

Исх. № EXE/4428



January 28, 2013

VIA HAND DELIVERY



- To: His Excellency, Zhanoro Satybaldiyev, Prime Minister of the Kyrgyz Republic
- To: Ministry of Economics, Chairman State Commission,  
Attention: Mr. T.A. Sariev, Minister
- To: State Inspectorate for Environmental and Technical Safety under KR Government  
Attention: Mr. O. M. Artykbaev, Director

Dear Sirs and Mesdames,

On behalf of Kumtor Operating Company CJSC ("KOC" or "Kumtor"), we acknowledge receipt of the claim No. 09/1499 (the "Claim") dated December 11, 2012 from the State Inspectorate Office for Environmental and Technical Safety under the Kyrgyz Republic Government ("SIETS"). The Claim is in the amount of 6,698,878,290 (Six Billion Six Hundred Ninety Eight Million Eight Hundred Seventy Eight Thousand Two Hundred Ninety) soms. The Claim is for the placement of subgrade ore rock ("Unprocessed Rock"), referred to in the Claim as "Waste Rock", onto glaciers for the period of 2000-2011.

This response is provided further to our notice of appeal to SIETS and the Government of the Kyrgyz Republic ("KR") dated January 4, 2013 (delivered to SIETS on January 8, 2013).

At the outset, we note that the Claim purports to be regarding placement of Unprocessed Rock on glaciers, but in fact relates to the placement of Unprocessed Rock for the entire Kumtor Project and not merely just in relation to glaciers.

Kumtor disagrees with the Claim. In this response, we will discuss four alternative bases for why we believe that this Claim is invalid and therefore must be withdrawn. In particular we submit the following reasons for disputing the Claim (each will be discussed in greater detail below):

1. The issuance of the Claim is invalid as it was based on findings from a SIETS inspection that violated KR legislation.
2. The Restated Investment Agreement among the Government of the Kyrgyz

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Republic (the “Government”) on behalf of the Kyrgyz Republic, Centerra Gold Inc. (“Centerra”), Kumtor Gold Company CJSC (“KGC”), and KOC dated June 6, 2009 (the “Restated Investment Agreement”) governs the activity in question and provides a complete regime of payments to be made directly to the Government. Accordingly no additional fees are payable, even if characterized as a claim for damages or losses.

3. The analysis carried out by SIETS in determining the damages is incorrect as the practice of moving Unprocessed Rock to access ore (solid material with mineral that can be economically extracted) does not generate “Waste” under the KR legislation referred to in the Claim.
4. SIETS, a governmental agency, cannot commence action for the payment requested due to the Release Agreement and Statute of Limitation (as such terms are defined below), and the proper procedure for resolving disputes with respect to the Kumtor Project is expressly provided in the Restated Investment Agreement.

**Basis #1 – The Claim is invalid as it was based on findings from a SIETS inspection that violated KR legislation.**

1. SIETS breached requirements under KR legislation for inspections. The Claim was issued as a result of an inspection conducted by SIETS on August 3, 2012. We note that the following breaches of KR Law #72 “On Procedure for Conducting Inspections of Business Entities” dated May 25, 2007 (the “Law on Inspections”) occurred:
  - a) The inspection was authorized by an approval of the Ministry of Economics dated August 2, 2012 (the “Prescription for Inspection”). The KR legislation governing SIETS and its inspections requires that SIETS provide at least 10 days’ advance notice of the inspection. In this case, the approval of the Ministry of Economics was obtained by SIETS on August 2, 2012 and SIETS undertook the investigation the next day. In doing so, SIETS contravened its own notice obligations under KR legislation by not providing the requisite notice to Kumtor.
  - b) The Prescription for Inspection provided that SIETS could inspect the activity at the Kumtor mine from December 2011 to August 2012. However, SIETS issued a Claim for the disposal of Unprocessed Rock for the period from 2000 to 2011.
  - c) Inspections by SIETS should be conducted in accordance with the quarterly plan to be developed by SIETS and approved by the Ministry of Economy 30 days prior to the next period of inspections. As the Prescription for Inspection referenced the State Commission (which was not formed until July 3<sup>rd</sup>, 2012), and

SIETS carried out the inspection on August 3, 2012, we assume that this inspection was not included in SIETS' quarterly plan. Given that the SIETS inspection was not included in its quarterly plan, the inspection must be considered illegal.

2. SIETS does not have the authority to issue claims. The KR legislation, including Regulation of SIETS #136 dated February 20, 2012, does not provide SIETS with the power to issue such document as a "claim". Therefore, SIETS acted outside of its authority in issuing this Claim. We also note that if SIETS had discovered a violation during its inspection, it is obligated to explain to Kumtor the essence of the violation and issue a written warning requiring it to eliminate the violation within 3 days (if such violation affects the security, life or health of people) or 30 days in other cases.
3. The Purpose of the SIETS investigation was to assist in the State Commission review of Kumtor. The Prescription for Inspection provides that the inspection by SIETS is in furtherance of KR Government Resolution #465 dated July 3, 2012 which established the state commission (the "State Commission") to verify and investigate compliance with the norms and requirements for the rational use of natural resources, environmental protection, operations processes, safety and social protection of the population. The Prescription for Inspection provides for a broad purpose of the inspection, being the inspection of industrial and environmental safety conditions during conducting of mine works on the surface and underground on Kumtor deposit.

The Claim also notes that the SIETS investigation was conducted "...in accordance with the Resolution of the Jogorku Kenesh of the KR No. 2117-U, dated June 27, 2012, "Regarding the report of the temporary parliamentary committee aimed at verifying compliance on the part of Kumtor Operating Company CJSC of the norms and requirements for the rational use of natural resources, environmental protection, safety of operational processes and social protection of inhabitants in the areas of impact of the gold mine and the state of the government oversight", such committee being established on the basis of the Resolution of the Jogorku Kenesh (the "Parliament") #1642-V, dated February 15, 2012, and the Resolution of the Government # 465, dated July 3, 2012, "Regarding the establishment of the State Committee to verify and investigate compliance with the norms and requirements for the rational use of natural resources, environmental protection, operational processes, safety and social protection of the population".

The fact that SIETS inspected not the prescribed period from December 2011 to August 2012 but the period from 2000 also confirms that SIETS acted to assist the State Commission.

We note that under the KR legislation, State inspection of the activities at the Kumtor Project can be conducted only in accordance of the "Law on Inspections" and Regulation #533 "On Procedure of Conducting Inspections of Business

Entities” approved by the Government Resolution on November 6, 2007 (the “Regulation on Inspections”). There are no other legal acts granting a right to State bodies to conduct inspections of business entities. The Law on Inspections does not allow conducting the inspection of Kumtor by the State Commission and Resolutions of Parliament and/or the Government cannot serve as a ground for conducting inspections. Thus, in our opinion the inspection of Kumtor’s activities by the State Commission was carried out through the efforts of SIETS. Therefore, we submit that the SIETS inspection violated current Kyrgyz legal framework, as it was conducted arbitrarily at the instruction of the Parliament and Government.

4. The Government’s action by creating the State Commission and the inspection of the Kumtor Project by SIETS violated the Government’s contractual obligations to treat Centerra, KOC and KGC in a non-discriminatory manner. The creation of the State Commission and the inspection of the Kumtor Project by SIETS (for the purposes of furthering the State Commission) violated Section 6.3 of the Restated Investment Agreement that provides for national treatment and non-discrimination. Among other guarantees provided therein, Section 6.3 of the Restated Investment Agreement provides that Centerra, KGC, and KOC shall, in no event, be subject to legislation that is, either by its terms or in its effect, discriminatory.
5. Non-Discrimination of Foreign Investors is also guaranteed in the KR Investment Law. Discrimination is also prohibited by Article 4 of the KR Law #66 “On Investments in the KR” stipulating that the KR grants foreign investors investing in the territory of the KR, with national treatment and rights equal to those enjoyed by local investors.

**Basis #2 - The Restated Investment Agreement governs the activity in question and provides a complete regime for direct payments to the Kyrgyz Republic. Accordingly no additional fees are payable, even if characterized as a claim for losses.**

1. The Restated Investment Agreement provides a complete regime for direct payments to the Kyrgyz Republic. Section 5.1 of the Restated Investment Agreement expressly provides that except for the payments provided in Article 5 thereof, “the Project Companies [KOC and KGC] shall be exempt from all other present or future Taxes...in respect of the New Tax Regime Activities”. Taxes are defined in Annex 1 (Definitions) of the Restated Investment Agreement as:  
“...means taxes, duties, rates, royalties, withholding obligations, deductions or other governmental charges whatsoever, however characterized, and whether assessed by the Kyrgyz Republic or by any national, regional, municipal, local or administrative instrumentality of the Kyrgyz Republic”.
2. The handling of Unprocessed Rock as part of the open pit mining process is a New Tax Regime Activity, and therefore is covered under the New Tax Regime. The

displacement of rock at the Kumtor Project is an inevitable consequence of open-pit mining, and has been occurring continuously at Kumtor since 1995. This activity is integral to the concept of mining and accordingly covered under the New Tax Regime Activities, which is defined as follows:

... “means all of the business, undertakings and activities of any Project Company [KOC and KGC] in relation to the Kumtor Project, contemplated in or authorized by this Agreement [the Restated Investment Agreement] and the Restated Concession Agreement, including without limitation:

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(a) exploration (including feasibility studies) for, mining, production, milling, processing and sale of Products [as defined in the Restated Investment Agreement] within the Concession Area [as defined in the Restated Investment Agreement]

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(f) transportation, handling and disposal of waste arising from the activities described in this definition;

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(p); activities directly related to those activities listed in (a)-(o) above.

The generation of Unprocessed Rock and the placement thereof in deposition areas are activities directly related to the activities at the Kumtor Project. Therefore, these activities are New Tax Regime Activities and no further payments other than that provided in the New Tax Regime should be applied.

3. Handling of Unprocessed Rock was contemplated in the original Kumtor Feasibility Study and also in Kumtor’s annual mining plans which are submitted to, and approved by the relevant Kyrgyz Republic authorities. The removal of Unprocessed Rock to access ore and the placement of it into deposition areas were contemplated in the Kumtor Feasibility Study that was produced by Kilborn Western Inc. in 1993, and later revised in 1994. In addition, handling of Unprocessed Rock is discussed in the Technical Designs of the ultimate Central Pit which are submitted by Kumtor whenever changes to the ultimate pit design occur. These technical designs undergo a review by KR experts in the following three areas: safety, subsoil and environmental protection. Technical Designs of the ultimate Central Pit were carried out in 2003, 2007, and 2010. In the case of the 2010 Technical Design, positive expert conclusions were given by the State Inspectorate on Industrial Safety and Mining Supervision and Department of Geoecology [sic] under the Ministry of Natural Resources of the KR as well as reserves indicated in this Technical Design were approved by the Protocol of the KR State Committee on mineral reserves. Furthermore, Kumtor annually submits a mine plan for the ensuing year, which is based on the most recently approved Technical Design. These annual mine plans set out, among other things, the amount of Unprocessed Rock being generated in the year and the placement thereof. The annual mining plans are submitted to, and agreed with by KR regulatory authorities. From 2010 onwards, annual special technical

designs are developed which are subject to expertise in the areas of safety, subsoil and environmental protection.

The submission of annual mining plans to KR authorities and the review in these three areas is contemplated in Section 2.3(c) of the Restated Investment Agreement. Accordingly, the fact that Unprocessed Rock is generated as part of mining operations and the transportation and handling thereof, and the eventual placement in deposition areas are all activities that KR regulatory authorities have been aware of and repeatedly approved.

4. A fixed charge for “Environmental Pollution”, which includes waste disposal is already contemplated in the Restated Investment Agreement. The Claim alleges that Kumtor is in violation in respect of primary accounting, placement and monitoring and accuracy of generated waste for the period of 2000 to 2011, and states that KOC has not paid in full for its “disposal” of Unprocessed Rock in deposition areas for the period of its operations. Assuming that Unprocessed Rock is considered “waste” under KR legislation, which we do not agree with (as further discussed below), the attempt of SIETS to calculate the payment for waste disposal (1.2 Soms per ton of pollutant, pursuant to Law No. 32 of the KR) is wrong because it covers the same charge as contemplated in the Restated Investment Agreement as the “Environmental Pollution Charge”. Pursuant to Section 5.3(d) of the Restated Investment Agreement, from January 1, 2009, KGC pays a fixed environmental pollution charge, which takes precedence over any other taxes or payments or charges generally payable under KR law for environmental pollutants.
5. The demand for approximately 6 billion soms is a payment/charge that is not permitted under the Restated Investment Agreement. In the alternative that one argues that the fixed environmental pollution charge does not cover the handling of Unprocessed Rock, we assert that any payment demanded by SIETS would constitute a direct payment under the Restated Investment Agreement and therefore is invalid because the Restated Investment Agreement provides a full and comprehensive regime for all direct payments to the KR. The Restated Investment Agreement provides that except for the charges included therein, there are no other “taxes, duties, rates, royalties, withholding obligations, deductions or other governmental charges whatsoever, however characterized...”. Regardless of the legal basis for the claim and its validity, which Centerra and Kumtor do not agree with (see below), the demand of 1.2 Soms per ton of Unprocessed Rock is essentially a payment/charge for an activity permitted under KR legislation and which has been previously and continuously approved by relevant Kyrgyz authorities. Such charge is not contemplated in the comprehensive regime of payments set out in the Restated Investment Agreement, and therefore the Claim is invalid.
6. The Restated Investment Agreement prevails over KR legislation where there is a conflict. As contemplated in the Restated Investment Agreement (and endorsed by the Parliament pursuant to the New Kumtor Law dated as of April 30, 2009, as defined in the Restated Investment Agreement) if the Agreement of New Terms for the Kumtor Project dated April 24, 2009 among the Government, Centerra, KOC,

KGC and Kyrgyzaltyn, or any restated project agreement, one of which is the Restated Investment Agreement, specify different rules than the legislation promulgated by the KR, the rules of the agreements shall apply to the relations so regulated.

**Basis #3 - In the further alternative, if Kumtor must pay additional amounts for the Unprocessed Rock (which we expressly disagree with), the analysis carried out by SIETS in determining its lost payments (for waste disposal) is incorrect as Unprocessed Rock generated from mining operations at Kumtor does not constitute "Waste" under KR legislation.**

1. SIETS Interpretation of KR Legislation is flawed. The Claim refers to various pieces of KR legislation as a basis for arguing that Unprocessed Rock is considered "Waste" and for setting out the applicable compensation framework for such activity. Kumtor disagrees with SIETS on its interpretation of KR legislation with respect to the Unprocessed Rock and the placement of it in deposition areas. In particular, Kumtor notes that (as more fully described below), under KR legislation, the Unprocessed Rock is not "Waste" and the mining of rock and the placement thereof in deposition areas without any further processing and alteration of the rock does not constitute the creation of "Waste".
2. Applicable KR legislation discussed. The following pieces of KR legislation are discussed in the Claim, and each in turn will be discussed below. In each case, we show that Unprocessed Rock does not constitute "Waste" under these pieces of KR legislation. We note that some of these laws relate to the management of waste only and not the payment for waste creation. Accordingly, we submit that their utility in the Claim is limited.
  - a. KR Law # 89 "Regarding Production Waste and Consumer Garbage", dated November 13, 2001;
  - b. KR Law #53 "On Environmental Protection" dated June 16, 1999, as referred to in KR Law #32 "Regarding the rates/tariffs of payment for environmental pollutants (emissions, discharges of pollutants and waste disposal)", dated March 10, 2002; and
  - c. KR Law # 57 "On Tailings Facilities and Mining Dumps", dated June 26, 2001.
3. KR Law #89 'Regarding Production Waste and Consumer Garbage' dated November 13, 2001. The Claim makes reference to the Law 'Regarding Production Waste and Consumer Garbage' (KR Law #89) and in particular, Article 20 which discusses the economic regulation of waste management. Kumtor submits that Unprocessed Rock is not consumer waste because it is not produced by an end consumer of a material. Furthermore, Unprocessed Rock is not industrial waste, because it is not waste material left over after a manufacturing process, where the end material has lost its usefulness. In the case of Kumtor, there is no processing or milling of Unprocessed Rock which would render it useless or which changes its nature or features. Unprocessed Rock is simply extracted and moved to another location as part of the

open-pit mining process. Accordingly, the legislation does not apply to Kumtor as the Unprocessed Rock generated from the open-mine pit operations is neither consumer waste nor industrial waste.

4. KR Law #53 “On Environmental Protection” dated June 16, 1999 (as referred to in Law #32 of the KR “Regarding the rates/ tariffs of payment for environmental pollutants (emissions, discharges of pollutants and waste disposal)”, dated March 10, 2002). The Claim refers to Article 1 of the Law #32 on “Regarding the rates/ tariffs of payment for environmental pollutants”, and notes that in accordance with Article 15 of the KR Law #53 ‘On Environmental Protection’, the rate of payment for environmental pollution shall be set as 1.2 soms per ton of pollutant (in this case, rock). Kumtor submits that the law “On Environmental Protection” does not apply in the circumstances of the Kumtor Project’s deposition areas and accordingly, Law #32 setting out the rate for payment is also not applicable. In particular, Kumtor notes that Article 2 of Law # 53 ‘On Environment Protection’, provides a similar definition of waste as found in KR Law #89 discussed above, being waste material left over after a manufacturing process, where the end material has lost its usefulness.

As discussed above, in the case of the Kumtor Project, Unprocessed Rock and deposition areas cannot be considered waste as they are not waste material left over after a manufacturing process, where the end material has lost its usefulness. Unprocessed Rock is just rock that is moved from one place to another – it has not been subject to any manufacturing process.

5. KR Law#57 “On Tailings Facilities and Mining Dumps”, dated June 26, 2001. This legislation regulates the field of tailings dumps and waste dumps, including matters relating to safety, oversight, and the rights, obligations and liability of legal entities, citizens and public unions in the field of tailings dumps and waste dump handling. The legislation does not have any provisions relating to payment for tailings facilities or mine dumps.

With respect to this legislation, Kumtor argues that this legislation does not apply to Kumtor because the Unprocessed Rock and the deposition area do not constitute “waste” under this legislation. Article 5 of this law provides a definition for ‘mining waste’, the treatment of which is regulated by the law:

‘mining waste (hereinafter referred to as ‘waste’) includes wastes of the whole mining complex which is:

- (A) radioactive waste not suitable for further use, being:
  - (i) substances in any aggregate state, materials, goods, and equipment, which in each case the content of radionuclides exceeds the levels established by regulatory documents; or
  - (ii) off-grade ores extracted from the subsoil placed in deposition areas, tailings dumps, and wastes of the floatation and leaching process, which in each case the



content of radionuclides exceeds the levels established by regulatory documents’;

- (B) toxic waste of a mining facility, which is waste containing salts of heavy metals (e.g. cadmium, lead, zinc, chromium, etc.), as well as other toxic substances (e.g. cyanides, acids, silicates, nitrates, sulfates, etc).

As per Article 5 of KR Law “On Tailings Facilities and Mining Dumps”, Unprocessed Rock and deposition areas at the Kumtor Project cannot be classified as mining waste, as these do not have (a) any radionuclides, nor (b) other toxic substances. Therefore, the management regime contemplated in this KR legislation cannot be applied to them.

**Basis #4 - In the further alternative, SIETS, a governmental agency, cannot commence an action for the damages requested due to the Release Agreement and Statute of Limitation (as such terms are defined below), and the proper procedure for resolving disputes with respect to the Kumtor Project as expressly provided in the Restated Investment Agreement.**

1. The claim relates to activity prior to June 6, 2009. The Claim for payment requested by SIETS covers a period from 2000-2011.
2. All matters before June 6, 2009 are released and cannot be claimed. Pursuant to the terms of a Release Agreement entered into between and among Centerra, KGC, KOC, Cameco Corporation, Cameco Gold Inc., Kumtor Mountain Corporation, the Government and Kyrgyzaltyn JSC dated as of June 6, 2009 (the “Release Agreement”), the parties agreed to release each other from any claims, including any legal, tax and fiscal matters, in respect of any matter arising or existing prior to June 6, 2009, whether such matters were known or unknown as of June 6, 2009 (except for unknown environmental damages, which is not applicable in the circumstances as the activity in question has been known since 1995). The parties also agreed never to arbitrate or litigate, directly or indirectly, on any of the matters so released. Accordingly, even if the basis for the Claims were valid (which we do not agree with), SIETS is restricted from commencing portions of the Claim relating to the period prior to June 6, 2009 and Kumtor respectfully submits that an arbitrator will summarily dismiss them.

We note that Section 3 of the Release Agreement provides the following:

This Agreement [Release Agreement] is deemed breached and a cause of action accrued thereon immediately upon the commencement or continuation of any action based upon any claim, demand, action or cause of action released by this Agreement. In any such action, this Agreement may be pleaded as a defence, or by way of counterclaim.

3. In addition, claims in respect of 2009 are also barred due to the limitation period. As

per Article 212 of the KR Civil Code, the limitation period for commencing a claim is three years from the event (the “Statute of Limitation”). The Claim is dated December 11, 2012. Accordingly, any claim for Unprocessed Rock from and before 2009 are barred from being commenced.

4. Dispute Resolution for matters relating to Kumtor Project is provided for in the Restated Investment Agreement and should be complied with by SIETS and the Government. All disputes or claims relating to the Kumtor Project, its operations or regulation thereof by the Government or Government instrumentality (the “Disputes”) shall be resolved through good faith negotiations or, if not resolved, through arbitration in accordance with Article 11 of the Restated Investment Agreement. Accordingly, if SIETS is to continue with this Claim (or any portion thereof), the proper forum for such Dispute (assuming that good faith negotiations do not result in a resolution satisfactory to both parties) is arbitration in accordance with Article 11 of the Restated Investment Agreement. We remind SIETS that the Restated Investment Agreement was reviewed and approved by the Government and Parliament, and supported by a decision of the KR Constitutional Court dated June 2, 2009 and a legal opinion from the KR Ministry of Justice dated June 9, 2009. The Restated Investment Agreement is a valid, legally binding and enforceable obligation of the Government.

Kumtor has operated, and continues to operate, in compliance with Kyrgyz Laws on environmental, safety, and health standards. Kumtor submits that SIETS must withdraw the Claim based on the reasons set out in this response. In particular, the investigation by SIETS breached KR legislation and SIETS acted outside its authority by issuing the Claim for the period of 2000-2011. The SIETS inspection was carried out for the purposes of the State Commission and this is evidence of discrimination on the part of the Government against Centerra, KOC and KGC, contrary to KR legislation and contractual obligations. Next, generation of Unprocessed Rock and the placing of it in disposition areas are inevitable consequence of open-pit mining, and actions that have been well known by the Government and SIETS (including its predecessors) since 1995. Next, the Claim made by SIETS is essentially a charge for additional payments to the Government, which under the Restated Investment Agreement is prohibited as the Restated Investment Agreement provides a comprehensive regime of all direct payments to the KR. We also respectfully submit that SIETS has incorrectly applied the legislation in determining that the Unprocessed Rock produced from open-pit mining constitutes “waste” under KR legislation. Lastly, we submit that the Claims dating from or before 2009 cannot be commenced due the Release Agreement and the Statute of Limitation. For these reasons, we request that the SIETS immediately withdraw the Claim.

If SIETS fails to withdraw the Claim, we request that the Government take action to withdraw the Claim based on the arguments presented in this response. We also refer to Section 8.2 of the Restated Investment Agreement which states that if any Public Official (as defined in the Restated Investment Agreement) takes any action that conflicts with the Restated Investment Agreement or has the effect of denying KOC, KGC or Centerra of

its investment benefits under the Restated Investment Agreement, the Government shall use its best efforts to reverse, annul or otherwise terminate or remedy such action.

KOC, KGC and Centerra expressly reserve their rights to bring any claim to arbitration under Article 11 of the Restated Investment Agreement. As provided for in Article 11, any disputes and claims relating to the Kumtor Project are subject to international arbitration.

Sincerely,

Michael Fischer,  
President, Kumtor Operating Company

Copy Almambet Shykmamatov, Kyrgyz Republic, Minister of Justice  
Ian Atkinson, President and CEO, Centerra Gold Inc.