



Proposed Federal Law Lays Groundwork for Skolkovo Innovation Project

One of the top priorities declared by President Medvedev is to diversify Russia's economy to reduce its dependence on commodities. In particular, the Skolkovo Bill aims to create an innovative business environment and encourage companies to create research-driven subsidiaries, increase overall investment in research and development, and commercialize the results of such activities. Perhaps the crown jewel in this effort is the planned creation of Innovation Centre Skolkovo (Skolkovo), located in the Moscow suburb of Skolkovo, known for the elite business school that opened there in the fall of 2006.

The State Duma (the lower chamber of Russia's parliament) is currently reviewing the initial draft of a new federal law that will lay the groundwork for the creation and operation of Skolkovo. The draft was approved on the first hearing of the State Duma on 2 August 2010. Two more hearings are expected to consider further amendments to the Skolkovo Bill, with the second hearing most likely taking place in September. The Medvedev Administration reportedly would like to see the Skolkovo Bill finalized and passed into law in October of this year. It is expected that adoption of the Skolkovo Bill will trigger the need to make significant amendments to Russian legislation involving numerous areas of law.

The Skolkovo Bill may still undergo profound changes, but the first draft provides a glimpse into the future.

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Role of the Management Company

The Skolkovo Bill envisions the creation of a management company that will have broad-ranging responsibility and authority for the development and management of Skolkovo. In addition to providing all services typically provided by municipal and regional authorities, the management company will be responsible for realizing the overall goals of the project (i.e., all actions aimed at achieving the goal of creating and securing the functioning of Skolkovo).

Governance of the Management Company and Delegation of Duties

At the most basic level, Skolkovo will be an independent city operated by a state-established management company. The charter of the management company will be stipulated by law, the amendment of which will require the approval of the Presidential Commission on the Modernization of Russia's Economy (Modernization Commission). The Modernization Commission comprises numerous ministers, members of the president's administration and certain prominent businesspeople.

While it is expected that the management company will fund its operations from its own resources, the Skolkovo Bill expressly provides that the project will be funded with a combination of assets of the federal government and the management company.

Furthermore, the management company is authorized to create wholly owned subsidiaries to which it may delegate powers and duties, excluding those exclusively granted to the management company. Such nondelegable duties include (i) development and establishment of the rules governing the development and operation of Skolkovo and other documents necessary for the realization of the project (project rules), (ii) making decisions as to the certification of project participants, (iii) maintenance of the register of certified project participants, (iv) presentation of documents necessary for the payment of customs duties by project participants and (v) regulation of outdoor advertisements.

Consistent with its mandate, the management company is granted vast authority to develop, build and govern Skolkovo from the ground up, starting with developing the city plan and organizing delivery of utilities, public transportation, public safety and primary educational services for residents and including developing and enforcing the project rules and terms and conditions of project participation.

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Ownership of Real Property

The management company shall own all of the real property within the territory of Skolkovo. It may not sell or encumber the real property. The property may be leased by the management company to project participants only for the purpose of realizing the goals of the project. Subleases by project participants are prohibited.

Preemption of Local and Regional Governing Bodies

The management company is granted numerous powers to the exclusion of regional and local governmental agencies including, but not limited to:

- Determining land use;
- Exercising eminent domain powers;
- Establishing administrative liability for breaches of law;
- Establishing city plans;
- Determining procedures for applying for and receiving building, land use and related permits;
- Providing utility services;
- Establishing and maintaining public safety services; and
- Regulating outdoor advertising.

Creation and Operation of Skolkovo Subdivisions of Federal Governing Bodies

In addition to ceding powers of regional and local governmental agencies to the management company, the bill mandates that the relevant federal executive bodies create subdivisions to exclusively service Skolkovo in the areas of internal affairs, immigration, tax, customs, intellectual property and public safety. These subdivisions will have exclusive authority on the territory of Skolkovo within their respective spheres to enforce the laws of the Russian Federation. The management company, however, will have special powers in these areas also, most notably, but not limited to, regulation of customs payments, immigration and outdoor advertising. Moreover, the management company will have the authority to develop stricter regulations in areas such as public health and safety that the relevant Skolkovo subdivisions of federal executive bodies will be charged with implementing and enforcing.

Special Customs Procedures

The Skolkovo Bill offers a unique approach to customs.

It does not provide for any direct customs duty exemptions for project participants. However, it states that "the customs duties incurred by the parties participating in the project shall be subject to reimbursement in accordance with the budget law of the Russian Federation." This means that project participants will be able to import products subject to payment of the applicable customs duties to the national budget. Thereafter, however, upon submission to the management company, which acts as a specially appointed customs broker, participants will be reimbursed for these amounts. Reportedly, it is currently expected that no actual customs payments will be made by the project participants, as this responsibility will be taken over by the management company, which will also handle all formalities in connection with the reimbursement from the budget.

It is likely that these provisions will change substantially before the bill is passed, so it is too early to propose how customs will be handled at Skolkovo. For example, one significant impediment to the implementation of this scheme is that it seems to violate provisions of the Customs Union being created by Belarus, Kazakhstan and Russia. These provisions regulate the operation of free economic zones (FEZs) and stipulate that no customs privileges will be available to entities located in FEZs after 2017. However, efforts are underway to distinguish Skolkovo from FEZs so that its customs regime is not prohibited by the Customs Union rules on phasing out customs privileges.

Special Advertising Procedures

The Skolkovo Bill would also amend the Advertising Law and effectively exempt advertising in Skolkovo from the regulation of federal law in certain areas. The advertising provisions of the Skolkovo Bill state that outdoor advertising will be administered by the management company. No outdoor advertising will be allowed without the consent of the management company, which will also develop and approve the consent procedure. The management company will have the authority to order the removal of unauthorized outdoor advertising installations and charge removal costs to those who created them, the owner of the building or the lessee of the land plot on which the installations were located.

Special Immigration Procedures

The bill provides a special regime for the hiring and retention of highly qualified foreign workers by project participants in furtherance of project goals. Rather than

apply directly through the Federal Migration Service (FMS), project participants will apply for invitations for highly qualified foreign workers through the management company, which will then interact with the Skolkovo subdivision of the FMS to obtain the required invitations and work permits. Project participant employees will not need to present medical records demonstrating they are free of certain diseases, as is currently required by the FMS. Work visas may be issued for the length of an employee's labor contract but in no case more than a period of three years; visas can be renewed thereafter. The FMS currently gives work visas for no longer than one year.

Participation in the Project

Certification of Participants

The management company may grant certain entities the status of "certified participant." This status is effective upon registration in the Register of Certified Participants maintained by the management company. The bill provides that a company can be certified only if it meets each of the following requirements:

- It is an entity organized under Russian law;
- Its executive body is permanently located in the territory of Skolkovo; and
- Its charter documents limit its operations to "research activities" and it commits itself to engaging in such activities.

Certification automatically expires after 10 years. There is no express provision outlining requirements or procedures for recertification.

Qualifying Research Activities

"Research activities" are defined as activities focused on the following areas:

- Energy efficiency and energy savings;
- Nuclear technology;
- Space technology, particularly in the areas of telecommunications and navigational systems (including establishment of corresponding space-based infrastructure);
- Medical technology: instruments and medicines; and
- Strategic computer technology and programming security.

The management company seems to have broad

authority in interpreting what constitutes research activities in the first instance.

Certified participants must perform their research activities in the manner and under the conditions established by the management company. The management company can establish additional criteria for certification and may revoke a participant's certification for (i) breaching project rules; (ii) failing to comply with project demands; or (iii) refusing to participate in the project. The performance by a certified project participant of activities that do not constitute research activities is a breach of the project rules and therefore a basis for decertification.

Initial Thoughts

The key to the success of the Skolkovo experiment will be the degree to which the ultrapowerful management company conducts itself in a fair, open and transparent manner and is able to reduce bureaucratic inefficiencies through close and direct cooperation with the new Skolkovo subdivisions of federal executive power.

If the management company succeeds in creating an environment of effective and restrained executive power that is perceived to be a largely impartial, neutral arbitrator, project participants will be able to focus their energies on developing new and innovative technologies rather than struggling to navigate the shifting sands of ever-changing regulations and opaque and time-consuming procedures for obtaining basic permits and registering property rights, and protecting themselves against capricious and corrupt actors.

Whether or not the larger goals are achieved, Skolkovo presents real opportunities for foreign investors interested in Russia. Project participants should enjoy several benefits not available to nonparticipants, including:

- **Reduced bureaucracy:** The management company will serve as a one-stop shop.
- **Reduced interferences:** Given that the management company certifies participation, it will also have an understanding of the needs of project participants, permitting participants to reach clear understandings with the management company at the outset of their project and perhaps avoid barriers that investors often encounter when working with numerous and competing interests of governmental bodies.
- **Potential for incentives:** The bill expressly provides that the management company may

approve special conditions connected with the lease of property, which may include incentives as well as deterrents.

- **Deep labor pool:** Skolkovo will be a magnet for Russia's most talented workers, and its more flexible immigration rules will make it simpler and faster to bring in foreign labor.
- **Attractive work environment:** Residents of Skolkovo will have the benefit of living in a green area away from the congestion of Moscow, but close enough to enjoy the city.
- **Good will:** Given the high profile of the project, participation likely will generate substantial good will and present additional opportunities to certified project participants and project participants that nonparticipants likely will not enjoy.

Squire Sanders' Skolkovo Project Team

We have created a cross-disciplinary team consisting of lawyers resident in our offices in Moscow, San Francisco and Palo Alto to assist clients in building relationships and developing mutually beneficial business opportunities supportive of the diversification of Russia's economy in the areas of high technology and innovation, with particular focus on the opportunities presented by the Skolkovo project and cross-fertilization opportunities in Northern California.

If you have questions about Skolkovo or investing in innovative projects in the Russian Federation, please contact a member of our Skolkovo project team.

The contents of this update are not intended to serve as legal advice related to individual situations or as legal opinions concerning such situations. Counsel should be consulted for legal planning and advice.

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