



August 4, 2017

Inspections and Enforcement

Field Operations Unit

Indigenous & Northern Affairs Canada
Nunavut Regional Office
PO Box 100
Iqaluit, Nunavut X0A 0H0
Andrew.keim@aandc-aadnc.gc.ca

Attention: Andrew Keim

Re: Part C Item 1 of Amendment No. 1 of Water Licence 2AM-LUP1520

Dear Mr. Keim,

We are writing in respect of your letter of July 28, 2017 and to provide you with an update respecting our efforts to post additional reclamation security in the amount of C\$9,149,091 under Water Licence 2AM-LUP1520 (the Type A Water Licence).

Given current circumstances and our ongoing efforts to provide the security by way of a bond (as described below) the additional reclamation security has not yet been posted. However, to reinforce our commitment to working in good faith to satisfy our obligations in a timely manner, we have instructed HSBC to deposit an extra C\$2,000,000 into the existing LOC today August 4, 2017 currently held by INAC in respect of the Type A Water Licence.

We note that Section 90.1 of the NWNSRTA which provides that failing to furnish or maintain security as required is an offence unless, there is a reasonable excuse. We respectfully submit that in the current circumstances we have a reasonable excuse and have taken reasonable actions, for not yet having posted the full amount of the additional reclamation security. Our reasons follow:

- We have proposed providing the security by way of a bond, and note a performance bond is one of the approved methods of posting securities. INAC has not yet confirmed whether this proposal will be acceptable. We submitted a draft surety bond to INAC for consideration on July 6, 2018 and have not yet received a formal response.
- As an alternative source of funding for the additional security, we have entered into a senior secured revolving credit facility with HSBC Bank Canada for up to US\$40 million on July 25, 2017. Our ability to access funding under this new facility is subject to the satisfaction of a number of conditions. We are in the process of satisfying those conditions and anticipate that we will be able to begin drawing under that agreement within a week or two. If our surety bond proposal is not accepted, our working capital position will not allow us to fund the remaining full amount of the additional security until we have access to the new credit facility.



- We believe that the IARP (Interim Abandonment and Restoration Plan) that is due August 10, 2017 will result in a significant reduction in reclamation bonding requirements based on work and studies completed under Mandalay ownership.
- As discussed with INAC in our phone call of July 24, 2017, the request for additional bonding has pushed us into pursuing final reclamation and we expect in that transition, from interim to final closure, the regulatory assumptions of abandonment leading to unusable fuel and inoperable equipment, will prove to be invalid, further reducing the bonding requirements.

We would like to emphasize that Mandalay is committed to satisfying its reclamation bonding obligations and moving forward to actual reclamation. We note that current activities on site are primarily reclamation oriented and we presume that INAC does not want to take any actions that would delay this work.

Background

As you are aware, Mandalay Resources (Mandalay) has had ongoing discussions with INAC in order to seek approval to post all required reclamation security under the Type A Water Licence, including the additional security amount (a total amount of C\$34,649,091) in the form of a surety bond. Surety bonds are not novel and have been accepted by governments throughout Canada as a form of mining reclamation security (see attachment 1). In addition to engagements by telephone and email, Mandalay met with INAC in person to discuss this approach on June 12 and July 24, 2017. We also provided some examples of surety bond agreements to you, Karen Costello, Ian Parsons and Eva Paul by email on July 6, 2017, as well as some information respecting the Government of the Northwest Territories recent approval of Dominion Diamond Ekati Corporation's surety bond as security for approximately \$253 million under its Ekati water licence. Mandalay provided a draft form of surety bond (patterned on the Ekati example) to INAC specific to the Lupin Mine on July 21 (see attachment 2) and our understanding is that the terms and conditions of the draft bond are currently under active review by INAC.

Current Status

We are continuing to actively pursue bonding as form of security acceptable to the Minister and appreciate INAC's continued engagement on this option. We note in the regulations that performance bonds are an acceptable form of security and would like to engage in INAC on how we can modify our draft surety bond to an acceptable form of performance bond, also acceptable to the Treasury Board. However, when INAC indicated to us that it would not be in a position to make a decision on whether the proposed bond would be acceptable to the Minister before August 4, 2017, we took steps to post reclamation security in an alternative form as an interim measure while INAC is considering our request. These steps included increasing the existing LOC by \$2 million and securing the new credit facility with HSBC Bank Canada (see attachment 3), both as described above.

We continue to hope that INAC will ultimately conclude that it is comfortable accepting bond security, to facilitate the extra working capital required to proceed to final reclamation prior to release of bond at completion. We are committed to fulfilling our reclamation security obligations regardless.



Current Activities at Lupin Mine

Mandalay is a responsible mining company and has met all its closure and reclamation obligations since 2009 for all its properties in Canada, Chile, Australia, and Sweden. Environmental responsibility is a core value of our company and whether assets are held for sale or not, Mandalay reaffirms that it is meeting and will fully meet its compliance obligations at Lupin in the short and long term. We have attached our corporate Environmental Policy to this letter (attachment 4), which specifically emphasizes our high corporate standards regarding eventual closure and rehabilitation of each of our projects.

Mandalay is currently actively reclaiming the Lupin Mine site. We were told during our most recent INAC inspection (July 2017) that the Inspector did not note any items of concern. In addition, INAC requested that we have the Inspector return to site before the field season closes to validate our work and receive appropriate credit in bonding reduction (meeting July 24, 2017). We are carrying out compliance activities and water management, and currently pursuing reclamation activities at the mine site with the intent to pursue final closure. We are reviewing the Type A Water Licence and regulatory requirements related to taking the site into final closure, and look forward to engaging with INAC to receive advice on these matters. Based on our understanding that INAC was considering a bond for the reclamation security, our working capital has been engaged in these reclamation activities, and is therefore not immediately available as security. However, from our perspective, as we are undertaking activities that the security is meant to ensure, any risk to the public or to the federal government is mitigated, if not outright removed.

As required under Part I, Item 2 of the Type A Water Licence we are preparing an updated Interim Abandonment and Restoration Plan for submission to the NWB on August 10, 2017. We look forward to engaging with INAC staff in advance of filing the updated assessment of reclamation security with the NWB in September 2017, as required by Part C, Item 4 of the Type A Water Licence. This will reflect the reclamation work that was undertaken at site in 2016 and 2017 and will reflect the current potential liability at site based on the work completed since Mandalay assumed ownership and by the amount justified by recent government-agreed studies. This reclamation work was not taken into account in the most recent estimates prepared by the company or by INAC, and we anticipate the update will illustrate that the work that has been undertaken has already reduced potential financial liabilities at the mine site.

Conclusion

While there is no risk that Mandalay will abandon the Lupin Mine site, we recognize that INAC must ensure that there are sufficient funds in place to properly mitigate any worst case potential liabilities. We believe that this letter, the good faith increase in the existing bond, the desire to collaborate with INAC on an acceptable form of bond, and the various conversations and site visits taken by Mandalay on July 17 to 19, 2017, demonstrate that we are aligned on the objective of environmental stewardship and reclamation and that no enforcement actions should be initiated by the INAC office at this time.

Mandalay reconfirms that it has been acting in good faith to engage with INAC, the NWB and most recently, the KIA, on the option of bonding as a form of security acceptable to the Minister. While we have made alternative arrangements to satisfy our reclamation security obligations, a bond remains the best option for our company and we continue to strongly advocate this approach.



We believe that INAC's acceptance of this form of security will signal to Nunavut and to the industry that INAC is supportive of mining and exploration investment in Nunavut, while appropriately ensuring protection of the health and safety of the public and the environment. We continue to believe we can work with your team on a way forward and reaffirm our desire to proceed with the surety bond, as it continues to be the preferred financing mechanism while providing tremendous benefit to mine development in the north for companies with similar working capital constraints as us.

Mandalay has been in direct contact with Karen Costello via emails (dated July 26 and 28, 2017) and has requested an in-person meeting in late August to discuss the matters in this letter. We look forward to confirming this and to meeting with in Iqaluit soon.

Sincerely,

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