

Addressing Compliance Challenges in the Interaction of Canadian and US Economic Sanctions and Export Controls in 2019

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Why Does This Matter?

- ¬ growing impact of export and technology transfer controls and economic sanctions in recent years
- ¬ significant costs of compliance failure:
 - ¬ penalties and fines
 - ¬ administrative costs for the business
 - ¬ reputational impact
- ¬ companies now more concerned than ever before about whom they deal with, where their products and technology end up, and who uses their services
- ¬ financings, banking relationships, mergers and acquisitions

Legislative Landscape: Canada's Trade Controls

- ¬ export and technology transfer controls
 - ¬ Import Control List
 - ¬ Export Control List, Area Control List
 - ¬ new brokering controls
- ¬ economic sanctions
 - ¬ Special Economic Measures Act
 - ¬ United Nations Act
 - ¬ Freezing Assets of Corrupt Foreign Officials Act
 - ¬ Justice for Victims of Corrupt Foreign Officials Act (Sergei Magnitsky Law)
 - ¬ Criminal Code (“terrorist groups”)
- ¬ domestic industrial security
 - ¬ Defence Production Act, Controlled Goods Program
- ¬ other legislation of potential concern
 - ¬ blocking orders (Cuba)
 - ¬ anti-boycott policy and discriminatory business practices laws
 - ¬ anti-bribery law (Corruption of Foreign Public Officials Act, US FCPA, UK Bribery Act)
- ¬ “compliance convergence”

Today's Focus

- ¬ Bill C-47: significant amendments to Canada's export and technology transfer regime
- ¬ "lost in the cloud": technology transfer compliance and enforcement challenges
- ¬ five key challenges in economic sanctions compliance and enforcement
- ¬ continuing conflicts between US and Canadian export controls and economic sanctions
 - ¬ Cuba, Iran, Russia
 - ¬ deemed re-exports and human rights and employment law
- ¬ defence trade controls – Canada's Controlled Goods Program and US ITAR

Bill C-47 - Accession to UN Arms Trade Treaty

- ¬ amends EIPA to create a control and permit regime for “brokering”
 - ¬ **broker** means to arrange or negotiate a transaction that relates to the movement of goods or technology included in a Brokering Control List from a foreign country to another foreign country, including a transaction referred to [below]
 - ¬ a transaction that relates to the movement of goods or technology includes **a transaction that relates to its acquisition or disposition**, and a transaction that relates to the movement of technology also includes **a transaction that relates to the disclosure of its contents**
- ¬ “includes all items listed in Group 2 (Munitions List) of the Export Control List, as well as dual-use ECL items likely to be used as weapons of mass destruction”

Bill C-47 - Accession to UN Arms Trade Treaty

- ¬ amends EIPA to add mandatory criteria for export and brokering permits
 - ¬ shall not issue permit if substantial risk that the export or brokering of the goods or technology would result in
 - ¬ a serious violation of international humanitarian or human rights law
 - ¬ an offence under international conventions or protocols relating to terrorism or transnational organized crime
 - ¬ serious acts of gender-based violence or violence against women and children
 - ¬ increasing alignment with objectives of economic sanctions

Bill C-47 - Accession to UN Arms Trade Treaty

- received Royal Assent on December 13, 2018
- ongoing consultations on Bill C-47 with deadline for submissions on January 31, 2019
- also considering
 - additional reporting requirements for military and defence exports and transfers to the United States
 - longer export permit processing timelines due to new requirements for more detailed documentation of permit reviews
 - expanding existing export and technology transfer controls to "certain emerging technologies or dual-use items of national security concern"
 - alignment with US review on export controls over foundational and emerging technologies, including artificial intelligence, quantum computing, etc

Controlled Technology Transfer Challenges

- ¬ Export Controls Division examples of transfers by intangible means in its latest Export Controls Handbook (August 2017):
 - ¬ provision of services or training (e.g., “help desk” advice)
 - ¬ downloads or other electronic file transfers
 - ¬ file sharing
 - ¬ cloud access
 - ¬ e-mails
 - ¬ faxes
 - ¬ telephone conversations (e.g., negotiations)
 - ¬ teleconference
 - ¬ face-to-face meetings

- ¬ most common area for compliance errors, violations and voluntary disclosures

Canada's Current Position on Export Controls and the Cloud

- ¬ generally, transfers within a cloud structure that involve cross-border transfers or access are covered
 - ¬ verbal guidance on encrypted data in transmission and at rest
 - ¬ access to encryption key
- ¬ no written guidance - contrast with US export controls under EAR and ITAR
- ¬ if any uncertainty regarding control status, can apply for a permit to obtain comfort

Assessing Your Cloud Risk: Three Key Questions

- ¬ what is the nature of the data or technology being transferred or accessed?
 - ¬ is it export-controlled?
 - ¬ is it of US-origin?
 - ¬ is it subject to Defence Production Act / Controlled Goods Program?
- ¬ where is data being stored, transferred to or through, or accessed from?
 - ¬ is an Area Control List country involved?
 - ¬ is a sanctioned country involved?
- ¬ what parties are involved in the storage, transfer or access?
 - ¬ are the parties listed, or owned or controlled by someone listed, under economic sanctions?
 - ¬ nationality of involved individuals (for US purposes)

Best Practices – Controlling Technology Transfers

- ¬ coordination with IT to identify email structures, servers, cloud services, applications – diligence 3rd party providers
- ¬ implementation of controls on server/file access, rights management apps restrictions on emailing and downloading controlled data
- ¬ marking drawings, specs, data storage devices
- ¬ hand carry controls – encryption of laptops, devices
- ¬ firm-wide training especially critical for controlling tech transfers

Five Key Sanctions Issues for Canadian Companies

- ¬ rise of targeted or “smart” sanctions
- ¬ application to entities owned or controlled by sanctioned (listed) persons
- ¬ lack of guidance from authorities
- ¬ the sanctions screening deficit
- ¬ increasing disconnect with US and other sanctions regimes

Rise of Targeted or “Smart” Sanctions

- ¬ designated or listed individuals and entities, and the entities they own or control, regardless of where you are or they are
 - ¬ country sanctions regulations (UNA and SEMA)
 - ¬ Al-Qaeda and Taliban (UNA)
 - ¬ Criminal Code – terrorist entities
 - ¬ Freezing Assets of Corrupt Foreign Officials Act
 - ¬ October 2017 Magnitsky Law and changes to Special Economic Measures Act
 - ¬ involvement in gross violations of human rights
 - ¬ significant corruption
- ¬ continuing determination and periodic reporting to financial regulator
- ¬ mandatory disclosure to RCMP or CSIS

Sergei Magnitsky Law

- ¬ Justice for Victims of Corrupt Foreign Officials act came into force October 28, 2017 - broad prohibitions against engaging in activities involving listed foreign nationals
- ¬ adds new grounds for imposing sanctions:
 - ¬ “gross violations of internationally recognized human rights”
 - ¬ “acts of significant corruption”
- ¬ current listings of foreign nationals
 - ¬ Russia – 30
 - ¬ Venezuela – 19
 - ¬ South Sudan – 3
 - ¬ Myanmar - 1
- ¬ importance of screening all counterparties and all individuals and entities who own or control them

Owned or Controlled by Listed Persons?

- ¬ application to entities owned or controlled by listed or designated persons under sanctions measures and impact on due diligence
- ¬ prohibition against, for example, dealing “in any property, wherever situated, that is owned, held **or controlled** by a listed person or by a person acting on behalf of a listed person”
- ¬ US 50% rule for Specially Designated Nationals
- ¬ no public clarification from the Canadian government but...

Lack of Guidance from Canadian Government

- ¬ significant differences in Canadian administration and guidance on economic sanctions vs the United States and other countries
 - ¬ no guidelines, rulings, opinions – notional “FAQs”
 - ¬ limited consolidation of blacklists
 - ¬ no formal voluntary disclosure process
 - ¬ no deferred or non-prosecution agreements

Lack of Guidance from Canadian Government

- ¬ key recommendations of Canada's House of Commons Foreign Affairs Committee in April 2017 Magnitsky Report
 - ¬ properly resource and reform the structures for sanctions regimes
 - ¬ comprehensive, publically available, written guidance for public and private sectors regarding interpretation of sanctions regulations
 - ¬ produce and maintain a comprehensive, public and easily accessible list of all individuals and entities targeted by Canadian sanctions containing all information necessary to assist with proper identification
 - ¬ independent administrative process by which designated individuals and entities can challenge in a transparent and fair manner
 - ¬ clear rationale for the listing and delisting of persons

Lack of Guidance from Canadian Government

- ¬ changes are coming...
 - ¬ funds repeatedly committed in Federal Budget
 - ¬ August 2018 - new Global Affairs Canada Division: “Sanctions Policy & Ops Coordination”
 - ¬ separate from the “United Nations, Human Rights, and Economic Law” section of Legal Affairs
 - ¬ anticipated consultations

The Canadian Sanctions Screening Deficit

- ¬ prohibition against dealings involving designated or listed persons
- ¬ screen for any involvement in the activity – customer, borrower, ultimate user, agent, vendor, creditor, broker, service provider, research partner, collaborator
 - ¬ and the individuals and entities that own or control them
- ¬ limited consolidation of lists by Canada
- ¬ practical necessity of using a third party screener
 - ¬ due diligence on screener

Increasing Disconnect With US Sanctions

- ¬ Canadian sanctions can be more aggressive than those of the United States or European Union
- ¬ increasing differences – no longer moving in lockstep
 - ¬ Iran – JCPOA
 - ¬ Russia
 - ¬ different blacklists
- ¬ blocking orders – prohibiting compliance with US sanctions measures
 - ¬ Cuba
 - ¬ Iran

Canada vs United States Sanctions: Iran

- ¬ new “disconnect” between US and Canadian sanctions against Iran
 - ¬ re-exports/re-transfers of US-origin items to Iran
 - ¬ US takes jurisdiction with as little as 10% US-origin – differs from ECL 5400 test applied by Canadian authorities
 - ¬ Iranian visitors / temporary resident employees access to US technology
 - ¬ are you US-owned or controlled?
 - ¬ OFAC General License H authorizes certain transactions for US-owned foreign entities – now revoked with authorization to wind down until November 4, 2018
 - ¬ involvement of US persons – use of recusals
 - ¬ other US touchpoints

The Cuban Conundrum

- ¬ problem, whether or not you trade with Cuba
- ¬ Canada's expanding economic relationship with Cuba
 - ¬ Canada is one of Cuba's largest trading partners
 - ¬ Canadian exports to Cuba - machinery, agrifood products, sulphur, electrical machinery, newsprint
 - ¬ Canadian imports from Cuba - ores, fish and seafood, tobacco, copper and aluminum scrap and rum
 - ¬ Canada is one of Cuba's largest sources of foreign direct investment
 - ¬ Canadian FDI - nickel and cobalt mining, oil and gas, power plants, food processing

Current U.S. Measures vs. Cuba

- ¬ Cuban Assets Control Regulations
 - ¬ administered by U.S. Treasury' Office of Foreign Assets Control
 - ¬ prohibition on foreign entities owned or controlled by U.S. persons from doing business with Cuba
- ¬ Export Administration Regulations
 - ¬ administered by the U.S. Department of Commerce's Bureau of Industry and Security
 - ¬ requires that a re-export license be applied for where U.S. content is 10% or more
- ¬ Helms-Burton Act
 - ¬ Title III – private right of action vs. “traffickers” in “confiscated property” (right suspended)
 - ¬ Title IV – bar on entry in the United States for traffickers, their spouses and minor children

The Foreign Extraterritorial Measures Act

- ¬ 1996 “blocking” order
 - ¬ obligation to notify Canadian Attorney General of certain communications
 - ¬ prohibition against complying with certain U.S. trade embargo measures
- ¬ penalty exposure: up to \$1.5 million and/or 5 years imprisonment

FEMA Enforcement Experience

- ¬ there has never been an attempted prosecution of the Canadian blocking order
- ¬ no case law or administrative/prosecutorial guidelines
- ¬ no guidance from the Canadian government
- ¬ numerous investigations - American Express, Eli-Lilly, Heinz, Red Lobster, Wal-Mart and others
- ¬ Wal-Mart's Cuban pyjamas
 - ¬ nationalistic sensitivities

Critical FEMA Conflict Points

- ¬ training programs
- ¬ compliance manuals
- ¬ communications and instructions
- ¬ server accessibility
- ¬ meetings and telephone conversations
- ¬ M&A due diligence
- ¬ contracts – e.g., supply agreements with U.S. companies, intercompany agreements, purchase orders, etc.
- ¬ end-use certificates

US Export Controls vs Canadian Human Rights Laws

- ¬ prima facie breach of Canadian human rights and employment law, if on basis of citizenship or country of origin:
 - ¬ terminate an employee
 - ¬ deny employment
 - ¬ restrict access to training
 - ¬ treat others preferentially
 - ¬ promotions
 - ¬ overtime
 - ¬ scheduling
 - ¬ also - asking about citizenship, nationality, country of birth

US Export Controls vs Canadian Human Rights Laws

- ¬ US Export Administration Regulations and deemed exports and re-exports in Canada
- ¬ US BIS recognizes an individual's most recent country of citizenship or permanent residency as his or her home country for licensing requirements
- ¬ issue for Canadian employees who may access US-controlled items in Canada

US Export Controls vs Canadian Human Rights Laws

- ¬ working with employment counsel to develop procedures to assess potential exposure and minimize likelihood of human rights complaint
- ¬ accommodation to the point of undue hardship
- ¬ may require attempt to obtain US license from BIS
- ¬ has the Defence Production Act CGP solved ITAR conflicts with Canadian human rights?

Best Practices in Managing the Relationship Between US and Canadian Trade Controls

- ¬ trade control compliance in the shadow of the United States
- ¬ Canadian controls can be more onerous than US controls – e.g., cybersecurity, encryption, Russia/Ukraine, Belarus, Burma, North Korea
- ¬ cannot simply adopt US trade control policies for Canadian operations
- ¬ export control and trade sanctions compliance manuals and any related directives should be “home grown”

Best Practices in Managing the Relationship Between US and Canadian Trade Controls

- ¬ when potential conflicts arise:
 - ¬ case-by-case analysis, very context-specific
 - ¬ addressing exposure of US citizens in Canada
 - ¬ involvement of Canadian and US counsel
- ¬ cultural - sovereignty issues particularly sensitive

Canada's Controlled Goods Program

- ¬ domestic industrial security program
 - ¬ Defence Production Act and its Controlled Goods Regulations
 - ¬ must register to examine, possess or transfer “controlled goods” in Canada (defence, space, missile controlled tech)
 - ¬ subject to certain exemptions, cannot transfer controlled goods to someone who is not registered
 - ¬ not an export control regime
- ¬ administered by the Controlled Goods Directorate (CGD) (part of Public Services and Procurement Canada)
 - ¬ background and history
 - ¬ relationship with U.S. ITAR and “Canadian exemption”

Canadian Human Rights vs. US ITAR

- ¬ examples of conflicts (ITAR)
 - ¬ General Motors Defense (2007 – Ontario Human Rights Commission)
 - ¬ complaints by six employees, Canadian citizens or landed immigrants, citizenships of third countries (ITAR proscribed states)
 - ¬ employees sent home with pay, restricted their access to information, reassessments
 - ¬ settled, including monetary remedies
 - ¬ employer to make “all reasonable efforts to secure such lawful permission as may be obtained to minimize any differential treatment”

Canadian Human Rights vs. US ITAR

- ¬ examples of conflicts (ITAR) (cont'd)
 - ¬ Bell Helicopter (2008 – Quebec Human Rights Commission)
 - ¬ complainant born in Haiti, Canadian citizen for 30 years
 - ¬ applied for and hired on internship and training
 - ¬ subsequently denied internship because of ITAR rules
 - ¬ claim for damages settled

Canadian Human Rights vs. US ITAR

- ¬ Québec Human Rights Commission
 - ¬ “reiterates its opposition to the application of the ITAR rules in Québec because of their discriminatory impact”
 - ¬ “they include requirements that are inconsistent with the Québec Charter of Human Rights and Freedoms”
 - ¬ “can no longer accept that companies established in Québec submit to foreign rules that infringe on the values and rights of citizens as recognized by the National Assembly”
 - ¬ “following the political developments in this matter attentively ... any person that believes that his or her rights have been infringed by the application of the ITAR rules may rely on the services of the Commission”

ITAR Rule (ITAR 126.18)

- ¬ May 16, 2011 final rule – became effective August 15, 2011
 - ¬ no approval from the US State Department Directorate of Defense Trade Controls required for the transfer of defence articles, including technical data, to a foreign business entity, foreign government entity, or international organization that is an approved end-user or consignee for those items,
 - ¬ “**including the transfer to dual nationals or third-country nationals who are bona fide, regular employees, directly employed by the foreign business entity**”
 - ¬ transfer must take place completely within the territories where the end-user is located or where the consignee operates, and must be within the scope of an approved export license, other export authorization, or license exemption
 - ¬ the recipient of the defence article is **required to have in place “effective procedures to prevent diversion”** to destinations, entities, or for purposes other than those authorized by the applicable export licence or other authorization

ITAR Rule (ITAR 126.18)

- ¬ “effective procedures to prevent diversion” – non-US firms that are consignees or end-users of the defence articles must either:
 - ¬ require a security clearance approved by a foreign government for its employees **or**
 - ¬ **implement a screening process for their employees and execute Non-Disclosure Agreements (NDA)** that provide assurances that employees will not transfer any information to persons or entities unless specifically authorized by the employer
 - ¬ must screen all employees who are to access controlled items for "substantive contacts" with the 25 restricted or prohibited countries under ITAR — including China, Vietnam, Haiti, Cuba, Venezuela and other countries subject to U.S. military sanctions

How Does Canada's Controlled Goods Program Work With ITAR 126.18?

- ¬ problem: the ITAR rule does not contain an explicit exemption for companies that are registered under and comply with CGP
- ¬ CGD Enhanced Security Strategy (October 1, 2011)
- ¬ August 2011 Exchange of Letters Between US DDT^C and PWGSC
 - ¬ DDT^C has “high regard for the CGP as a means to mitigate the risks of diversion”

How Does Canada's Controlled Goods Program Work With ITAR 126.18?

- ¬ what has DDTC policy section said (May 2012)?
 - ¬ gives CGP the “golden seal of approval”
 - ¬ no circumstances in which CGP screening will be insufficient for 126.18 substantive contact screening
 - ¬ non-disclosure agreement is not required if CGP-screened – but has since retracted
 - ¬ endeavouring to put it in writing

How Does Canada's Controlled Goods Program Work With ITAR 126.18?

- ¬ employee concerns and pushback
 - ¬ on sensitive and personal information regarding:
 - ¬ travel frequency, duration and location
 - ¬ “significant and meaningful” associations
 - ¬ criminal history
 - ¬ financial issues
 - ¬ previous broad Privacy Act statement: consent to disclosure “to law enforcement and other government departments and agencies, including foreign governments, which conduct checks and/or investigations in accordance with Memoranda of Understanding (MOUs) established with Public Works and Government Services Canada (PWGSC)”
 - ¬ no longer references foreign governments

How Does Canada's Controlled Goods Program Work With ITAR 126.18?

- continuing ITAR/CGP challenges
 - ¬ no guarantee yet that screening in accordance with ESS, CGP and Canadian law will meet the ITAR section 126.18 requirements
 - ¬ are US exporters/partners comfortable relying on section 126.18?
 - ¬ does this resolve human rights and privacy issues?
 - ¬ practical issues remain
 - ¬ highly sensitive area for employees
 - ¬ continue education and explanation
 - ¬ careful adherence to the CGP application and guidance

How Does Canada's Controlled Goods Program Work With ITAR 126.18?

- continuing ITAR/CGP challenges
 - DDTC's suggested non-disclosure agreement (NDA) requires employees to comply with ITAR and certify that they have never acted for or provided information to 126.1 countries, including Cuba, etc.
 - October 2014 - “made in Canada” NDA screening form to be signed by the security-assessed employee in Canada (<http://ssi-iss.tpsgc-pwgsc.gc.ca/dmc-cgd/ft-fo/aaee-nsaa-eng.html>)
 - CGD states that “for those CGP registrants accessing U.S. International Traffic in Arms Regulations (ITAR) goods, this acknowledgement may be used to meet the requirements of ITAR 126.18(c)(2)”

How Does Canada's Controlled Goods Program Work With ITAR 126.18?

- ¬ continuing ITAR/CGP challenges
 - ¬ does not resolve anything for academic institutions
 - ¬ broader issues:
 - ¬ is this consistent with Canadian constitutional (Charter) law?

Compliance Vulnerabilities: Where Are Companies Tripping Up?

- ¬ mandatory disclosure under Controlled Goods Regulations
 - ¬ section 9
 - ¬ change in any information from registration must be notified within 10 days
 - ¬ change in anyone owning 20% or more: must be notified later of 32 business days before the date of the acquisition or one business day after the day on which you become aware of the acquisition
 - ¬ section 10
 - ¬ any actual or potential security breach must be notified within three days
 - ¬ need to consider whether other export control issues (for ECD, CNSC, etc.)

Compliance Vulnerabilities: Where Are Companies Tripping Up?

- ¬ accessibility to servers hosting controlled data in Canada
 - ¬ by Canadian employees and others
 - ¬ by others from abroad
 - ¬ by visitors from abroad, within and outside organization
 - ¬ by IT staff
- ¬ use of isolated servers, access tracking, check-in/check-out for controlled data (vs email)
- ¬ hosting or transmitting controlled data abroad

Compliance Vulnerabilities: Where Are Companies Tripping Up?

- ¬ applies to more than just US-origin ITAR defence articles or items made from US-origin ITAR technical data - Schedule to Defence Production Act also includes
 - ¬ non-US origin
 - ¬ items that would not be subject to ITAR
 - ¬ modification of ECL items in Group 2, 5 (includes some 1-9), and 6

Compliance Vulnerabilities: Where Are Companies Tripping Up?

- ¬ record-keeping obligations for transfers
 - ¬ paragraph 10(a) of Controlled Goods Regulations
 - ¬ a description of any controlled goods received by the person, the date of their receipt and an identification of the person from whom they were transferred,
 - ¬ a description of any controlled goods transferred by the person, the date of their transfer and the identity and address of the person to whom they were transferred, and
 - ¬ a description of the manner and date of disposition of the controlled goods
 - ¬ required to be kept for five years after cease to be registered
 - ¬ consider not transferring controlled goods by email given compliance challenges



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