

Blakes Bulletin

International Trade & Investment

Announced Overhaul of U.S. Export Control Regime Likely to Impact Canadian Businesses

On August 31, 2010, President Obama announced that the U.S. government is in the process of making significant changes to its system for the control of exports from the United States. Some of these changes may be significant for Canadian companies, particularly those that import goods from the U.S. whether for domestic consumption or as an input into goods that are subsequently exported from Canada. While these changes are yet to be implemented, Canadian companies would be well advised to closely monitor any developments and consider the potential impact on their operations.

EXISTING U.S. EXPORT AND RE-EXPORT CONTROLS

The U.S., like Canada, maintains a system of export control. Certain goods and technology require a permit in order to be legally exported. These rules are for the purpose of controlling the movement of military goods, "dual use" items (items that could have both military and civilian applications) and materials for use in nuclear proliferation, among other sensitive goods and technologies. These rules can be complicated. For instance, items subject to export controls may fall under one of two lists, each of which is administered by different bodies within the U.S. government – the Munitions List (USML) administered by the U.S. Department of State or the Commerce Control List (CCL) administered by the U.S. Commerce Department – and the requirements imposed on exporters may differ depending on which list the item falls under. As the U.S. government notes, this has resulted in, among other things, ambiguity in jurisdiction, delays in issuance of licences, disparate licensing requirements and redundancies, etc.

U.S. export controls can impact Canadian companies in several different ways. First, these controls limit the ability of Canadians to import certain items and may require them to obtain export permits from the relevant U.S. department. Second, U.S. export controls also place restrictions on the export from Canada of certain

items that incorporate items of U.S. origin, including: (i) items produced or originated from the U.S.; (ii) items that contain a specified percentage of U.S.-controlled content; and (iii) items based on certain U.S.-origin technology or software intended for shipment to specified destinations.

PROPOSED OVERHAUL OF U.S. EXPORT REGIME

The reform of the U.S. export control system announced by the U.S. government is intended to streamline and simplify the process of export controls to allow U.S. exporters (and consequently Canadian importers and re-exporters) to know exactly what can and cannot be exported and where the products can and cannot go. While the proposed overhaul of the U.S. export controls covers a range of areas – including a change in the licensing policies, the creation of an entity to co-ordinate enforcement efforts and the transition to a single IT (information technology) system to administer all export controls – of particular interest to Canadian companies is the plan to revamp the lists of controlled items.

The U.S. government proposes to restructure both the USML and CCL as "positive" lists that classify and control items based on objective technical criteria and specific characteristics. Currently, the lists use criteria that are considered to be open-ended, subjective, and broad. The U.S. government also intends to create a "bright line" between the two control lists, so that it is clear which agency has jurisdiction over a particular item. Ultimately, the U.S. government intends to collapse the two lists into a single controls list, much like the single *Export Controls List* (and *Guide to Export Controls*) used by Canada.

In addition, the plan provides for the creation of a 'tiered' classification system for the items on the control lists. The top tier would be for items that are of critical military or intelligence advantage to the U.S. and are available almost exclusively from within the U.S., as well as weapons of mass destruction. A second tier would be for items of substantial military or intelligence advantage and are available almost exclusively from within the U.S. Finally, a third tier would be reserved for items that provide a significant advantage but are available more widely.

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The U.S. government claims this process will lead to the de-control of many items currently subject to export controls. It is expected that certain items currently covered by the USML will be subject to less stringent controls. Moreover, controlled items will be subject to different licensing requirements depending on the tier in which they are classified. Items in the highest tier would generally be subject to the requirement of a licence for export to all destinations (presumably including to Canada). Items in the second tier would be eligible to be exported to U.S. "allies" and most multilateral partners under a licence exemption or general authorization. Presumably, items in this tier would not require a permit for the export to Canada. Items in the lowest tier would generally not require a licence.

The U.S. has stated that one of the purposes of the announced reform is to focus controls on certain items. To that end, the announcement notes that "new controls [will be] imposed on the re-export of those items" not subject to a licence requirement. While many of the details are yet to be finalized, U.S. government officials suggest that this may include, among other things, more frequent end-use checks, and a new requirement for markings on items subject to re-export control.

CONCLUSION

The U.S. government has announced a significant overhaul of the U.S. export controls regime. Once implemented, Canadian companies importing goods from the U.S. may face revamped U.S. export permit requirements and Canadian companies wishing to re-export U.S.-origin goods may be subject to stricter U.S. controls. It is therefore important for Canadian companies importing goods from the U.S. to keep track of the status of the proposed changes to U.S. export controls.

In addition, the proposed changes to the U.S. export control system may trigger a review by the Canadian government of its own export control requirements. For instance, currently, all goods and technology of U.S. origin that are not otherwise controlled by Canadian

export controls, that do not involve a substantial change in value, form or use, may be exported from Canada under a general export permit (General Export Permit No. 12), subject to certain destination restrictions contained in that general export permit. (Goods exported under General Export Permit No. 12 cannot be exported to Iran, Syria, Cuba, the Democratic People's Republic of Korea or any country on Canada's *Area Control List*). Depending on the changes to U.S. export controls, this exemption may need to be modified. In addition, the Canadian government may consider raising with the U.S. government whether Canada would be included as a "permitted" destination for exports of goods, not only under the proposed "second tier", but also, subject to necessary restrictions, under the "first tier". Finally, the Canadian government may consider that an overall review of the Canadian *Export Controls List* is necessary in order to ensure alignment with the revised U.S. export controls.

Blakes will provide updates as the U.S. government finalizes and implements these changes to its export control regime.

For further information, please contact:

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| <u>Ottawa</u> | <u>Cliff Sosnow</u> | 613-788-2233 |
| | <u>David Peaker</u> | 613-788-2237 |
| <u>Toronto</u> | <u>Greg Kanargelidis</u> | 416-863-4306 |
| | <u>Prakash Narayanan</u> | 416-863-2907 |
| <u>Vancouver</u> | <u>Roy Millen</u> | 604-631-4220 |

or a member of our International Trade & Investment Group.

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