



# The Brief Case: DRI Committee News

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## Sanctions Update: Global Affairs Canada Issues its First Official Guidance on Economic Sanctions

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On March 22, 2024, Global Affairs Canada (**GAC**) provided its first public guidance on Canadian sanctions legislation. This guidance, among other things, significantly broadens the scope of prohibited business dealings under the *Special Economic Measures (Russia) Regulations* (**Russia Regulations**). Since Russia's invasion of Ukraine two years ago, the number of Russian individuals and entities on Canada's sanctions list has surpassed 2,000 names.

### Sanctions Framework

Sanctions against Russia and Russian nationals are imposed through regulations made under the *Special Economic Measures Act* (**SEMA**) and the *Justice for Victims of Corrupt Foreign Officials Act (Sergei Magnitsky Law)* (**JVCFOA**).

The Russia Regulations and the *Justice for Victims of Corrupt Foreign Officials Regulations* (**JVCFOR**), respectively, prohibit any person in Canada or any Canadian outside Canada from “dealing in the property” of a sanctioned person listed on Schedule 1 to the Russia Regulations or the Schedule to the JVCFOR (**Dealings Ban**). The Dealings Ban encompasses dealings with persons owned or controlled by sanctioned persons based on the deemed ownership test set out in the respective Acts. The Dealings Ban further prohibits “any person in Canada or any Canadian outside Canada” from facilitating, directly or indirectly, any transaction related to such dealings.

### **Section 3: Prohibited transactions and activities**

It is prohibited for any person in Canada and any Canadian outside Canada to:

- a. Deal in any property, wherever situated, held by or on behalf of a designated person whose name is listed in Schedule 1;
- b. Enter into or facilitate, directly or indirectly, any transaction related to a dealing referred to in paragraph (a);
- c. Provide any financial or other related service in respect of a dealing referred to in paragraph (a);

- d. Make any goods, wherever situated, available to a designated person listed in Schedule 1; or
- e. Provide any financial or related service to or for the benefit of a designated person listed in Schedule 1.

A “dealing in property” may apply to real property (e.g., land or buildings), as well as all other forms of property, including physical goods – such as equipment, vehicles, and artwork – or intangible property – such as money, financial instruments, and intellectual property.

Section 5 of the Russia Regulations prohibits, among other things, knowingly facilitating or assisting in any prohibited activities under section 3.

It is important to note that the prohibitions under the Russia Regulations only apply to persons in Canada and Canadians abroad. Canadian sanctions laws do not apply to foreign entities or individuals located outside Canada and cannot be enforced against them extraterritorially. As a result, coordination with allies and partners is a critical component to creating a sanctions framework that reduces legal risk while also exerting pressure on the target nation.

### **Impact on Canadian Industry**

The Dealings Ban strictly prohibits Canadians from doing business sanctioned entities. GAC’s recent guidance seeks to address whether the scope of the Dealings Ban extends to:

- a. dealings with non-sanctioned foreign entities that in turn deal with entities sanctioned by Canada; or
- b. dealings with entities that became sanctioned midway through a transaction

That said, recent guidance from GAC seems to take an expansive view of the legislation irrespective of its potential extraterritorial impact. The examples below illustrate specific scenarios where The Dealings Ban may apply:

***Scenario 1:*** A Canadian company (“A”) is the end-user of a type of product that it purchases from a non-designated foreign supplier (“B”). Company B manufactures this product using materials that it sources directly from a company recently designated under the Russia Regulations (“C”).

GAC’s guidance states that while a foreign supplier is not subject to Canadian sanctions and it may be legal for B to deal with C in jurisdictions outside of Canada, transactions between Canadian company A and foreign supplier B

involving company C's products are nonetheless considered prohibited under the Russia Regulations unless an exception is applicable. It would therefore be prohibited for the Canadian end-user company, A, to continue procuring goods from B that involve dealings with C past the date on which C became a sanctioned entity.

GAC's interpretation of the Russia Regulations significantly broadens of the scope of the Dealings Ban. Paragraph 3(b) of the Russia Regulations prohibits Canadians and persons in Canada from facilitating transactions related to prohibited dealings referred to in paragraph 3(a). Prior to the issuance of this guidance, "prohibited dealings" could be reasonably interpreted to mean dealings between Canadians or persons in Canada with sanctioned persons. GAC is now interpreting paragraph 3(b) as prohibiting the direct or indirect facilitation of dealings between any person, including foreign supplier B, and a sanctioned person.

From a statutory interpretation perspective, GAC appears to be improperly divorcing paragraph 3(a) from the global clause immediately preceding it. In our view, these provisions only prohibit the facilitation of a transaction or activity that involves a "Canadian" or "person in Canada," as the prohibitions in section 3 only apply to Canadians and persons in Canada. This view is supported by the fact that sanctions legislation, being penal legislation, is interpreted strictly in accordance with its terms. In addition, we note that a more expansive interpretation that does not limit the application of s. 3(b) or s. 5 to transactions where a "Canadian" or "person in Canada" is involved gives the *Russia Regulations* profound international reach without express words necessitating that effect, which would offend the interpretive presumption against extraterritoriality.

It remains to be seen whether Canada will prosecute these transactions and, if so, whether GAC's interpretation will hold up in court. Nevertheless, GAC's official position on the matter presents a significant legal and commercial risk to Canadian businesses and international partners.

A key question raised by the recent additions to the Russia Regulations relates to whether Canadians can complete transactions that were started before the counterparty was added to the Russia Regulations.

***Scenario 2:*** A Canadian company ("A") has entered into a contract with a non-designated Russian company ("B"). As per the contract, A sends funds to B in return for the delivery of non-sanctioned goods. At a given time, company B is sanctioned under the Russia Regulations and is thus subject to the Dealings Ban. At the time that the sanctions against company C came into force, payment had been made but the goods provided by B had not yet been delivered.

The current GAC guidance indicates that the financial transaction between company A and B is not considered to have contravened the Dealings Ban because it was completed prior to the coming into force of B's designation as a sanctioned entity. As for the goods: given that company A has already provided payment to company B, and provided that the activity does not require in any further dealings with B or benefit it in other ways, A may receive the goods delivered by B and use them without risk of contravening the Dealings Ban.

Interestingly, GAC appears to approve of Canadians receiving property directly from a sanctioned entity as long as it refrains from engaging in any financial transactions relating to it.

### **Legal and Commercial Risks**

A breach of the SEMA is a criminal offense, enforced by the Canadian Border Services Agency and the Royal Canadian Mounted Police. A breach of these sanctions is considered a hybrid offense and may be prosecuted on either a summary or indictable basis. If pursued summarily (roughly equivalent to a misdemeanor), the maximum penalty is a \$25,000 fine or a one-year prison term. Conversely, if pursued by indictment (roughly equivalent to a felony), a conviction may result in up to a five-year prison term, and a corporation could be subject to a fine at the discretion of the Court.

In addition to the legal and reputational risks associated with prosecution under Canada's sanctions regime, Canadian businesses will have to rethink their existing global supply chains and be particularly diligent where entities are sanctioned in some jurisdictions but not others. For example, Canada added VSMPO-AVISMA Corporation (**VSMPO-AVISMA**) to Schedule 1 of the Russia Regulations on February 21, 2024. VSMPO-AVISMA is one of the world's largest titanium producers and a leading supplier for aerospace and defense firms. It is in part owned by Rostec, the Russian state-owned defense conglomerate, which is also sanctioned by Canada and its Western allies.

While Canada generally coordinates with its Western allies when adding individuals and entities to its sanctions lists, Canada appears to have acted unilaterally in sanctioning VSMPO-AVISMA. Notably, the, United States, European Union and United Kingdom have refrained from placing sanctions on VSMPO-AVISMA, given the integral role it plays in supplying critical minerals to Western aerospace and defense firms.

As a sanctioned entity under Canadian legislation, Canadian businesses and individuals are prohibited from sourcing titanium directly VSMPO-AVISMA. Under GAC's interpretation of the Dealings Ban, Canadians are now further

prohibited from purchasing goods from suppliers, wherever situated, if those manufactured goods contain titanium from VSMPO-AVISMA. As VSMPO-AVISMA has not been sanctioned by other Western countries, countless firms in Europe, the US and elsewhere may be supplying titanium products to Canadians in violation GAC guidance on sanctions law.

GAC's interpretation of the scope of the Dealings Ban has additional consequences for Canadian individuals working abroad. As the Dealings Ban applies to Canadians outside of Canada, Canadians working internationally within non-Canadian companies that may transact (directly or indirectly) with sanctioned Russian entities. For example, a Canadian living in Europe and employed by a firm that obtains components or material that contains titanium from VSMPO-AVISMA may be violating the Dealings Ban. Despite the fact that it remains legal for their employer to transact with VSMPO-AVISMA under EU and UK sanctions laws, it may be illegal for a Canadian in Europe to be employed by such an entity.

### **Discretionary Exemptions and Chaotic Implementation**

Canadians may apply to the Minister of Foreign Affairs, via GAC, for a permit to engage in specified activities otherwise prohibited under Canadian sanctions laws. Permits are issued on an exceptional basis and there is no guarantee that an application for a permit will be approved. Additionally, GAC states that it cannot estimate how long a permit will take to be granted, and some applicants have reported waiting more than sixteen months without receiving a response to their application for a permit.

Far from allaying concerns, it is more unclear than ever whether Canadian businesses and their foreign suppliers should invest heavily shifting their supply chains away from Russian titanium or hope that they will be granted similar exemptions by GAC.

### **Key Takeaways**

- Legal risk arises where supply chains run through multiple jurisdictions whose sanctions laws vary. Businesses must be diligent in identifying the applicable sanctions laws and considering the interaction between various sanctions regimes.
- Canadian businesses should implement compliance measures that flag new individuals and entities added to Canada's sanctions lists.
- Suppliers to Canadian aerospace businesses must be careful to vet for VSMPO-AVISMA material in its supply chain.

- The Government of Canada's official position is that dealings with foreign companies that do business with sanctioned entities, such as VSMPO-AVISMA, are prohibited under the Dealings Ban. While we anticipate legal challenges to this broad statutory interpretation in the near future, this position presents a significant compliance risk to Canadian businesses with complex, global supply chains.
- Canadian individuals abroad working for foreign companies transacting with sanctioned entities must assess whether they are violation of Canadian sanctions law.

This situation continues to evolve and further GAC guidance may be forthcoming. Until that time it appears that GAC's guidance creates a material separation between the legal risk associated with interpreting and complying with the Russia Regulations and the business risk associated with disagreeing GAC's guidance, even if it may be supported by the legislation.

In the interim, however, Canadian companies and their international partners should take care to consider the practical risks that stem from GAC's guidance and review their supply chains with legal counsel and their export control teams.



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