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Trade law, sanctions and export controls in a new era of global geopolitics

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In 2021, “maintaining the status quo” was the defining feature of the Canadian trade landscape. In many ways, 2022 has been the exact opposite. Russia’s invasion of Ukraine has spurred a new era of global geopolitics, and Canada’s sanctions and export laws have evolved in response. While Russia dominated the headlines, 2022 also saw important updates stemming from Canada’s obligations under its trade agreements, as well as new proposed legislation to bring Canada into line with its allies in combatting slavery and other forms of forced labour in its supply chains. We provide a snapshot of some of these key developments.

Russian sanctions

On the morning of February 24, 2022, people around the world woke to the news that Russia had invaded Ukraine. As Russian forces marched toward Kyiv, the governments of the European Union, the United Kingdom, the United States, Canada and other allies were preparing to levy what U.S. Senator Bob Menendez referred to as the “mother of all sanctions.” Since then, Canada has passed a comprehensive sanctions package in unprecedented coordination with its allies. The government continues to implement a broad suite of far-reaching sanctions. We have previously written several Osler Updates regarding Russian sanctions.

The sanctions and export controls imposed to date include a number of restrictive or prohibitive measures.

One of the key restrictions is the prohibition against Canadians or persons in Canada entering into any direct or indirect dealings with various designated persons or persons acting on their behalf, or knowingly causing, facilitating, assisting or intending to cause, facilitate or assist such dealings. This includes a prohibition on dealing in any property of, or providing any financial or related services or making any goods available to, such persons. The list of designated persons has grown rapidly throughout 2022. A consolidated list of designated persons subject to the regulations under the *Special Economic Measures Act* (SEMA), including those relevant to entities and individuals in Russia, Belarus and the Ukraine, can be found in the Consolidated Canadian Autonomous Sanctions List. The Canadian government has kept this list mostly up to date throughout this volatile period.

Additionally, Canadians or persons in Canada are prohibited from engaging in various dealings in the Crimea, Donetsk, Luhansk, Kherson and Zaporizhzhia regions of Ukraine, or knowingly causing, facilitating, assisting or intending to cause, facilitate or assist such dealings. They are also precluded from buying or dealing in most new Russian debt, directly or indirectly.

Most-Favoured-Nation tariff treatment for goods originating in Russia and Belarus has been withdrawn. Similarly, Russian vessels and aircraft are restricted from entering Canadian airspace or landing in Canada. Certain Russian banks have been “de-SWIFTed” – i.e., removed from the SWIFT global wire system. An export ban has been implemented on certain services and goods identified on the “Restricted Goods and Technologies List.” There is an import ban on designated luxury goods and gold. Finally, there is a prohibition on providing certain services to Russian oil, gas, chemical and manufacturing industries.

As 2023 begins, one thing is certain: the global sanctions landscape will further evolve. As the situation in Ukraine continues to escalate, businesses should expect the federal government to strengthen existing sanctions measures and potentially implement additional measures, even in the face of continuing economic pressures.

Russia and Iran: Flexible sanctions frameworks

Perhaps the most notable feature of Canada’s sanctions levied in response to Russia’s actions in Ukraine is the speed at which the federal government has acted, in connection with its international partners. In 2022, sanctions evolved at a breakneck pace. While sanctions have long been a foreign policy tool used by the Canadian government, the way in which sanctions are being implemented seems to have shifted.

In response to prior foreign events, the federal government tended to follow a similar pattern when instituting sanctions. After an initial violation, the government would announce sanctions, which would typically be imposed pursuant to country-specific regulations made under the SEMA. These sanctions could be amended from time to time, but generally they would remain relatively stable, making compliance a relatively straightforward exercise.

In response to Russia’s actions in Ukraine, and more recently in response to Iran’s gross and systemic human rights violations, the government has implemented “flexible sanctions frameworks.” While the measures may look the same (i.e., dealings bans, export restrictions, etc.), the speed at which these measures are subsequently revised is unprecedented. No formal legislative amendment is required to amend country-specific SEMA regulations.

Most frequently updated are the lists of individuals and entities designated as subject to a broad dealings ban under certain SEMA regulations. As we have seen with respect to both Russia and Iran, the government has designated increasingly more individuals and entities under these lists, amending them as frequently as twice a week at the onset of Russia’s invasion of Ukraine. In total, Canada made an unprecedented 31 separate regulations to amend the Special Economic Measures (Russia) Regulations since their initial adoption in February 2022. This has made it difficult for companies to keep abreast of the constant changes.

This approach appears to be reflective of a broader trend that businesses operating in Canada and Canadians operating abroad should expect to continue in the near future. This trend allows the government to pivot quickly and escalate sanctions to respond to evolving geopolitical situations. Prime Minister Trudeau and Deputy Prime Minister Freeland have repeatedly stated that they are committed to working towards listing individuals and entities responsible for human rights violations on an ongoing basis. As these lists continue to be updated, businesses must remain vigilant and ensure compliance policies are revised regularly to reflect this new reality.

The first challenge under CUSMA

This year was also been a period of evolution under Canada's trade agreements. The first challenge under the Canada-U.S.-Mexico free trade agreement (CUSMA) concluded in 2022.

The regulation of Canada's dairy industry – specifically, Canada's "supply management" system – has long been a source of tension between Canada and its trading partners, particularly the U.S. An essential element of this system is the use of tariff rate quotas, or "TRQs." Additional information on the supply management system can be found in our blog post. These TRQs limit the volume of foreign dairy products that can enter the Canadian market at a lower rate of duty. A preferential rate of duty is applied to "in-quota" imports of a certain product; any imports exceeding the quota are subject to higher (frequently prohibitive) duties.

After consultations between Canada and the U.S. did not resolve the issues, the U.S. advanced the first state-to-state dispute under CUSMA when it called for the establishment of a dispute panel to review Canada's practice of reserving 85% to 100% of each TRQ for processors. The challenge was launched in May 2021, and the Panel's decision was made public on January 4, 2022. In its decision, the Panel held that Canada was in breach of its commitments under CUSMA by reserving 85% to 100% of certain TRQs for exclusive use of processors.

As only state-to-state disputes are permitted under CUSMA, this decision sheds light on how future disputes under CUSMA will be reviewed. Importantly, the decision highlights the speed and efficiency of the CUSMA dispute resolution process. Approximately six months elapsed from the composition of the panel to the issuance of the final report. While disputes will be assessed on a case-by-case basis, the institution of an efficient and reliable dispute resolution mechanism is a welcome development for business.

Modern slavery legislation update

In 2022, Canada proposed unprecedented measures to combat slavery and other forms of forced labour in its supply chains.

Canada has taken additional steps to limit the importation of goods mined, manufactured or produced wholly or in part by forced labour in line with its obligations under free trade agreements, including CUSMA. Such importation is currently prohibited by the Canadian *Customs Tariff*. In addition, Canada has levied narrow sanctions with respect to the Xinjiang Uyghur Autonomous Region (Xinjiang) in connection with allegations of forced labour in the region.

As we approach the end of 2022, four bills introduced into Parliament seek to address the risk of forced labour and child labour in supply chains. These are Bill C-243: *An Act respecting the elimination of the use of forced labour and child labour in supply chains*; Bill C-262: *An Act respecting the corporate responsibility to prevent, address and remedy adverse impacts on human rights occurring in relation to business activities conducted abroad*; Bill S-204: *An Act to amend the Customs Tariff (goods from Xinjiang)*; and Bill S-211, *An Act to enact the Fighting Against Forced Labour and Child Labour in Supply Chains Act and to amend the Customs Tariff.* Bill S-211 has advanced the furthest in the parliamentary review process and is the most likely to become law.

This legislation, if enacted, is expected to become effective the year after it is enacted and would apply to government institutions and "entities" that produce, sell or distribute goods anywhere in the world, that import goods into Canada or that control an entity engaged in these activities. For the purposes of this legislation, "entities" include businesses listed on a Canadian stock exchange or with a connection to Canada, such as those doing business in Canada, having a place of business in Canada or reporting assets in Canada. In addition, entities must meet at least two of these three conditions for at least one of its two most recent financial years:

1. the entity has at least C$20 million in global assets
2. the entity has generated at least C$40 million in global revenue
3. the entity employed an average of at least 250 employees

As these thresholds are not based on Canadian operations, but rather on global operations, reporting entities may have a very limited nexus to Canada.

If passed in its current form, this legislation will seek to increase transparency in supply chains by instituting an annual reporting requirement. Entities and government institutions will be required to provide the Minister of Public Safety and Emergency Preparedness a report of the measures and diligence processes used to prevent and reduce risk of forced labour or child labour being used to produce goods in or import goods into Canada. The report will also have to be made public. Entities incorporated under the *Canada Business Corporations Act* will also be required to provide the report to their shareholders, along with their annual financial statements.

The legislation will also amend the *Customs Tariff* to prohibit the importation of goods into Canada that are mined, manufactured or produced wholly or in part by child labour. This builds on the existing similar ban applicable to forced labour.

Businesses with a nexus to Canada should expect that this legislation will come into force as early as January 2023. Reporting entities could face an obligation to file their initial reports by May 2023. Reporting entities that fail to comply with these new reporting requirements could face fines up to C$250,000. Any party that authorizes, consents to or participates in the infringement may also face similar penalties. Reporting entities should be prepared to start reporting. Businesses unsure whether they are in fact reporting entities should consult with external counsel regarding their reporting obligations.

We note that, notwithstanding the proposed legislation described above, Canada has historically been criticized for its limited enforcement when it comes to forced labour. Canada has also been criticized for failing to create a presumption that all products sourced from Xinjiang are products of forced labour, and for failing to impose a corresponding obligation on importers to rebut this presumption in relation to all imports from the region, as was done in the U.S. Canada Border Services Agency (CBSA) has denied requests to impose a presumptive ban, and the CBSA's approach has historically been upheld by the courts.

Continued challenges with supply chains

As the world continues to recover from the COVID-19 pandemic, the war in Ukraine rages on and inflation remains staggeringly high, global economies are going to continue to face uncertainty. The World Trade Organization predicts that world trade is expected to lose momentum in the second half of 2022 and remain subdued in 2023 as these shocks continue to be felt throughout the global economy. Specifically, import demand is expected to soften as growth slows in different economies for different reasons.

While governments attempt to balance various policy objectives, ranging from tackling inflation to fighting climate change, it’s possible that they may impose additional trade restrictions and retrench to focus on internal demand. Such retrenchment would exacerbate existing challenges with supply chains created by COVID-19, which have also been detrimentally affected by the Russia-Ukraine conflict and recent COVID-19 lockdowns in China. It is also possible that if Canada imposes its proposed Digital Services Tax (effective as of January 1, 2022 if no changes are made), the U.S. may retaliate with trade sanctions against Canada.

What’s ahead in 2023?

As we move into 2023, businesses should expect to continue to operate in a shifting economic climate. If there is one thing 2022 has taught us, it is to expect the unexpected. As supply chain disruptions continue, global geopolitics remain unstable and the government’s policy priorities continue to evolve, the compliance burden for businesses with a nexus to Canada will increase. Ensuring strong compliance policies are implemented and enforced and creating a culture of compliance will be essential for businesses to effectively weather these challenges.