China’s First Shale Gas Policy

On October 30, 2013, the National Energy Administration (“NEA”) of the People’s Republic of China released the First Shale Gas Industrial Policy (“Shale Gas Policy”), pursuant to China’s 12th Five-Year (2011 to 2015) Plan for Shale Gas (“Five-Year Plan”). The Shale Gas Policy is to be implemented to promote more rapid development of the shale gas industry in China with the goals of enhancing China’s gas supply, reducing carbon emissions and improving energy security.

Background

Under the Five-Year Plan, the Chinese government set ambitious targets for shale gas growth in China, calling for dramatic increases in annual production to 230 billion cubic feet by 2015 and 2.1 to 3.5 trillion cubic feet by 2020. China is believed to have the largest shale gas reserves in the world, dwarfing those of the United States which is currently enjoying a shale boom. However, China’s shale gas industry is still in its infancy, with an annual production of around 883 million cubic feet and less than 100 shale gas wells drilled as of 2012. To put this in perspective, in the United States shale gas production reached 8.5 trillion cubic feet in 2012 and 400,000 shale gas wells were drilled.

The challenges to the growth of shale gas in China are manifold. They include geography and lack of readily available large quantities of water (which is crucial to the fracking process used in shale gas extraction) close to the shale gas reserves. Whilst these challenges will take time to overcome, the Chinese government, by issuing the Shale Gas Policy, is at least trying to address some of the structural barriers to the development of the shale industry in China. It hopes that making market access easier, reducing bureaucracy and providing financial incentives will create an environment that leads to investment and innovation, which in turn will help solve the other challenges.

New Tax Incentives

The Shale Gas Policy calls on government authorities to formulate and adopt new tax incentives to encourage shale gas exploitation. Unfortunately, there is little detail regarding these new tax incentives as yet. However, according to the Five-Year Plan, financial support policies for the shale gas industry should be implemented by reference to the policies for the coal bed methane industry. So it is expected that the Chinese government will borrow from the tax incentive policies relating to coal bed methane when formulating the same for the shale gas industry.
Pilot Development Zones ("PDZs")

The National Development and Reform Commission and the NEA have approved several shale gas PDZs, most of which are located within or around Sichuan Basin. The PDZ is not a new concept, but the Shale Gas Policy adds more color to the PDZ scheme. Under the Shale Gas Policy, the Chinese government has stated its commitment to expedite the approval process for land use and has encouraged the construction of supporting facilities within the PDZs. In addition, the Shale Gas Policy places particular emphasis on the importance of PDZs in: joint collaboration of shale gas participants; technology integration; production costs control and production safety.

Market Access

In the Five-Year Plan, the Chinese government acknowledged that China’s existing gas pipeline network has been a barrier to the development of shale gas. Accordingly, the Shale Gas Policy encourages private investments in the construction of new gas pipelines and infrastructure. Perhaps more important, the Shale Gas Policy also explicitly states, for the first time, that the shale gas producers and distributors should have access to the existing pipeline network and infrastructure on a “non-discriminatory” basis. Although no specific implementing rules have been provided yet, the mandatory requirement of “non-discriminatory infrastructure access” should be welcomed. At present, China’s existing onshore pipelines are almost entirely controlled by two Chinese oil and gas corporations, China National Petroleum Corporation (CNPC) and Sinopec Group.

Measures Reiterated

The Shale Gas Policy affirms that shale gas falls within China’s strategic emerging industries ("SEIs"). Since October 2010, China has identified seven SEIs that officials hope will become the backbone of China’s next phase of industrial development including, among others, energy efficient technologies and new energy sources.

The Shale Gas Policy also restates China’s policy that Sino-foreign joint ventures and non-state-owned enterprises are encouraged to engage in shale gas exploration and development in China. Foreign entities with advanced shale gas-related technologies are encouraged to partner with Chinese enterprises. Several foreign oil and gas enterprises have already signed joint research agreements with their Chinese partners regarding shale gas exploration, development and production. In March 2013, a shale gas production sharing agreement ("PSA") between Shell and CNPC was approved by the Chinese government, which is the first Sino-foreign PSA approved in China’s shale gas industry.

Apart from calling for tax incentive policies for the shale gas industry, the Shale Gas Policy also reiterates certain existing financial support measures including: subsidies for shale gas production enterprises; mineral resources compensation fees; and exemption from customs tariffs for equipment imported for shale gas exploration and development projects.

What does it all mean for shale business in China?

As the first policy specifically designed for the shale gas industry, the Shale Gas Policy reflects a concerted effort by the Chinese government to encourage and support the shale gas industry’s growth and should be welcomed by the energy industry as a step in the right direction. However, until the details behind the policies become known, the policies are unlikely to have a transformative effect on shale gas development in China. We believe, based on our experience with the shale industry in the United States, that only a transparent, clear and stable environment will attract the foreign participants (with finance, know-how and operational skills) whose involvement will be crucial to the development and success of China’s shale industry.
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