I would like to short more, but I haven't been able to borrow any more. I am currently in the money on the shares.

I am also short approximately 25,000 shares of UTEK because of its relationship to Xethanol. I have tried to short more, but have been unable to borrow the stock. I am currently underwater on this short.

My intention is not to cover based on any short-term swing in the price of either stock. I will stay short until there is a material change in the operations of either company. My goal is to never have to cover.

As a note, my personal preference is that you not take any investment action based on the information in this report. We are not trying to move the price of the stock. The operations of the company will define the long-term prospects of the companies mentioned.

What we are doing is the nook-and-cranny research that most people are unable or unwilling to do. The process of tying together the little pieces that you find when you visit a plant and talk to local officials, from uncovering information from newspapers that haven't made it onto the Net yet, from making the calls to confirm a resume. Those are the Nth degree of investigation that all investors wish they could do, but can't afford the time or resources to do. It's uncovering this depth of minutiae that can be valuable. Valuable not in the sense that you should trade on this information. Valuable in knowing more information about the people involved, just in case you come across them in your personal business dealings.