

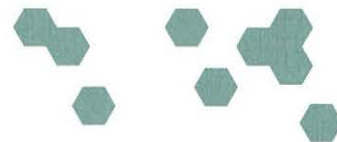
Исх. № EXE/4426



January 28, 2013

VIA HAND DELIVERY

centerra**GOLD**



- 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 #09/1502 dated December 11, 2012 (the “Claim”) from the State Inspectorate Office for Environmental and Technical Safety under the Kyrgyz Republic Government (“SIETS”). According to the Claim, Kumtor did not pay for the use of water from Petrov Lake and therefore is required to pay 188,533,730 (One Hundred Eighty Eight Million Five Hundred Thirty Three Thousand Seven Hundred Thirty) soms for use of water resources for the period of 2000-2011. The Claim also states that Kumtor has not fulfilled the condition of applying the circulating [оборотная] water supply system as it was required in the water use permits issued to Kumtor.

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).

Kumtor disagrees with the Claim. In this response, we will discuss five alternative bases for why we believe that this Claim is incorrect and therefore must be withdrawn.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 Claim is invalid as it was issued by SIETS which according to KR legislation has no right to issue claims relating to water use.
2. The issuance of the Claim is invalid as it was based on findings from a SIETS inspection that violated KR legislation.

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3. 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 as of 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.
4. The analysis carried out by SIETS in determining the payments for use of water is incorrect as SIETS wrongfully used the tariffs for use of potable water, whereas water from Petrov Lake does not meet the standards required to be considered potable water. Furthermore, the KR legislation does not provide for payments for water as a natural resource and therefore SIETS is unable to make a calculation of payments for water use.
5. SIETS, a governmental agency, cannot commence action for the payment for water use 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 issued by SIETS which according to KR legislation has no right to issue claims relating to water use.

1. The Claim was issued by SIETS which has no right to issue claims related to water use. According to Article 12 of the KR Law “On Water” dated January 14, 1994, the state authorities authorized by the KR Government submit claims and actions regarding payment of damages caused by violations of water use legislation.

We note that SIETS does not have a right to issue the Claim as only the Department of Water and Melioration under the KR Ministry of Agriculture and Melioration could issue the claim.

Basis #2 – 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 use of water 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 3rd, 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 #3 - 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, including payments for use of water.

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. Use of Water 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]

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

Kumtor uses water for industrial and household purposes in direct relation to its activity at the Kumtor Deposit. Therefore this activity is a New Tax Regime Activity and no further payments other than that provided in the New Tax Regime should be applied.

3. The activity in question is permitted by the water use permits issued to Kumtor by the relevant Kyrgyz Republic authority. Kumtor uses water from Petrov Lake in accordance with the permits issued by the Department of Water Resources and Melioration and its predecessors since 1996. The most recent permission is for the period from March 1, 2012 until March 1, 2013. During the entire period of time when water from Petrov Lake has been used for Kumtor’s operations, this activity has been approved and permitted and Kumtor has not received any refusals to issue water use permits. None of the said permits required payment for use of water.
4. The demand for approximately 188 million soms is a payment/charge that is not permitted under the Restated Investment Agreement. Any payment demanded by SIETS would constitute a direct payment which is not expressly included under the Restated Investment Agreement. 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 188 million Soms for use of water is essentially a payment/charge for an activity permitted under KR legislation, which has been previously and continuously approved by relevant Kyrgyz authorities, and contemplated in comprehensive regime of payments set out in the Restated Investment Agreement, therefore such claim is invalid.

5. 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 #4 –In the further alternative, if Kumtor is liable for the use of water from Petrov Lake (which we expressly disagree with), the analysis carried out by SIETS in determining its lost payments (for use of water) is incorrect.

1. SIETS wrongfully applied the tariffs for potable water. The Claim states that the calculation of use of water is based on tariffs for use of potable water by population, budget organizations and other organizations on Kyzyl-Suu Vodokanal Enterprise (the “KS Tariffs”). Kumtor disagrees with SIETS on its interpretation of the KR legislation with respect to applicability of the KS Tariffs. In particular, Kumtor notes that the water used by Kumtor from Petrov Lake is untreated water found in its natural form and is not potable water. The regime of use, of and payment for, potable water is governed by the KR Law#33 “On Potable Water” dated March 25, 1999 (the “Law on Potable Water”). Pursuant to Article 1 of the Law on Potable Water, potable water is defined as water of the quality that meets the standards and hygienic requirements set by sanitary rules and norms for household and public supply purposes. The water taken by Kumtor from Petrov Lake does not meet the criteria of potable water and therefore the KS Tariffs cannot be applied to Kumtor.
2. No tariffs for water as natural resource have been established. The key law governing the water use regime in the Kyrgyz Republic is the Water Code of the KR #8 dated January 12, 2005 (the “Water Code”). According to Article 7 and Section 1 of Article 48 of the Water Code, the payment for water as a natural resource shall be established annually by the Parliament per each water basin on the basis of actual costs of study, assessment and protection of water resources as well as costs related to operation of the State Water Administration. The payment for water as natural

resource has never been established by Parliament. Due to lack of the relevant regulation, SIETS is not able to calculate the relevant payment for use of water by Kumtor.

Basis #5 - In the further alternative, SIETS, a governmental agency, cannot commence an action for the payment for water use 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

1. The claim relates to activity prior to June 6, 2009. The payments requested by SIETS cover a period from 2000-2011.
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 here). 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 Claim was valid (which we do not agree with), SIETS is restricted from commencing the Claim. Accordingly, even if the basis for the Claim was 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"). As noted above, Kumtor has been using water from Petrov Lake since the development of the mine in 1995, and such use has been in accordance with permits issued by the Department of Water Resources and Melioration and its predecessors. None of these permits required payment for the use of the water. The Claim is dated December 11, 2012. Accordingly, any claim for water use, if any, 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.

Application of recycle water supply system

As stated in the Claim, the water permits issued to Kumtor requires Kumtor to apply the circulating [оборотная] water supply system. The Claim alleges that Kumtor has not complied with this condition, which we expressly disagree with (as more fully described below). We understand that the subject of “water recycling” is complex and would like to help clarify the requirement and to show that Kumtor complies with the condition in the water permit.

There are (at least) two meanings for water recycling that can be carried out at Kumtor, both of which serve the purpose of using less water from Petrov Lake:

- (a) Circulating water supply (“оборотное” in Russian): This is a water supply system permitting the re-use of water treated after its use in technological processes.
- (b) Repeating water supply (“повторное” in Russian): This is a closed system permitting the re-use of water in a technological process without any interim treatment.

The permit for water use from the Petrov Lake was conditioned by the usage/utilization of repeating water supply (the Russian word, “повторное” is specifically used). Kumtor is in full compliance with this condition. In particular, we note that the repeating water supply process is being fully exploited by Kumtor in the mill (in-mill water circulation):

- about three (3) million m³ of water after flushing thickener and tailings flotation thickener is re-directed to the grinding process annually;
- about one (1) million m³ of water after final tailings thickener is re-directed to the leaching process annually;
- about one point four (1.4) million m³ of water after concentrate thickener is re-directed to technical water tank annually for subsequent use for the mill’s

technological needs.

Thus, about five point four (5.4) million m³ of water is recycled at the mill. This volume is comparable to the entire volume of water used by Kumtor for industrial purposes (about 5.5-6 million m³ of water per year).

With respect to the usage of a “Circulating water supply” process, Kumtor has reviewed this process in the past (in one case at the request of a board member of Centerra) and has determined that the process would not be appropriate for Kumtor – mainly for three reasons:

- a. Recirculating treated water could negatively impact gold recovery - The presence of even minor quantities of residual cyan-ions (free cyanide) could significantly impact the recovery of gold in the flotation process. For instance, results of the research held in 2012 at the metallurgical lab of the Kumtor Project suggested that availability of cyanides in water in concentration of 0.012 mg/l, led to reduced gold recovery by approximately 10% - 12% due to suppression of pyrite flotation by cyanide.
- b. Recirculating treated water is not cost-effective - Due to harsh climate conditions at the Kumtor Project, the effluent treatment plant (“ETP”) can only function for 4 to 4.5 months of the year (early June to early October) - (thawing of water in the tailings pond begins only in late April - early May). Therefore, treated water from the ETP (or TMF supernatant) could only be used in this period and during the rest of the year, i.e. 7.5-8 months, all water to the Kumtor mill would have to be supplied from the Petrov Lake. We also note that for the 4-4.5 month period, approximately 5 million m³ of effluents could be treated, whereas the Kumtor mill would only consume approximately 2 million m³ of water. Therefore, when the recirculating water system could be used (during the 4-4.5 period per year), more water would be treated than could be used by Kumtor during such period, resulting in treated effluents (approximately 3 million cubic meters) being discharged into the Kumtor river.
- c. Additional environmental risks would be created - In order to feed water from the ETP, or TMF supernatant, into the recycle water supply system, Kumtor would have to build an additional water pumping station near the ETP. Pressure within this pipeline would have to be higher than the pressure in the pipeline supplying water to the mill from the Petrov Lake, as the applicable pond to be used (the 3rd pond) is located at the elevation of 3,660 m, i.e. approximately 74 meters lower than the pumping station at the Petrov Lake (3,734 m). High pressure in the pipeline which would be located next to the 2 tailings pipelines would create additional environmental risks in case of a breach of the pipeline.

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, SIETS is not the

correct Governmental body which has the authority to issue claims for water use. Secondly, 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 we argue that this is evidence of discrimination on the part of the Government against Centerra, KOC and KGC, contrary to KR legislation and contractual obligations. The use of water from Petrov Lake has been well known by the Government and SIETS and permitted over the years, without any request for compensation. We submit that the Claim made by SIETS is essentially a new charge (direct payment) under the Restated Investment Agreement and this is prohibited as the Restated Investment Agreement provides a comprehensive regime of all direct payments to the KR. In the further alternative, and on the basis that Kumtor must pay for water use from Lake Petrov (a fact that we dispute), we respectfully submit that SIETS has incorrectly applied the legislation by determining that the water taken from Petrov Lake is potable water. We also note that SIETS is unable to make a calculation of payments for use of water because the KR Parliament has not yet established payment rates for use of water as a natural resource. Lastly, we submit that the portion of the Claim from and before 2009 cannot be commenced due the Release Agreement and the Statute of Limitation. We also submit that Kumtor is in full compliance with the stated requirement of applying recycle water system as Kumtor recycles about five point four (5.4) million m³ of water at the mill. 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 Shykmatov, Kyrgyz Republic, Minister of Justice
Ian Atkinson, President and CEO, Centerra Gold Inc.