

# Key issues in district cooling master arrangements

**Euan Lloyd** - Partner - Construction and Infrastructure  
e.lloyd@tamimi.com - Abu Dhabi

October 2013

---

This method of cooling is commonly used in large residential projects across the GCC and replaces the need for individual air conditioning units or traditional in-building chillers.

A key advantage of district cooling is the relatively small space it takes up (thus increasing the total sellable/lettable area of a plot of land) and this also brings aesthetic benefits. Water and energy use is also less than alternative forms of air conditioning, which has both pricing and environmental benefits.

Given the popularity of district cooling as a means of cooling large developments in the region, together with rapid population growth, it is an opportune time to touch on some of the key issues in a typical district cooling arrangement/concession agreement.

The GCC's district cooling industry is subject to little law and regulation. This means that the rights and obligations of stakeholders need to be addressed in a clear and integrated contractual framework.

On account of the high cost of constructing a district cooling plant and associated pipe network and infrastructure, district cooling services are usually procured under a long-term concession agreement that authorises the provider to exclusively provide district cooling services to a development for an agreed period of time (i.e. 25 years but sometimes as long as 50 years) in accordance with certain benchmarks and standards, particularly regarding quality and availability. These benchmarks are commonly known in the industry as key performance indicators and are usually abbreviated to KPIs.

Adherence to KPIs is especially important as exclusivity prevents end-users from obtaining air conditioning from an alternative source if they are dissatisfied with the provider's performance. To incentivise performance, financial penalties are often levied against a provider if it fails to comply with KPIs, while the concession agreement may contain a right to terminate for persistent or fundamental breach. To avoid this, providers must diligently operate and maintain both the plant and network.

A key risk in a district cooling arrangement is demand and it is imperative, from the provider's (and any funder's) perspective, that end-users are contractually required to enter into agreements for the provision of cooling services and that this obligation is rigorously policed. Allocation of demand risk is a matter for negotiation between the developer and provider, but the provider often seeks that the master developer underwrites a portion of demand. Master developers, however, do not like to provide any demand guarantee and will generally only agree to this if a considerable portion of end-user agreements have been entered into. This subject is normally a key element of negotiation in these types of agreements.

Closely connected to demand is the issue of billing and collection. Payments can either be made to the provider by the developer (as a single point of collection for all end-users) or by each end-user. Providers unsurprisingly prefer that they are paid by the developer, which avoids the time and expense of seeking payment from each individual end-user. This can be considerable if there are many end-users (i.e. individual unit owners in a high-rise tower).

If the developer is responsible for the collection of district cooling charges, a provider may require the

developer to provide security to guarantee these payment obligations and, as a last resort, the provider typically seeks a right to disconnect the service if non-payment passes a particular threshold. A hefty penalty is usually charged for reconnection.

Although there is no independent regulator of the industry, tariffs usually consist of a connection charge, an availability/capacity charge and a consumption charge. Given the length of district cooling concessions, tariffs should be subject to clear and periodically applied adjustment mechanisms to allow the charge to vary on account of such things as the fluctuating cost of providing district cooling services (i.e. water, power and labour), inflation and the consequences of changes in law. The benchmarking of the tariff regime is obviously a subject that parties need to carefully negotiate when entering into long-term agreements.