



1 September 2010

Dear Cougar Energy shareholder

Safe environmental conditions around our Kingaroy Project

Your company, Cougar Energy Limited, remains totally committed to maintaining its position at the forefront of progressing the development and commercialisation of Underground Coal Gasification (UCG) in Australia, using the world's best proven technology.

Most disappointingly, such progress has been recently interrupted by a series of events which now have Cougar Energy facing its greatest challenge as a publicly listed company.

This letter provides you with details of the events which have burdened your Company with this setback and brings all shareholders up to date on recent developments relating to the current shutdown imposed by the Queensland Government on our flagship UCG project at Kingaroy.

SUMMARY

Cougar Energy strongly maintains that no environmental harm has been caused to the Kingaroy site and surrounding farm lands.

Queensland Government tests confirm that there are no concerns with water quality in the local bores. The water tested conforms to the Australian Drinking Water Guideline standards.

These satisfactory test results vindicate your Company's tests and environmental protection plan.

There is no evidence to indicate that the Kingaroy Project presents any danger to human health or local farming activities.

Your Board, Senior Management and Staff are working intensively with the Queensland Government and other stakeholders to enable the resumption of the gasification operations at the Kingaroy pilot plant at the earliest possible time.

We are continuously correcting misinformation in the public arena and re-enforcing the benefits of UCG for cost-competitive electricity generation.

Your Company continues to progress its highly prospective portfolio of UCG projects in Western Australia, Victoria, Pakistan and the People's Republic of China.

Our Kingaroy Flagship Project

In 2008 the Queensland Government granted Cougar Energy an Environmental Authority to operate a trial UCG plant at Kingaroy under very strict environmental controls. As part of the Authority granted to Cougar Energy, the results from the trial plant operation are to be submitted to the Queensland Government. The independent Scientific Expert Panel (three high ranking scientists) nominated by the Government will consider the results and during 2011 make recommendations on the future of large scale UCG development in Queensland. Under its UCG Policy, the Queensland Government Cabinet will make its final decision in 2012.

We are required to satisfy 130 tests and monitoring regimes to ensure that our project is not presenting a danger to the surrounding environment and communities. Importantly, all water sampling and subsequent analysis is undertaken independently of Cougar Energy.

Your Company has invested approximately \$25 million into Kingaroy in this first stage over the past three years to develop the state-of-the-art trial plant which can be seen in this photograph.



Gas Processing
Plant at Kingaroy

We engaged a highly qualified engineering and operating team with both local and international experience to bring this project to life. These also included personnel employed from the Kingaroy region.

The project is designed to expand to a 400 MW power station, with the capacity to provide electricity to 400,000 homes in Queensland for more than 30 years. At various times the project will employ over 200 staff and provide significant direct economic benefits into Kingaroy and transform it into a genuine energy hub for the State of Queensland.

Cougar Energy is convinced that the UCG process of generating cost competitive electricity is the alternative energy source of the future - for an energy-hungry Australia as the population grows quickly

and demand for power expands from numerous large scale mining and infrastructure projects planned across Queensland.

The UCG technology is environmentally friendly. It boasts lower emissions than coal fired power stations, has minimal impact on the ground surface and utilises 15 times less resources than Coal Seam Gas (CSG) to produce the same energy outputs. Another benefit is that the UCG process does not generate the extraction of large quantities of groundwater, unlike CSG operations.

Recent and unexpected Queensland Government Department actions

After the recent installation of two new injection and production wells, we were preparing to commence re-ignition of the Kingaroy Project in the last week of July before the Queensland Government's Department of Environment of Resource Management (DERM) took the unexpected action during the night of 15/16 July 2010 via a media release to stop this next stage of your Company's project development.

We have released a number of statements to the public* since then. It is important to emphasise that Cougar Energy is committed to the continued health, safety and well-being of the communities and environments in which it works as its first priority.

We are very pleased that DERM has carried out its own extensive water sample testing at the Kingaroy site as well as on surrounding privately owned land holdings: five sets of tests taken over a two week period in the second half of July. The Department has reported publicly that all of the test results confirm that the water quality meets the Australian Drinking Water Guideline (2004) and that no adverse health effects would be expected. DERM began publishing its results as early as 17 July 2010, the day we were ordered to stop operations at Kingaroy.

The results of these tests validate and vindicate the test results taken by your Company under a very rigorous testing regime and confirm our unwavering confidence in our industry-leading UCG process. It is significant to note that at an early stage of the Kingaroy project your Company instituted its own voluntary groundwater sampling regime in addition to the independent testing requirements imposed under the Environmental Authority granted to us.

Correcting incorrect public statements and assertions

Given that there have been numerous uninformed and misleading statements made or published in the public arena in what appeared at times to be associated with "fear campaigns", it is important to set the record straight on a number of matters and provide you with the facts.

There is no evidence to indicate that Cougar Energy's Kingaroy project has presented

- **danger to human life**
- **danger to drinking water**
- **danger to livestock, and**
- **danger to other farming activities.**

* Media/ASX Releases of 16, 19, 20 and 23 July 2010 and 12 August 2010 and Response to an ASX Query Letter of 29 July 2010 (appearing under the Company's symbol CXY on the ASX website (www.asx.com.au) and on the Company's website www.cougaenergy.com.au)

There is no evidence that the Kingaroy project has spread

- **poisons, or**
- **cancer causing agents**

into community groundwater supplies.

The map attached at the end of this letter identifies several bores used by local landowners in the vicinity of the Kingaroy project. The wells marked in yellow (T5037 and T5038) are monitoring wells only, close to where the gasification process commenced. The numerous wells marked in red are water bores used by the local landowners for farming purposes. All of these bores marked yellow and red have been regularly tested for water quality.

None of the water bores outside your Company's pilot plant and used by local landowners for extracting saline water (unfit for human consumption) have ever measured any detectable levels of hydrocarbons.

Further, it is important to note that two readings analysed by the independent testing laboratory proved to be false and provided incorrect results. These were readings of 84ppb (parts per billion) of benzene attributed to one of your Company's *monitoring* wells in the pilot plant area (250 metres from the gasification process) and 3ppb of toluene (trigger standard 800 ppb) attributed to a distant saline water production bore. The independent testing laboratory engaged by Cougar Energy has confirmed these mistakes in writing to your Company and copies of these reports have been passed on to DERM, for which DERM has acknowledged and accepted.

Despite DERM's acceptance that these results were false and incorrect, there continue to be reports (see South Burnett Times "Residents confront environment minister" 10 August 2010) of these tests being relied on as evidence that Cougar Energy's Kingaroy project should be shut down permanently.

Media reports that landowners near the Kingaroy site would "continue not to drink the water" were also nonsensical, given that the local bores source water from aquifers which are so saline as to be unfit for human drinking water. The drinking water for Kingaroy citizens is sourced from surface tanks and dams which are situated several kilometers from the Kingaroy project and not connected in any way to the saline aquifers around the site.

Your Company expects that any representations on this issue deal only with the facts and that the proper processes of evaluation will be allowed to continue. Cougar Energy will continue to correct any further misrepresentations of fact in the public arena and take legal advice on remedies available to it for any such misrepresentations of fact.

There have been public reports of "exceedances" of chemicals attributed to the Kingaroy site. The reality is that there were only ever two such instances reported in June 2010 where traces of benzene above the prescribed trigger levels were detected in *monitoring* bore T5037 (see the attached map). In both instances, 2 ppb of benzene were detected, against the Australian Drinking Water Guideline standard of 1 ppb.

It is worth making the following points in relation to these elevated benzene readings:

1. The Australian Drinking Water Guideline standards are being applied to groundwater proven to be too saline for human consumption.
2. No traces of benzene above the Australian standard have ever been detected in *monitoring* well T5038, which is 10 metres away from T5037.
3. The *monitoring* well in question was installed solely for monitoring, is not designed to draw water for any purpose and contains water unfit for human consumption.
4. Subsequent sampling by both your Company and DERM from T5037 and other monitoring wells have failed to find any new or recurring traces of benzene above the Australian Drinking Water Guideline standard in the water drawn from T5037 or any of the other groundwater and monitoring wells. This reinforces your Company's belief that the two benzene detections were isolated and transitory readings.

In fact DERM states that persons will have significantly more exposure to the hydrocarbon chemicals under investigation (benzene and toluene) from the air they breathe, and most particularly at suburban petrol stations (DERM Media Release 17 July 2010).

Your Company - addressing this challenge

Local community trust and support and public confidence in the UCG process has been dented by the misleading statements and information I referred to earlier. Your Company is working to restore this trust, support and confidence with all of our stakeholders.

As well as continuing to advance our projects in other parts of Australia and Asia, we continue to work constructively with the Queensland Government and DERM to enable the Kingaroy trial to be completed and prove to all stakeholders the substantial environmental benefits of UCG for producing cost competitive electricity for the Queensland market.

We have completed the submission in answer to DERM's Environmental Evaluation notice and lodged this on time on 16 August 2010. The Queensland Government-nominated UCG Scientific Expert Panel will consider this submission and then make comments and recommendations to DERM.

DERM has advised that our submission in its present form will not be accepted. Following discussions with DERM late last week, a meeting has been arranged for Friday 3 September 2010 at which the issues outstanding will be clarified and the further information required by DERM will be sought.

It will then be the Company's intention to respond to these information requests as quickly as possible and in the manner requested of it.

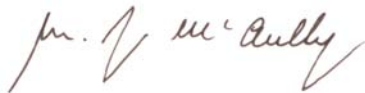
In the meantime, Cougar Energy has been able to obtain a financing commitment from Yorkville Associates (New York). This commitment will assist in part in funding the on-going working capital requirements of your Company whilst DERM completes its deliberations. Your Company will also be required to raise further capital to ensure its on-going viability as a going concern. We are considering a private placement of new equity in September and a further Share Purchase Plan to all shareholders in October. For information on our fund raising requirements, we recommend you refer to section 6 of the prospectus lodged by your Company with the ASX this week, which can be found under the Company's symbol CXY on the ASX website (www.asx.com.au) and on the Company's website (www.cougarenergy.com.au).

You can also contact Brad Glynn, Cougar Energy's General Manager – Corporate Finance and Investor Relations, by telephoning 03 – 9909 7200.

As a result of obtaining the funding commitment from Yorkville Associates, the ASX has granted our application to lift the voluntary suspension and allow the shares of your Company to freely trade again on 2 September 2010.

Your Board, Senior Management and Staff thank you for your continued support.

Yours sincerely

A handwritten signature in cursive script, appearing to read "Malcolm McAully".

Malcolm McAully
Chairman

