

Исх. № EXE/4427



January 28, 2013



VIA HAND DELIVERY

- To: His Excellency, Zhantoro 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 #09/1501 dated December 11, 2012 (the "Claim") from the State Inspectorate Office for Environmental and Technical Safety under the Kyrgyz Republic Government ("SIETS"). The Claim is in the amount of 1,004,500 (one million four thousand five hundred) soms and is purportedly for placement of unrecorded waste in 2009, 2010, and 2011, including:

- (a) 902,642.4 soms for placement of unaccounted sediments (waste) from the effluent treatment plant ("ETP"); and
- (b) 101,865.6 soms for placement of unaccounted sediments (waste) from the sewage treatment plant sewage ("STP").

The Claim also raises allegations that Kumtor is storing water from external sources in the tailings dump, in contradiction to legislation of the Kyrgyz Republic ("KR") regarding tailings dumps. We will address the Claim for Kgs 1,004,500 and the allegation regarding the tailings dump separately.

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).

Claim for unaccounted waste

Kumtor disagrees with the Claim. In this response, we will discuss four alternative bases for why we believe that this Claim is incorrect and therefore must be withdrawn.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 the KR legislation.
2. The Restated Investment Agreement among the Government of the Kyrgyz 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. Even if the Restated Investment Agreement did not establish a comprehensive financial regime for the Kumtor project, and KOC was required to make payments under the KR legislation, the analysis carried out by SIETS in determining the payments for placement of waste is incorrect as SIETS wrongfully applied the KR legislation.
4. SIETS, a governmental agency, cannot commence the 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 activities that predated December 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 State Commission was formed by Government decree #465 on July 3, 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 (the "Parliament") 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 Parliament of the KR #1642-V, dated February 15, 2012, and the Resolution of the Government of the KR # 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 Jogorku Kenesh 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 equal rights for local and foreign investors.

Basis #2 - 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 for the activity in question.

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 transportation, handling and disposal of waste is a New Tax Regime Activity, and therefore covered under the New Tax Regime. New Tax Regime Activities is defined in Annex 1 (Definitions) of the Restated Investment Agreement as:

... “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:

- (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]

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

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

Therefore, the activity in question (the generation and handling of waste) is a New Tax Regime Activity and no further payments other than that provided in the New Tax Regime should be applied.

3. The sediments arise from the operations of the ETP and STP, which were approved by KR regulatory authorities. We point out that the ETP and the STP at Kumtor were developed in 1999 and 1996, respectively, following the receipt of all necessary approvals by KR regulatory authority, including in the case of the ETP, Scientific Conclusion of the National Academy of Science of the KR.
4. KOC makes full and timely payments for pollution of environment as provided in Section 5.3 (d) of Restated Investment Agreement. Pursuant to Section 5.3 (d) of the Restated Investment Agreement, the parties agreed to establish the fixed fee of US\$310,000 per annum (the “Environmental Pollution Charge”) as a payment for environmental pollution. Pursuant to the Law of the Kyrgyz Republic “On Protection of Environment” dated as of June 16, 1999 payments for environmental pollution include emissions and discharge of pollutants, disposal of waste and other forms of pollution and negative impact on the environment. SIETS’ claim requesting the payment of 1,004,500 (one million four thousand five hundred) soms in addition to the Environmental Pollution Charge for pollution of environment is in violation of Section 5.3 (d) of Restated Investment Agreement and therefore illegal.
5. The demand for approximately 1 million soms is a payment/charge that is not

permitted under the Restated Investment Agreement. In the alternative that one argues that the Environmental Pollution Charge does not encompass the activity in question (and it clearly does), 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 additional payments for waste disposal 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 - Even if the Restated Investment Agreement did not establish a comprehensive financial regime for the Kumtor Project, and KOC was required to make payments under the legislation of the KR (a conclusion that Kumtor does not agree with), SIETS has incorrectly applied the KR legislation and made incorrect calculations.

1. Due to legislative stabilization provided for in the Restated Investment Agreement, SIETS cannot apply a methodology for calculating payments which was approved in 2011. When determining the amount of payments for placement of the sediment waste, SIETS applied the methodology of determining the payment for pollution of environment, approved by the Government Resolution #559 (the “Methodology of 2011”). SIETS should not have applied the above document because pursuant to Section 6.2 of the Restated Investment Agreement, Kumtor enjoys legislation stabilization on all matters except for legislation relating to environmental protection, industrial safety, worker health and safety and labor conditions (with the exclusion of legislation affecting labor compensating or benefits which shall be stabilized as of April 24, 2009), and subsoil and mining operations (which applied as of June 6, 2009 or in the future to the extent not in conflict with any provision of the Restated Investment Agreement or the Restated Concession Agreement). We submit that the Methodology of 2011 is not legislation relating to environmental protection as it only

regulates payment terms rather than addressing substantive matters that will protect the environment. Accordingly, the Methodology of 2011 cannot apply and the methodology that existed as of April 24, 2009 shall be applicable.

In particular, SIETS should have applied the methodology of determining the payment for pollution of environment, approved by the Government Resolution #823 on November 10, 2004 (the "Methodology of 2004"). Pursuant to Section 7.8 of the Methodology of 2004, KOC is not required to make payments for the placement of the waste in question if such waste is placed in a specially constructed engineered facility, including tailings, where, according to data of instrumental monitoring, no impact on air, soil and water bodies occurs provided that the placement of such waste is properly insured from potential risks to environment. Kumtor places the sediment from the ETP and the STP in the specially constructed engineered facility (tailings management facility) and has the relevant insurance coverage.

2. In the alternative, if legislative stabilization does not apply (which we do not concede), the Methodology of 2011 can only be applied from its effective date. The Methodology of 2011 was adopted and effective only from September 30, 2011. Pursuant to Article 9(5) of the Law on Legal Acts which prohibits the application of legal act to matters arising before the effective date of the legal act, SIETS' application of the Methodology of 2011 for calculation of payments for emissions, discharges and placement of waste in 2009, 2010 and first 3 quarters of 2011 is illegal. For the stated period from 2009 to the 3rd quarter of 2011, SIETS should have used the Methodology of 2004 (as described above). The Methodology of 2011 can only be used by SIETS from September 30, 2011 to December 31, 2011.
3. Incorrect estimate indicator was used in the calculation of the charge: We note that in its calculation of charges for sediments from the ETP, SIETS incorrectly used the *Hi* estimate indicator of 159.5, based on the miscategorization of the sediment waste as being waste with high metal oxide content that is produced in the galvanic industry. We submit that if charges were to be payable by Kumtor for the activities in question, a fact that we do not agree with, the appropriate estimate indicator to be used would equal 7.2, which is waste (sludge) from treatment plants.
4. The lack of permit should not impact the calculation of the payment because the Government has not adopted a process to enable Kumtor to obtain a permit. While calculating the payment for placement of the waste, SIETS incorrectly applied doubled rates due to the absence of Kumtor's waste placement permit. The reason why Kumtor could not obtain the permit is because the Government has failed to adopt the guidelines (normative acts) on regulation of waste management which are used to develop waste disposal limits (standards). Without these normative acts, Kumtor is unable to develop the technical designs on waste disposal limits which are needed to obtain a permit for waste management. According to Article 3 of the Law on Inspections, inconsistencies and ambiguity of the KR legislation setting mandatory requirements cannot be used against entrepreneurs. As Kumtor could not receive the waste placement permit due to lack of legal act adopted by the Government, Kumtor shall not be liable for absence of the permit and subject to double rates.

Basis #4 – In the further alternative, SIETS, a governmental agency, cannot

commence an action for payment for waste disposal due to the Release Agreement and Statute of Limitation (as defined below), and the proper procedure for resolving disputes with respect to the Kumtor Project is 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 2009-2011.
2. All matters before June 6, 2009 are released and cannot be claimed. Pursuant to the terms of the 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 this case) and agreed never to arbitrate or litigate, directly or indirectly, on any of the matters so released. Accordingly, even if the basis for the Claim was valid (which we do not agree with), SIETS is restricted from commencing the portion of the Claim covering the period before June 6, 2009.

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 wastes 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.

Allegations of Storing Water from External Sources in the Tailings Dump

The Claim also refers to Kumtor storing water from external sources such as the mill or upland water in the tailings dump, in contravention of KR regulations. We note that the regulation in question, the “Safety regulations for operation of tailing, slurry, and hydraulic facilities” is a regulation (normative act) of the Gosgortekhnadzor (“GGTN”) under the KR Ministry of Emergency Situations and Civil Defense. This regulation was invalidated effective January 1, 2011. Accordingly, we submit that SIETS is not able to rely on these regulations to bring any claim or action against Kumtor.

As an aside, we also note that the storage of sediments (sewage) from the STP in the tailings dump is an activity that has been known by KR regulatory authorities, and in fact, been encouraged by them, all prior to the relevant Release Agreement date of June 6, 2009. In particular, we reference the KOC Environmental Activities Inspection Act (report) of a working group inspection carried out from August 9 -12, 2005. The working group was comprised of members of the Department of Ecology and Nature Management (DENM) under the Ministry of Ecology and Emergency Situations of the Kyrgyz Republic. The inspection was to review compliance with environmental requirements. The working group recommended that Kumtor review the economic feasibility of discharging sewage directly to the tailings pulpline (rather than trucking), and the possibility of its realization from the point of view of industrial safety. No issues were raised with the practice itself of placing sewage from the STP to the tailings dump.

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 2009-2011. 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. 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 Government. Furthermore, we note that even if an additional fee or charge was to be paid to the Government for the activities in question (a fact that we expressly dispute), SIETS has incorrectly applied the KR legislation and made incorrect calculations of the fee/charge. Lastly, we submit that the Claims 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 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, Minister of Justice of the Kyrgyz Republic,
Ian Atkinson, President and CEO, Centerra Gold Inc.