

CONTENTS

Background

- Introduction
- Context
- Existing situation
- Parliament's starting position
- Council starting position

Proposal

- Preparation of the proposal
- The changes the proposal would bring

Views

- Advisory committees
- National parliaments
- Stakeholders' views

Legislative process

References

- EP supporting analysis
- Other sources

Common rules for gas pipelines entering the EU internal market

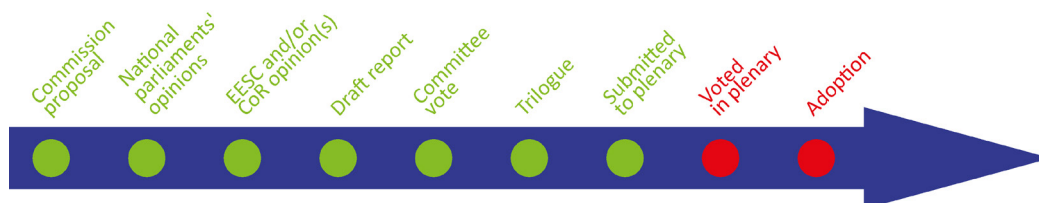
In November 2017, the European Commission adopted a legislative proposal to apply key provisions of the 2009 Gas Directive to gas pipelines between the European Union (EU) and third countries. The proposal seeks to apply EU internal gas market rules up to the border of the EU. Member States would need to cooperate with third countries to ensure full compliance with EU rules. The revised directive is seen by many observers as a part of the broader EU response to the Gazprom-led Nord Stream 2 project, which the European Commission publicly opposes.

The Parliament adopted its position on the gas directive in plenary on April 2018, whereas the Council only adopted its general approach on 8 February 2019. However, this was swiftly followed by a single trilogue meeting on 12 February 2019 at which the EU institutions reached a provisional agreement. The agreed text needs now to be formally adopted by both Parliament and Council.

Proposal for a Directive of the European Parliament and of the Council amending Directive 2009/73/EC concerning common rules for the internal market in natural gas

COM(2017) 660, 8.11.2017, 2017/0294 (COD), Ordinary legislative procedure (COD) (Parliament and Council on equal footing – formerly 'co-decision')

Committee responsible:	Industry, Research and Energy (ITRE)
Rapporteur:	Jerzy Buzek (EPP, Poland)
Shadow rapporteurs:	Dan Nica (S&D, Romania), Zdzisław Krasnodębski (ECR, Poland), Morten Helveg Petersen (ALDE, Denmark), Neoklis Sylikiotis (GUE/NGL, Cyprus), Benedek Jávor (Greens/EFA, Hungary), Dario Tamburrano (EFDD, Italy), Barbara Kappel (ENF, Austria).
Next steps expected:	First-reading vote in plenary



27 March 2019
Third edition
The 'EU Legislation in Progress' briefings are updated at key stages throughout the legislative procedure. Please note this document has been designed for on-line viewing.

[Introduction](#)[Context](#)[Existing situation](#)[Parliament's starting position](#)[Council starting position](#)

Introduction

The European Commission has proposed a targeted revision of [Directive 2009/73/EC](#) concerning common rules for the internal market in gas (hereafter 'Gas Directive'), in order to ensure that key provisions of this directive will apply to existing and future gas pipelines between the EU and third countries. The legal basis for this legislative proposal is Article 194 of the Treaty on the Functioning of the European Union (TFEU), which allocates specific competences to the EU in the energy field. These include ensuring the proper functioning of the internal market in natural gas (focus of the Gas Directive) and guaranteeing security of natural gas supply (focus of the separate [Gas Regulation](#), which was [revised in 2017](#)). The Commission argues that its proposal is compatible with the principle of subsidiarity, because similar objectives cannot be met through national laws, while most pipelines with third countries are large enough to impact the EU internal market and security of supply. The Commission also argues that its amendments are proportional and target only what is indispensable, while existing infrastructure can take advantage of possible derogations.

Context

The urgency for the European Commission to adopt this [legislative proposal](#) can largely be attributed to political controversy surrounding the Gazprom-led project to double the capacity of the Nord Stream underwater pipelines delivering natural gas from Russia to Germany. This project is known as '[Nord Stream 2](#)', to differentiate it from the two original Nord Stream pipelines (in operation since 2011-2012). Nord Stream AG is a consortium of companies that build and manage all the Nord Stream pipelines, with a majority stake (51 %) held by Gazprom (a large Russian state-owned company that holds a monopoly of pipeline natural gas exports), while minority stakes are held by energy companies from France (Engie, GDF Suez), Germany (E.ON, Wintershall) and the Netherlands (Gasunie). Supporters of Nord Stream 2 see it primarily as a commercial decision by Gazprom and several EU energy companies (which are co-financing the project) to meet the projected increase in natural gas imports to the EU through a more efficient system of modernised pipelines. Opponents of the project, including the Commission, see it as a choice that primarily reflects the geopolitical interests of the Russian state, in seeking to bypass the Ukraine transit route and increase Gazprom's influence over gas markets in the EU. According to this view, Nord Stream 2 would increase EU dependence on Russian gas, distort the internal EU gas market, and weaken security of supply at regional level.

Regardless of the merits or drawbacks of Nord Stream 2, the legal services of the Commission and the Council arrived at the shared conclusion that the 2009 Gas Directive, as currently worded, does not fully apply to gas pipelines between the EU and third countries. This currently gives the EU limited tools to influence the Nord Stream 2 project. The Commission has therefore asked the Council to deliver a mandate to negotiate an agreement between the EU, relevant Member States and Russia regarding management of the Nord Stream 2 pipelines. This legislative proposal to revise the Gas Directive, if adopted, would make it more difficult for Nord Stream 2 to proceed without such an agreement. However, the Commission stresses that the purpose of this legislative proposal is to fill a legal void in EU energy policy, which has broader application than Nord Stream 2. It would clarify the legal basis for any future pipeline projects with third countries, as well as providing a suitable legal framework for managing gas pipelines between the EU and the United Kingdom, once the latter has left the EU and become a third country in legal terms.

[Introduction](#)[Context](#)[Existing situation](#)[Parliament's starting position](#)[Council starting position](#)

Existing situation

The Gas Directive forms part of the [third EU energy package](#), adopted by the EU in 2009. The transposition deadline for the Gas Directive was 3 March 2011, alongside an equivalent Electricity Directive ([2009/72/EC](#)). The Gas Directive is a far-reaching measure that delivers several important changes, with the common goal of creating a competitive functioning EU internal market in natural gas. The following analysis focuses on those aspects of the Gas Directive that are most directly impacted by this new legislative proposal.

The Gas Directive obliges Member States to commercially and/or legally 'unbundle' the ownership of the gas network ('transmission system') from its effective daily management. The latter must be designated to a 'transmission system operator' (TSO). Since transmission systems are natural monopolies, the Commission insists they need to be regulated to ensure that other companies can access the network, allowing consumers to benefit from more competitive markets with lower prices. The Gas Directive envisages three different models of unbundling, varying from full ownership unbundling (integrated energy companies would sell off their gas and electricity grids); the creation of an independent system operator that would manage, maintain and invest in the gas network (but ownership of the transmission system would not change); or the creation of an independent transmission system operator (an autonomous subsidiary of the parent company owning the network). The Gas Directive also obliges Member States to create regulators that are independent of energy business interests and government, as separate legal entities with defined powers and resources. These regulators are obliged, inter alia, to ensure third parties non-discriminatory access to the infrastructure, by means of a regulated and transparent system of tariffs. The Gas Directive provides a definition of cross-border 'interconnectors' between EU Member States, and encourages their construction and modernisation, in order to improve gas flows between Member States and contribute to the development of a genuine single market. Interconnectors may become eligible for EU funding as strategic energy infrastructure.

The Gas Directive also envisages possible derogations from its rules for existing infrastructure, as well as possible exemptions for new infrastructure that would not otherwise be built. These are granted by Member State authorities but later reviewed by the Commission, which can ask the Member State to amend or withdraw them.

The Gas Directive was designed to advance the EU internal market, so few provisions address the complex issues surrounding application of EU law to physical infrastructure linking the EU with third countries, where most natural gas is either produced (Russia, Norway, Algeria) or transits through (Russia, Norway, Algeria) or through which it transits (Ukraine, Belarus) to reach EU markets. Existing gas pipeline infrastructure is usually managed under the framework of international agreements between the governments and companies involved. Different legal regimes apply (national, European, international), which contributes to varying legal interpretations that do not always ascribe primacy to EU law. Some third countries already comply with EU energy law, by virtue of their membership of the European Economic Area (Norway), European Free Trade Association (Switzerland), or Energy Community (various countries in south-eastern Europe, Ukraine and Moldova). Nevertheless, inconsistencies in the legal framework became more evident with the commissioning of the Nord Stream pipelines. In contrast to the (older) land-based pipelines linking Russian production to European markets via EU and non-EU transit countries, the underwater Nord Stream pipelines reach Germany directly from Russia, passing only through the territorial waters and/or exclusive economic zones of other EU Member States (Finland, Sweden, Denmark, Germany), where the full application of EU law is more ambiguous. Nord Stream 2 would increase EU dependence on a supply



Introduction

Context

Existing situation

Parliament's starting position

Council starting position

route that the EU has few legal means to influence. With the legal services of the Commission and the Council now agreeing that EU law does not fully apply (in its current form) to the Nord Stream pipeline, it has become more urgent to revise EU legislation on cross-border gas infrastructure with third countries, especially since Nord Stream 2 is [scheduled for completion](#) by the end of 2019.

Parliament's starting position

The European Parliament resolution of 25 October 2016 on the [EU strategy for liquefied natural gas and gas storage](#) 'expresses concern at the proposed doubling of capacity of the Nord Stream pipeline, and the counterproductive effects this would have on energy security and diversification of supply sources and the principle of solidarity among Member States ... it should not benefit from EU financial support or from derogations from EU law ... a doubling of the capacity of the Nord Stream pipeline would give one company a dominant position on the European gas market, which should be avoided'.

Council starting position

The [Energy Council of 26 June 2017](#) included a briefing by the European Commission on its request for a Council mandate to open negotiations between the EU and Russia on the regulatory framework for the operation of the Nord Stream 2 pipeline. Although no decision has yet been taken concerning the Council mandate, several Member States welcomed the Commission initiative and expressed concern that Nord Stream 2 'could jeopardise one of the energy union goals, namely diversifying supply sources and routes, and therefore endanger the EU's energy security'.



Proposal

Preparation of the proposal

The [legislative proposal](#) does not include an ex-post evaluation or fitness check of existing legislation, because, in the Commission's view, the proposal is 'limited to providing clarification in an area where applicable EU law (or the lack thereof) and applied practice diverge'. While existing or planned pipelines from third countries would be affected by the legislative proposal, the possibility of derogations for existing infrastructure means that investments are protected and existing international agreements will be largely respected. The Commission argues that the legislative proposal does not require a detailed impact assessment, since the proposed changes merely 'reflect the practice of applying core principles of the regulatory framework set out in the Gas Directive in relation to third countries'. The Commission maintains that such principles are already reflected in several international agreements between the EU (or individual Member States) and third countries, and have been applied consistently to onshore pipelines from third countries. The Commission envisages a very limited increase in administrative requirements, relating mainly to exemption requests that are anyway already a core task for Member States under the Gas Directive.

The targeted nature of the Commission proposal is used as justification for the choice not to pursue a full impact assessment. However, the latter decision may also reflect the sudden urgency attached to a legislative proposal that was not foreseen either in the Commission's energy union strategy (February 2015) or in subsequent updates on the state of energy union (November 2015, February 2017). The legislative proposal was first mentioned in Commission President Juncker's 2017 State of the Union [letter of intent](#) to the Parliament and Council (September 2017). It was subsequently included as a new initiative in the Commission's 2018 work programme, where it was [presented](#) as a measure to complete the energy union that would include an impact assessment.

The staff working document (SWD) accompanying the Commission proposal briefly considers its economic impact. It argues that most of the problems identified in the functioning of EU energy markets are caused by the existence of vertically integrated companies that control essential facilities and enjoy significant market power in the wholesale and retail markets. These problems were addressed by the third energy package in 2009. According to the Commission, applying the rules of the Gas Directive to gas pipelines connecting third countries with the EU should lead to a diversification of sources and a higher level of competition. This should achieve efficiency gains in the gas sector and lead to lower energy prices, favourably impacting the rest of the EU economy. However, these positive economic gains from the legislative proposal are simply assumed by the Commission in the SWD, without citing a specific body of evidence in favour.

The changes the proposal would bring

The Commission [proposal](#) seeks to apply many of the Gas Directive's key provisions to pipelines entering the EU from third countries. This proposal affects both existing and future pipelines, up to the border of EU 'jurisdiction' (intended as including territorial waters and exclusive economic zones). If the proposal is adopted, Gas Directive rules on third-party access, tariff regulation, ownership unbundling, and transparency would fully apply to pipelines between the EU and third countries. This is not the case at



present. According to the SWD, existing Gas Directive rules 'do not expressly provide for their application to gas pipelines connecting a Member State with a third country'.

Several articles of the Gas Directive would be revised in a targeted manner to achieve this principal objective. The current definition of 'interconnector' in the Gas Directive (Article 2) is 'a transmission line which crosses or spans a border between Member States'. The legislative proposal would expand this definition to include transmission lines 'between Member States and third countries up to the border of Union jurisdiction'. This would have the additional effect of making interconnectors with third countries potentially eligible for EU funding as strategic energy infrastructure.

The legislative proposal extends to gas pipelines between Member States and third countries the requirement to **unbundle** ownership of the transmission system from transmission system operators (Article 9). In addition, Member States would be obliged to ensure Gas Directive provisions are fully applied when settling any cross-border disputes over gas pipelines with third countries (Article 34). Member States would need to ensure that new gas infrastructure with a cross-border dimension (e.g. interconnectors, liquefied natural gas (LNG) import terminals, or gas storage facilities) are fully compatible with the Gas Directive, even where the relevant infrastructure is under the jurisdiction of third countries (Article 36). Independent regulatory authorities in the Member States would need to consult and cooperate with the relevant third country's authorities in relation to shared gas pipelines, to ensure the provisions of the Gas Directive are fully respected in operation of the pipeline concerned (Articles 41-42).

This legislative proposal would be applicable not only to planned and future pipelines, but also to existing pipelines between EU Member States and third countries. However, existing pipelines could be granted a **derogation** from the rules of the Gas Directive by the Member State where the first interconnection point is located (Article 49). Such derogations must be limited in time and must not be detrimental either to the competitive functioning of the internal gas market or to security of supply in the EU.¹ Derogations would only apply to pipelines that are already in operation when the Gas Directive enters into force. Nord Stream 2 and other future pipelines from third countries would instead probably have to apply for an **exemption** from the Gas Directive rules for major new infrastructure (Article 36). Exemptions need to meet more stringent requirements than derogations. The new infrastructure needs to enhance competition and security of supply; involve a level of risk that means it would not take place unless an exemption is granted; ensure unbundling of transmission system ownership from transmission system operators; and charge levies on all users. The procedure for obtaining an exemption under the Gas Directive is complex, and involves a review by the European Commission, which can ask for the exemption to be revised or withdrawn.

Interestingly, the Commission recognises that its legislative proposal could lead to a conflict of laws over gas pipelines with third countries, because these would be subject to separate jurisdictions (EU, non-EU) on each side of the border. Because it is not possible, in practice, to operate a single gas pipeline with two (or more) competing jurisdictions, this legislative proposal is designed to foster international agreements between the EU, the relevant Member State(s) and third countries. The explanatory memorandum considers that 'the appropriate instrument for ensuring a coherent regulatory framework for the entire pipeline will often be an international agreement with the third country or third countries concerned'.

1 Derogations could therefore apply to most pipelines between the EU and third countries, including the original Nord Stream pipelines. In the latter case, it would be up to German authorities to grant a derogation.



Preparation of the proposal

The changes the proposal would bring

while the SWD goes further, indicating that ‘an agreement between the Union and the third country would, depending on its content, prevail over the Gas Directive as well as the Gas Regulation.’² This is coherent with the Commission’s request for a Council mandate to negotiate an intergovernmental agreement with Russia over operation of the Nord Stream 2 pipelines, which would be ‘complementary’ to the revised Gas Directive (according to the [fact sheet](#) accompanying this legislative proposal). Commission competences in scrutinising intergovernmental agreements between Member States and third countries in the energy sector were significantly increased by an [EU decision adopted in May 2017](#).

The legislative proposal envisages that Member States ensure full implementation of the directive within 12 months of its eventual entry into force.

2 The content of the intergovernmental agreement would need to be compatible with the broad principles of EU law and the specific principles of the Gas Directive. The Gas Regulation referred to is the Security of Gas Supply Regulation, which was revised by the EU in 2017 in order to strengthen gas sharing mechanisms and regional cooperation. The staff working document suggests that any international agreement concluded between a Member State and a third country would need to comply with the Gas Directive and the Gas Regulation. If there are incompatibilities, these should either be renegotiated or (if not possible) the agreement should be terminated.

[Advisory committees](#)[National parliaments](#)[Stakeholders' views](#)

Views

Advisory committees

The European Economic and Social Committee (EESC) adopted an opinion (TEN/653) on [Amending the Internal Gas Market Directive](#) (rapporteur Baiba Miltoviča, Diversity Europe – Group III / Latvia) during its plenary session on 19 April 2018. The EESC opinion supports the Commission proposal and maintains that the necessary amendments should be adopted without further delay, in order to provide legal certainty to current and planned interconnectors. The EESC maintains that any exemptions should be 'strictly limited and restricted in time (e.g. max ten years)'. However, the EESC opinion does note the likelihood of legal challenges and political disagreements with the Commission's proposal, and therefore regrets the absence of an impact assessment that might have strengthened the case for these legislative revisions.

The European Committee of the Regions (CoR) adopted an opinion (ENVE-VI/026) on [Rules for the Internal Market in Natural Gas](#) (rapporteur Mauro D'Attis, EPP, Italy) during its plenary session on 16 May 2018. The CoR opinion welcomes the Commission proposal, while noting that an impact assessment should have been carried out. The CoR opinion would seek to limit derogations to three years, and allow the Commission the possibility to take a swift decision requiring the Member State concerned to amend or withdraw the derogation.

National parliaments

National parliaments were [consulted](#) on the proposal. The French Senate issued a [Reasoned Opinion](#) stating that the Commission's proposal infringes the principle of subsidiarity. The French Senate argues that the proposal prevents the Member States from deciding about their energy policy, and maintains that the EU has no competence to deal with foreign countries on energy infrastructure. No other reasoned opinions were received from EU Member State parliaments.

Stakeholders' views³

The targeted and technical nature of this legislative proposal may explain why few business, social and environmental associations have issued a public opinion. However, several commentators and specialists link it to the ongoing debate on Nord Stream 2.

[Siobhan Hall](#), writing for Platts Energy, sees the legislative proposal as part of efforts by the Commission to oppose Nord Stream 2, or at least ensure that it complies with the energy single market. The effectiveness of this approach will depend on the Council and Parliament adopting the proposal before Nord Stream 2 is operational, as well as the willingness of Russia to negotiate an agreement with the EU. A more realistic

³ This section aims to provide a flavour of the debate and is not intended to be an exhaustive account of all different views on the proposal. Additional information can be found in related publications listed under 'EP supporting analysis'.



Advisory committees

National parliaments

Stakeholders' views

possibility is that the legislative proposal increases uncertainty surrounding Nord Stream 2, discouraging potential project investors and making it harder to secure financing.

[Leonid Bershisky](#), a columnist for Bloomberg, maintains that 'if Germany agrees with the Commission and the proposed rule change becomes law, Russia will need to drop the project altogether or agree to the new terms'. These include unbundling of the transmission system, third-party access to the infrastructure by means of transparent tariffs, and Gazprom diluting its stake by selling shares to other investors.

[Severin Fischer](#), senior researcher at the Center for Security Studies at ETH Zurich, is critical of the Commission approach. Fischer argues that the legislative proposal creates a 'legal void' where none currently exists, in order to support the Commission's request for a Council mandate to negotiate an international agreement with Russia. The aim of the Commission seems to be to placate opponents of Nord Stream 2 among some Member States, as well as shift some of the burden of responsibility to the Council.

[Sebastian Sass](#), an adviser to the Nord Stream 2 consortium, considers that the legislative proposal is 'a far-reaching change to the scope of application of the EU's energy laws, which would have merited a thorough consultation of stakeholders', including a full impact assessment. Sass argues that the Commission is generating a legal conflict that would not exist without the new legislation, in order to justify its request for a Council negotiating mandate as a way to resolve this self-created conflict.

Some think-tanks have issued opinions on Nord Stream 2 and the EU response.

[Georg Zachman](#) (Bruegel) argues that Nord Stream 2 could destabilise regional energy cooperation in Europe and offers Gazprom excessive influence in central and eastern Europe. However, it could be valuable for gas markets in Germany. The German government is advised to consider the broader EU interest in opposing the project, rather than its narrow economic interest in supporting it.

[Annika Hedberg](#) (European Policy Centre) is critical of the Nord Stream 2 project on both legal and political grounds, arguing that Gazprom's Nord Stream 2 decision is largely a Russian geo-political choice, and not the best commercial option. It therefore needs to be countered by a strong political decision from the European Commission.

[Alan Riley](#) (Institute for Statecraft, London) argues in a Centre for European Policy Studies (CEPS) special report that the EU's regulatory authority *already* applies to Nord Stream 2 (indisputably in the case of territorial waters, highly probably in the case of exclusive economic zones). This is very different from the legal arguments advanced by the European Commission to justify this legislative proposal. The CEPS report sees it as unlikely that the EU and Russia will reach an agreement over the Nord Stream 2 pipeline, given the legal and political obstacles involved.



Legislative process

In the Parliament, the [proposal](#) was allocated to the Industry, Research and Energy Committee (ITRE), which held a first exchange of views on 28 November 2017. The chair of the committee, Jerzy Buzek (EPP, Poland) was appointed as rapporteur in order to produce a draft report, which was published on 7 December 2017. The final [report](#) was adopted by the ITRE committee after amendments on 21 March 2018, together with a mandate to enter into trilogue negotiations with the Council. The negotiating mandate was formally confirmed during the April plenary session of the Parliament.

The final report broadly endorses the Commission approach while proposing to complement and further strengthen some of its provisions. This includes specifying the application of the gas directive to the territorial waters and exclusive economic zones of EU Member States in Article 1 (the Commission proposal only specifies this in the preamble); limiting exemptions for major new infrastructure (from 1 January 2019) to a maximum of five years, and requiring a series of cumulative conditions to be met (including diversification and security of gas supply); requiring third countries to respond to consultations within three months (after which Member States would be free to take decisions without consultation); allowing the Commission to take into account economic sanctions imposed on a third country when deciding on whether to grant an exemption; involving the Commission more closely in the process of granting time-limited derogations; and allowing only a short timeframe (three months) for transposition of the revised directive into national laws in the Member States.

The Council discussed this proposal several times in its Energy Working Party and at Coreper level. The Council's Legal Service raised concerns about the compatibility of the Commission proposal with the United Nations Convention on the Law of the Sea (UNCLOS), as well as other issues relating to the legal basis, allocation of competences, and derogations. In 2018, the Bulgarian and Austrian Presidencies drafted several revisions to the proposal, in an attempt to find support for a general approach, which was finally reached on 8 February 2019 under the Romanian Presidency.

The Council's [general approach](#) seeks to restrict the scope of the revised gas directive to the territories and territorial waters of EU Member States, thereby excluding the (much larger) exclusive economic zones. It also makes clear that the Member State in which the first interconnection point is located should be primarily responsible for upholding the application of EU rules on pipelines with third countries. In the case of Nord Stream, this Member State would be Germany. The general approach envisages only a consultative role for neighbouring Member States through which the pipeline passes or whose gas markets may be heavily affected by its operation.

The general approach would ensure existing agreements with third countries are maintained in force unless (and until) they are superseded by new or revised agreements. A new empowerment procedure would allow Member State(s) to negotiate new or revised agreements with third countries (or to extend existing ones), but only after notifying the Commission at least five months before the intended start of negotiations. The Commission could block such negotiations on a defined set of grounds. However, Commission participation in any actual negotiations would be at the discretion of the Member State(s) concerned. The general approach seeks to exclude technical agreements between transmission system operators from the scope of this directive.



The general approach does not support any additional criteria or restrictions on granting exemptions, beyond those already contained in the 2009 Gas Directive. It would allow Member States to grant derogations for up to 20 years on 'objective' grounds, including security of supply and recovery of investment, and would allow such derogations to be renewed for a further (undefined) period of time. The Commission would not be formally involved in the process of granting derogations. The revised directive would need to be transposed into national laws within 12 months of entering into force.

On 12 February 2019 the first and only round of trilogue negotiations was held on this file. These negotiations concluded in a provisional agreement that now needs to be formally adopted by Parliament and Council. On 20 February 2019, Coreper endorsed the agreed text, and on 18 March the ITRE committee also did so. The text is now due to be voted in plenary in April 2019.

The [provisional agreement](#) is consistent with the Council approach of ensuring that the Member State with the first interconnection point is primarily responsible for applying EU rules on pipelines with third countries, particularly with regard to exemptions and derogations, and limits the scope of the directive to Member State territories and territorial waters. EU rules on exemptions are tightened, though, to ensure that any planned investment is not detrimental to market competition or security of supply, and that all affected Member States are appropriately consulted over a 90-day period. Derogations for existing infrastructure could be granted for up to 20 years, and potentially renewed again for 'objective reasons' including the recovery of investments made or security of supply.

The empowerment procedure (proposed by the Council) is retained in the provisional agreement, but subject to greater powers for the Commission (as demanded by the Parliament). The Commission will not only need to authorise the negotiations, it must also be fully informed about their outcome, and its authorisation will be required before the Member State(s) can sign and conclude the agreement. The empowerment procedure would be explicitly aligned with recent changes to EU law concerning [intergovernmental agreements in the energy sector](#). Existing agreements will remain valid unless and until they have been superseded. Technical agreements between transmission system operators would largely fall outside the scope of this directive.

The revised directive must be transposed into national laws within nine months of entering into force, except in Member States that have no geographical borders or transmission lines with third countries, where no immediate legal changes are needed.



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