2023 OSLER LEGAL OUTLOOK

Supply chains, 'friend-shoring' and cooperation with allies

DECEMBER 11, 2023 9 MIN READ

Related Expertise

- International Trade and Investment

Authors: John M. Valley, Jesse Goldman, Alan Kenigsberg, Matthew Kronby, Chelsea Rubin

Canadian businesses have experienced supply chain challenges since the beginning of the COVID-19 pandemic. Although some of these abated in 2023, new challenges have emerged as a result of ongoing geopolitical instability, inflation, monetary policy and other social and economic factors. In response, Canada has emphasized policy and regulatory measures intended to both strengthen domestic supply chains and protect those supply chains from overreliance on offshore sources necessary for the functioning of Canada's economy (known as "onshoring"). Canada has also sought to strengthen relationships with strategic allies and to make a conscious effort to build supply chains through the economies of other democracies – a concept referred to as "friend-shoring." Friend-shoring is a key element of the federal government's policy. Businesses should expect it to continue to be a priority in 2024.

In 2023, the federal government introduced a number of policies meant to strengthen relationships with allies. Moving into 2024, we anticipate this trend will continue. Canadians and Canadian business should be mindful of a number of other trends in 2024 and beyond. These include the need to prepare for the implementation of the new modern slavery legislation, ongoing sanctions activity together with enhanced enforcement, as well as increased use of export controls as policy instruments, among other things. Potential initiatives to address climate change through trade measures, steps to modernize free trade agreements and ongoing free trade disputes also bear close monitoring.

Canada implements legislation to combat 'modern slavery'

Earlier this year, Canada passed Bill S-211, the *Modern Slavery Act* (the Act), which will come into force on January 1, 2024. This is Canada's response to human rights abuses present in some supply chains – specifically, the use of forced or child labour. Canada joins other jurisdictions, such as, most notably, the European Union, the United Kingdom, Australia and California, in imposing public and transparent self-reporting requirements regarding supply chains on many businesses resident in Canada. Such obligations will also apply to businesses with only a nexus to Canada, such as businesses that are traded on a Canadian stock exchange or that have assets or otherwise do business in Canada.

For more detail regarding the types of organizations that are caught and the financial thresholds that trigger reporting obligations, refer to our blog post and compliance guide.

The Act builds on the existing ban on the import of goods manufactured with forced labour that resulted from Canada's implementation of its obligations under the *Canada–United States–Mexico Agreement* (USMCA). While enforcement of the existing ban by the Canada Border Services Agency (CBSA) has been limited to date, businesses should be mindful of the fact that reports under the new legislation must be published. The CBSA may use these reports, together with information obtained under an existing information sharing memorandum with U.S. Customs and Border Protection, to target imports by particular businesses. This could lead to an uptick in enforcement.

The Act is important because it applies to both publicly traded and privately owned businesses. Additionally, its obligations are mandatory, with a range of penalties that include director and officer liability for non-compliance. Certain reports will need approval from subject entities' boards of directors, will be filed with the federal government and must be available to the public. Organizations incorporated under the *Canada Business Corporations Act* will be required to provide their reports to shareholders together with their annual financial statements no later than May 31 of each year, irrespective of their fiscal year.

It is imperative that Canadian businesses and businesses with a nexus to Canada consider whether they are subject to the Act's reporting obligations. If so, they should begin tracing their supply chains and collecting the relevant information necessary for their report. Businesses with reporting obligations should implement measures to permit them to enumerate in their reports the steps they have taken to comply with the Act. These steps can include training and other compliance preparation. As discussed in *Corporate governance focuses on the who, what and how,* board oversight of this reporting will also be essential.

Sanctions activity continues to increase

As we head into the third year of Russia's invasion of Ukraine, Canada and its allies have continued to expand their use of sanctions. Notably, Canada has shown an increasing willingness to rapidly implement new unilateral sanctions. For example, Canada has enacted unilateral sanctions against Haiti and Iran, outpacing some of our allies.

Canada has also continued to expand existing sanctions measures at a breakneck pace. The lists of persons and entities designated under the *Special Economic Measures Act* (Russia Regulations) have been expanded to include nearly 500 entities and nearly 1,500 individuals. These lists continue to be regularly updated, sometimes daily, making it essential for businesses to carry out ongoing monitoring.

Although Canada has historically demonstrated a lack of sanctions enforcement efforts, Canadian businesses and businesses operating in Canada should be prepared for a potential uptick in enforcement in 2024. The Global Affairs Canada Departmental Plan 2023-2024 refers to the establishment of a dedicated Sanctions Bureau and various other mechanisms designed to enhance Canada's enforcement capabilities. This is particularly important where Canada enacts unilateral sanctions measures with no equivalents in other jurisdictions.

Export controls as foreign policy instruments

Export controls restrict the export of goods, technology and related technical data by generally requiring a permit or licence to export the item. Governments can use export controls to restrict foreign access to particularly sensitive goods or technologies. However, unlike sanctions, Canada's export controls have, to date, been less frequently tied directly to geopolitical and geoeconomic priorities.

Globally, we have seen trends towards governments using export controls and related measures as foreign policy instruments. There are signs that Canada may follow this trend in 2024. In May, for example, Canada, the United States and Mexico held the first North American semiconductor conference. The conference's joint statement declared that the parties will more closely align their strategic industrial and technological priorities with an emphasis on ensuring North American security in production necessary for emerging technologies.

The United States is ramping up its efforts to simultaneously reduce its reliance on Asia-Pacific chip production and foster domestic chip production. Consequently, in addition to its existing export controls, Canada may align its policies accordingly by restricting export or re-export of semiconductors or other sensitive inputs to China in particular.

This emerging policy shift is gaining momentum. It is detailed in the Global Affairs Canada Departmental Plan 2023-2024 which notes that Canada will be participating in the development of a global declaration and related norms regarding the governance of artificial intelligence.

A new frontier: carbon border adjustment mechanisms

Canada and other countries continue to increase regulation to address climate change, and in particular, "carbon leakage," which refers to the movement of carbon intensive industries to jurisdictions with lax regulations. As this occurs, new measures may be adopted that affect both domestic and international trade. As a party to the Paris Agreement, Canada has, alongside 194 other countries, agreed to implement domestic measures to limit greenhouse gas emissions. Parties have set targets for 2025 and 2030. In setting and advancing these targets, other jurisdictions have started to implement measures directed at international trade. Based on developments in 2023, we expect Canada to follow suit in years to come.

On October 1, 2023, the European Union's (EU) Carbon Border Adjustment Mechanism (CBAM) came into effect in its transitional phase. The CBAM is a multi-tool set of regulatory measures that is to be phased in over time. The CBAM applies fees, essentially a form of tariff by another name, to imported goods based on their emissions content. Rebates are available to domestic exporters who export their products abroad, particularly to countries with weaker emissions restrictions.

The CBAM will initially apply to imports into the EU of goods, as well as selected precursors within the cement, electricity, fertilizers, aluminum, iron, steel and non-renewable hydrogen sectors. The production of these precursors is carbon intensive and at the most significant risk of carbon leakage. The CBAM will also cover some upstream and downstream products, specifically iron, steel and aluminum from non-EU countries, including Canada.

While there are concerns that a CBAM may be used, intentionally or otherwise, as a form of trade protectionism or discrimination, Canada is exploring the possibility of introducing a form of its own CBAM. If introduced, depending on the structure of the measure, Canadian

OSLER

producers could be eligible for rebates on exports of high carbon goods to jurisdictions with lax regulations. At the same time, those producers could be exposed to injury claims and countervailing duties in foreign jurisdictions in relation to exports that benefit from Canadian green or cleantech subsidies intended to assist with Canadian carbon emission reduction. Conversely, Canadian businesses could also face increased competition from imports that themselves benefit from green subsidies, which could lead to an uptick in countervailing duties applied against those imports.

Developments in free trade agreements

Consistent with the "friend-shoring" policy objective, Canada continues, for various strategic reasons, to entrench and formalize trading relationships with trading partners. Canada is in the process of introducing or modernizing free trade agreements (FTAs) with the United Kingdom, Ukraine, Indonesia and notably, the Association of Southeast Asian Nations (ASEAN).

The status of these agreements differs by counterparty. For example, the draft text of the modernized *Canada-Ukraine FTA* has been finalized between the parties; implementing legislation was introduced in the House of Commons on October 17, 2023. Agreements with the United Kingdom, Indonesia and ASEAN are all at various stages of negotiation. These free trade agreements, once finalized, will enhance market access to critical economies for various Canadian industries.

There are still hurdles to overcome before these agreements are finalized. In some cases, this will not be achieved in 2024. The status of these negotiations and subsequent implementation bear close monitoring.

Investment and trade disputes continue

The sunset period for new investor-state dispute claims under the *North American Free Trade Agreement* ended in July 2023. Its successor, the USMCA, does not provide for investor-state claims by Canadian investors or against Canada. Nonetheless, such disputes have been and can continue to be brought both by Canadian investors and against Canada under bilateral investment treaties or other trade agreements.

The most notable state-to-state FTA disputes involving Canada in 2023 concerned the regulation of Canada's dairy markets, which continues to be a point of contention for Canada's trading partners. Specifically, Canada's supply management practices have been the subject of disputes under two of Canada's key free trade agreements: the USMCA and the *Comprehensive and Progressive Agreement for Trans-Pacific Partnership*.

Looking ahead to 2024

Heading into 2024, as crises unfold and the Canadian government responds, businesses can expect that the government will introduce new trade measures as a tool to respond to crises, strengthen relationships with allies and support domestic priorities. Lessons learned from ramped-up activities in a number of areas in 2023 will benefit businesses and provide a basis to further strengthen measures in 2024. Businesses would be well-advised to be proactive in implementing processes and procedures aimed at staying on top of this rapidly shifting environment.