A New Direction for China's Massive Shale Gas Reserves

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It's estimated that China holds more natural gas – locked in its huge shale reserve – than the U.S.

And while the country hasn't yet begun commercial production, a new Chinese law has just given the green light to start allowing North American companies to develop shale gas inside its borders — where natural gas prices are significantly higher than North America's.

In short, China recently designated shale gas as an independent resource, which means that smaller energy companies – and this could include some from outside of China – will be able to develop the resource in the country. As I said, China has NO commercial shale gas—but big reserves.

China's Ministry of Land and Resources did this to bring more firms into the sector, according to Reuters. The Asian country's energy sector is currently dominated by massive Chinese companies like PetroChina.

Xinhua News Agency cited a government official as saying China would seek to launch a second round of shale gas tenders in early 2012—i.e NOW.

China only uses clean burning natural gas for 4% of its energy supply, compared to 20% + for most of the modern world – and it is already the third largest consumer of natural gas in the world (after USA and Russia). They have a goal of getting to 10% by 2020. China is increasing their gas supply now via pipelines from foreign countries like Turkmenistan, Kazakhstan, Uzbekistan, Myanmar and Russia.

Natural gas prices vary widely across the country, as they are subsidized in some areas to keep inflation low. But in Shanghai you can now get $12+ per mcf and I have heard as high as $22/mcf—one of the best prices in the world (North American LNG export terminal proponents are salivating…). Price liberalization is increasing.

Firms from outside of China will NOT be allowed to participate in the tenders. However, outside firms will be able to partner with the Chinese companies that win them.

This move could have major implications for any companies that partner with the winning Chinese firms as the Asian nation has an incredible amount of shale gas reserves.

The U.S. Energy Information Administration estimated that there was 1.275-QUADRILLION-cubic-feet-worth of "technically recoverable" shale gas in China. By comparison, the U.S. –

which has led the way with the development of shale gas – has "only" 862 trillion cubic feet.

China has shown it's eager to develop its energy resources—they're on the record saying they want to increase oil and gas output by 23% by 2015 to 360 million tons equivalent—and to 450 million tons by 2030.

In terms of just shale gas, China says it hopes to produce 229.5 billion cubic feet of the resource by 2015. By 2020, the country is targeting 2.82 trillion cubic feet of shale gas production, according to Reuters—almost a ten-fold increase in just five years.

Because of these enormous reserves, whatever foreign companies are able to partner with the winning Chinese firms will be in a strong position.

To date, only the large Chinese firms have been winning bids to develop shale gas.

Earlier this month it was reported that China National Offshore Oil Corp, or CNOOC Ltd., which is the biggest Chinese offshore energy producer, began drilling its first shale gas project in the country.

Neil Beveridge, an energy analyst at Sanford C. Bernstein & Co. based in Hong Kong, told Bloomberg that this was a significant move for CNOOC.

"It may take more than five years for CNOOC to turn this exploration into real production, but the key message here is CNOOC signals a new direction on where the company will move in the future," he said. "CNOOC will count heavily on unconventional oil and gas for growth down the road."

Large companies dominated the first round of tenders in June. This second auction will likely see smaller companies get involved in shale gas, due to the resource's new designation.

Because of the challenges posed by recovering these unconventional resources, Chinese companies have been attempting to gain technical expertise by partnering with foreign firms to develop shale gas abroad.

One of the most prominent such ventures was Sinopec's acquisition of one-third of Devon Energy Corp. (DVN:NYSE) for $900 million in cash. Bloomberg also reports that the deal could include the Chinese firm paying up to $1.6 billion in Devon's future drilling costs.

"In these joint ventures, the partner does typically get some education on drilling," Scott Hanold, an analyst for RBC Capital Markets, told Bloomberg.

The news provider reports that Chinese firms spent over $18 billion in 2011 buying oil and gas companies around the world.

Fact is, China has a truly massive reserve of shale gas. And any company that is able to partner with a firm developing the resource in China could potentially realize significant profits.

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