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In-Q-Tel: The Central Intelligence Agency as Venture Capitalist

*By John T. Reinert**

Abstract: The Central Intelligence Agency (CIA), the United States' principal foreign intelligence and spy organization, chartered the first government-sponsored venture capital firm, dubbed In-Q-Tel, in February 1999. In-Q-Tel represents the twenty-first century fusion of U.S. spy efforts with the venture capital industry. Envisioned as a platform to expand the research and development (R&D) efforts of the CIA into the private sector, In-Q-Tel uses CIA-supplied funds to make strategic investments in startup companies developing commercially focused technologies that are of interest to the CIA and greater intelligence community. This Comment contends that, although R&D collaboration between the public and private sectors is vital and should be encouraged, such collaboration should not be in the form of a venture capital firm chartered and sponsored by the CIA. The CIA is not equipped to succeed in the notoriously perilous business of venture capital, and heightened ethical concerns surround the making of government-sponsored equity investments in private companies. Indeed, In-Q-Tel often invests in companies with international operations, vicariously and unnecessarily exposing the CIA and larger U.S. government to foreign entanglements. This Comment begins by tracing relevant developments in the funding of U.S. spy efforts in Part II. Next, Part III explores the venture capital industry, paying particular attention to the interplay between venture capital and R&D. Part IV then analyzes the relationship between the CIA and In-Q-Tel. Finally, Part V: (1) contends the risks of In-Q-Tel currently outweigh its benefits; (2) suggests the current In-Q-Tel model inappropriately exposes the CIA and larger U.S. government to disputes arising from private international law; and (3) proposes alternative courses of action by which the CIA may tap into the R&D efforts of the private sector. Part VI concludes this Note.

* J.D., 2013, Northwestern University School of Law; B.A., 2007, Indiana University. I thank my editors, especially Pat Disbennett and Topher Michail, for their insightful comments and (almost) limitless patience. Special thanks also to Mike Molitor, whose thoughtful review of an early draft helped immensely.

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I. INTRODUCTION

The Central Intelligence Agency (CIA), the United States’ principal foreign intelligence and spy organization, chartered the first government-sponsored venture capital firm, dubbed In-Q-Tel, in February 1999.¹ Envisioned as a platform to expand the research and development (R&D) efforts of the CIA into the private sector, In-Q-Tel’s mission is “to identify, adapt, and deliver innovative technology solutions to support the missions of the Central Intelligence Agency and broader U.S. Intelligence Community.”²

Under the In-Q-Tel model, the CIA provides investment capital and

¹ BUS. EXEC. FOR NAT’L SEC., ACCELERATING THE ACQUISITION AND IMPLEMENTATION OF NEW TECHNOLOGIES FOR INTELLIGENCE: THE REPORT OF THE INDEPENDENT PANEL ON THE CENTRAL INTELLIGENCE AGENCY IN-Q-TEL VENTURE 6 (C. Lawrence Meador et al. eds., 2001), available at <http://www.iqt.org/attachments/BENS%20Report.pdf> [hereinafter BENS REPORT].

² *IQT Corporate Fact Sheet*, IN-Q-TEL, <http://www.iqt.org/mission/IQT%20Corporate%20Fact%20Sheet.pdf> (last visited Nov. 2, 2011).

identifies “pressing problems.”³ Tasked with finding solutions to these unclassified problems,⁴ In-Q-Tel turns to the private sector and makes “strategic . . . investments in startup companies that have developed commercially focused technologies that will provide strong, near-term advantages (within 36 months) to the [intelligence community’s] mission.”⁵ Through the investment process, In-Q-Tel becomes a shareholder of these portfolio companies.⁶

Within a few years of In-Q-Tel’s formation, other government entities also looking to bridge the gap between the R&D efforts of the public and private sectors followed the CIA’s lead and set up similar ventures to invest in unclassified commercial technology. For instance, the Army chartered OnPoint Technologies to “back technology designed to produce lighter-weight and longer-lasting energy sources for soldiers.”⁷ According to the Army’s chief scientist, A. Michael Andrews, “[f]inding new energy sources for soldiers is akin to a search for better power solutions for handheld computers like Palm Pilots, BlackBerries, personal digital assistants and cell phones. Lighter and smaller is better.”⁸ Not long after the founding of OnPoint Technologies, the National Aeronautics and Space Administration (NASA) chartered Red Planet Capital—a name that reflects NASA’s long-term goal of sending astronauts to Mars—to invest in emerging technologies “that NASA might be able to use” in the future.⁹ NASA’s manager for the project, Lisa L. Lockyer, explained: “NASA could see that a lot of technical innovation is coming out of companies that don’t traditionally do business with the government, and we wanted better and

³ GEORGE TENET WITH BILL HARLOW, *AT THE CENTER OF THE STORM: MY YEARS AT THE CIA* 26 (2007).

⁴ BENS REPORT, *supra* note 1, at 18.

⁵ *IQT Mission*, IN-Q-TEL, <http://www.iqt.org/about/mission.html> (last visited Feb. 4, 2013).

⁶ As one commentator noted, In-Q-Tel:

[C]an make either an equity investment, where it receives part ownership in the company, or a work program investment. Work programs typically provide funding for a company to develop its technology in a way that suits [Intelligence Community] needs. For example, if a company has developed a new communications antenna, but the CIA needs that antenna to be 50 percent smaller, it could make a work program investment to help fund that reduction in size. Typically, In-Q-Tel makes both equity and work program investments.

Andrew S. Mara, *Maximizing the Returns of Government Venture Capital Programs*, DEF. HORIZONS (Nat’l Def. Univ./Inst. for Nat’l Strategic Studies, D.C.), no. 71, Jan. 2011, at 2, available at <http://www.ndu.edu/CTNSP/docUploaded/DH%2071.pdf>.

⁷ *Deals & Deal Makers—Memo to Techies: This Army Wants Your Energy Ideas*, WALL ST. J., May 9, 2003, at C5.

⁸ *Id.*

⁹ Marc Kaufman, *NASA Invests in Its Future with Venture Capital Firm*, WASH. POST, Oct. 31, 2006, at A19.

faster access to that creativity.”¹⁰ Even the U.S. Postal Service, faced with a projected loss of \$7 billion for fiscal year 2010, expressed interest in the In-Q-Tel model.¹¹ Commenting on the projected loss, Louis Atkins, executive vice president of the National Association of Postal Supervisors, declared the Postal Service “lacks the vision, resources and know-how [to] generate additional revenue in innovative ways.”¹² His solution: “The Postal Service needs its own In-Q-Tel to achieve the same leverage that connects technology advances to improvements in communications, including going beyond hard-copy mail itself.”¹³

Although collaboration between the R&D efforts of the public and private sectors is vital and should be encouraged, this Comment contends that such collaboration should not be in the form of a venture capital firm chartered and sponsored by the CIA. The CIA is not equipped to succeed in the notoriously perilous business of venture capital, and heightened ethical concerns surround the making of government-sponsored equity investments in private companies. Indeed, In-Q-Tel often invests in companies with international operations, vicariously and unnecessarily exposing the CIA and larger U.S. government to foreign entanglements.

This Comment traces relevant developments in the funding of U.S. spy efforts in Part II. Next, Part III explores the venture capital industry, paying particular attention to the interplay between venture capital and R&D. Part IV then analyzes the relationship between the CIA and In-Q-Tel. Finally, Part V: (1) argues the risks of In-Q-Tel currently outweigh the benefits; (2) suggests the current In-Q-Tel model inappropriately exposes the CIA and larger U.S. government to disputes arising from private international law; and (3) proposes alternative courses of action by which the CIA may tap into the R&D efforts of the private sector. Part VI concludes this Comment.

II. FUNDING U.S. SPY EFFORTS: THE ORIGINS OF IN-Q-TEL

While the concept of a CIA-sponsored venture capital firm may seem odd, such an initiative derives from the exceptionally broad discretion granted to the U.S. intelligence community regarding the use of funds since 1775. This Part accordingly provides an historical context by which In-Q-Tel may be examined.

¹⁰ *Id.*

¹¹ Joe Davidson, *Postal Service Desperate for Good Ideas*, WASH. POST, June 23, 2010, at B03.

¹² *Id.*

¹³ *Id.*

A. Early History: 1775–1947

The historical context surrounding In-Q-Tel’s development traces back to November 29, 1775. In the midst of the Revolutionary War, the Second Continental Congress created the Committee of Secret Correspondence “for the sole purpose of corresponding with our friends in Great Britain, Ireland, and other parts of the world.”¹⁴ Recognizing such a group would require funding as well as the discretionary authority to expend funds as it deemed fit, Congress resolved “to defray all such expenses as may arise by carrying on such correspondence, and for the payment of such agents as they may send on this service.”¹⁵ Called “the distant ancestor of today’s CIA”¹⁶ by one historian, the Committee, chaired by Benjamin Franklin,¹⁷ carried out various foreign intelligence missions as assigned by Congress. On May 18, 1776, for example, Congress directed the Committee “to endeavour to discover the designs of the French in assembling so large a fleet, with so great a number of troops, in the West Indies, and whether they mean to act for or against America.”¹⁸

The members of the Committee of Secret Correspondence were not the only spies serving the revolutionary cause. Indeed, George Washington employed “an elaborate network of spies in the colonies.”¹⁹ But the Committee is remarkable in that it was given exceptionally broad discretionary authority to expend funds with little or no reporting to Congress.²⁰ This may seem an unusual grant of power in the context of the founding of a democratic, pluralistic republic. However, as Ben Franklin and other members of the Committee put it: “We find, by fatal experience, the Congress consists of too many members to keep secrets.”²¹ Almost two

¹⁴ 2 SECRET JOURNALS OF THE ACTS AND PROCEEDINGS OF CONGRESS, FROM THE FIRST MEETING THEREOF TO THE DISSOLUTION OF THE CONFEDERATION, BY THE ADOPTION OF THE CONSTITUTION OF THE UNITED STATES 5–6 (Thomas B. Wait 1820) [hereinafter SECRET JOURNALS].

¹⁵ *Id.* at 5.

¹⁶ CHRISTOPHER ANDREW, FOR THE PRESIDENT’S EYES ONLY: SECRET INTELLIGENCE AND THE AMERICAN PRESIDENCY FROM WASHINGTON TO BUSH 7 (1995).

¹⁷ Denys P. Myers, *Legislatures and Foreign Relations*, 11 AM. POL. SCI. REV. 643, 676 (1917).

¹⁸ SECRET JOURNALS, *supra* note 14, at 6.

¹⁹ Robert M. Gates, *Intelligence, Democracy, and Freedom*, 22 PRESIDENTIAL STUD. Q. 231, 231 (1992).

²⁰ *See, e.g.*, *Halperin v. Cent. Intelligence Agency*, 629 F.2d 144, 157 (D.C. Cir. 1980) (“The Committee exercised broad discretionary power to conduct intelligence activities independent of the Continental Congress and to safeguard the secrecy of matters pertaining to its agents, though Congress asserted greater direct control following the Declaration of Independence. It is especially remarkable that the Committee was in a position to insist upon secrecy even against Congress, which functioned both as the legislative and the executive power at this time and exercised control over foreign affairs.”).

²¹ AMERICAN STATE PAPERS: DOCUMENTS, LEGISLATIVE AND EXECUTIVE, OF THE

centuries later, the Central Intelligence Agency Act of 1949 would grant similar deference to the CIA.²²

George Washington's contributions to the development and funding of U.S. spy efforts did not end with the Revolutionary War. On January 8, 1790, during a speech to Congress that would be remembered as the first State of the Union address,²³ President Washington requested "a competent fund designated for defraying the expenses incident to the conduct of our foreign affairs."²⁴ On July 1, 1790, Congress responded by creating the Contingent Fund of Foreign Intercourse, known informally as the Secret Service Fund.²⁵ Congress authorized the President "to draw from the treasury of the United States . . . a sum not exceeding forty thousand dollars annually" to finance intelligence operations.²⁶ The Act included an annual reporting provision, but Congress required the President to account only for expenditures from the fund "as in his judgment may be made public."²⁷ On February 9, 1793, Congress clarified the reporting provision by requiring the President to certify expenditures from the fund. Significantly, Congress declared "every such certificate shall be deemed a sufficient voucher for the sums or sums therein expressed to have been expended."²⁸ Thus, while President Washington had to certify the sums spent from the fund, he could "conceal both the purposes and recipients of payments."²⁹

Although the Contingent Fund remained in use by U.S. Presidents until the mid-twentieth century,³⁰ the operations it funded consisted of "ad hoc efforts."³¹ This would change during World War II,³² when President

CONGRESS OF THE UNITED STATES, FROM THE FIRST SESSION OF THE FIRST TO THE SECOND SESSION OF THE SEVENTEENTH CONGRESS 568 (Washington, Gales & Seaton 1834).

²² Central Intelligence Agency Act of 1949, ch. 227, 68 Stat. 208 (codified as amended at 50 U.S.C. § 403 (2006)).

²³ See, e.g., Halperin, *supra* note 20 at 158 (describing President Washington's address as "the precursor to the 'State of the Union' message. . .").

²⁴ 1 ANNALS OF CONG. 969–70 (1790) (Joseph Gales ed., 1834).

²⁵ ANDREW, *supra* note 16, at 11.

²⁶ Act of July 1, 1790, ch. 22, § 1, 1790 FIRST CONG. 128-29 (providing the means of intercourse between the United States and foreign nations).

²⁷ *Id.*

²⁸ Act of Feb. 9, 1793, ch. 4, § 2, 1793 SECOND CONG. 299–30 (continuing "in force for a limited time," and amending "An act providing the means of intercourse between the United States and foreign nations").

²⁹ ANDREW, *supra* note 16, at 11.

³⁰ See, e.g., Halperin v. Cent. Intelligence Agency, 629 F.2d 144, 158–59 (D.C. Cir. 1980) ("The contingent fund remained in continuous use by the President throughout the nineteenth century and up to the creation of the CIA in the mid-twentieth century.").

³¹ Gates, *supra* note 19, at 232.

³² See Edward F. Sayle, *The Historical Underpinnings of the U.S. Intelligence Community*, 1 J. INTELLIGENCE & COUNTERINTELLIGENCE 1 (1986) (discussing the development of U.S. intelligence efforts between the Revolutionary War and World War II).

Franklin D. Roosevelt created the United States' first centralized intelligence agency—the Office of Strategic Services (OSS)—in order to coordinate wartime intelligence efforts.³³

Roosevelt named William J. Donovan to lead the OSS. An influential New York lawyer³⁴ and a recipient of the Medal of Honor,³⁵ Donovan would become known as the “founder of modern American intelligence”³⁶ for his innovative approach to OSS operations. Instead of building OSS manpower solely with military staff, Donovan recruited gifted civilians with seemingly unrelated talents. Robert M. Gates, who led the CIA from 1991 to 1993, commented: “Donovan’s greatest legacy to American intelligence was that he brought talented people from all walks of life into the national security business: people like prominent Harvard historian William Langer, jazz musician Miles Copeland, filmmaker John Ford, baseball player Mo Berg, and future chef Julia Child.”³⁷ Fifty years after the OSS turned to talented civilians for assistance with its wartime mission, the CIA would take Donovan’s approach one step further with In-Q-Tel. While Donovan had recruited civilians to join the OSS, In-Q-Tel would invest CIA money in technology-focused private-sector startups.

As World War II drew to a close, uncertainty surrounded the future of U.S. intelligence efforts. In September 1945, shortly after the ending of hostilities with Japan, President Harry S. Truman shut down the OSS and effectively cut off funding for intelligence operations.³⁸ “Americans had believed that their country was guided by uniquely high ethical principles,” wrote historian Christopher Andrew in 1995.³⁹ “They regarded peacetime espionage, if they thought of it at all, as a corrupt outgrowth of Old War diplomacy, alien to the open and upright American way.”⁴⁰ The Cold War, however, would finally “persuade them otherwise.”⁴¹

The charismatic Donovan sought to be a driving force in that

³³ Jennifer Davis Heaps, *Tracking Intelligence Information: The Office of Strategic Services*, 61 AM. ARCHIVIST 287, 289 (1998).

³⁴ *A Look Back: Gen. William J. Donovan Heads Office of Strategic Services*, CENT. INTELLIGENCE AGENCY, <https://www.cia.gov/news-information/featured-story-archive/gen-william-j-donovan-heads-oss.html> (last visited Nov. 2, 2011).

³⁵ See William J. Donovan, *A Plea for State Regulation*, 159 ANNALS AM. ACAD. POL. & SOC. SCI. 76, 83 (1932) (“William J. Donovan . . . was the only man in the World War who received every decoration in the power of the United States to give: the Congressional Medal of Honor, the Distinguished Service Medal, and the Distinguished Service Cross.”).

³⁶ Gates, *supra* note 19, at 232.

³⁷ *Id.* at 233.

³⁸ ANDREW, *supra* note 16, at 160.

³⁹ *Id.* at 29.

⁴⁰ *Id.*

⁴¹ *Id.*

persuasion, but he faced resistance from President Truman.⁴² Consequently, Donovan took his campaign directly to the public. Speaking to the Bar Association of New York City in February 1947, Donovan advocated for the permanent establishment and funding of coordinated intelligence efforts. The work of an intelligence agency, he explained, is not “mysterious” or “sinister”—it simply entails “pulling together myriad facts, making a pattern of them, and drawing inferences from that pattern.”⁴³ After addressing his audience’s fears of a peacetime intelligence agency, Donovan argued the United States “should have a Central Intelligence Agency, headed by a civilian with no allegiance to any governmental department, to collate and coordinate all of the information received in this country.”⁴⁴ A few months later, with the hostilities of the Cold War beginning “in earnest,”⁴⁵ Donovan won the debate.

B. Formation of the CIA and In-Q-Tel: 1947–1999

The National Security Act of 1947 created the CIA “[f]or the purpose of coordinating the intelligence activities of the several Government departments and agencies in the interest of national security.”⁴⁶ The newly formed CIA drew many of its first officers from the ranks of the former OSS.⁴⁷ Two years later, with the CIA formally established and staffed, the Central Intelligence Agency Act of 1949 further clarified issues related to the CIA’s administration.⁴⁸

While the Central Intelligence Agency Act addressed the future of a new government agency, it reflected the prior development of American spy efforts. Echoing the broad grant of discretionary power made by the Second Continental Congress to Ben Franklin and the Committee of Secret Correspondence, the Act grants the CIA the expansive authority to expend funds “for purposes necessary to carry out [the CIA’s] functions.”⁴⁹ And the reporting requirements of the Act mirror the language used by Congress at the end of the eighteenth century. Just as Congress in 1793 had required a simple “certificate”⁵⁰ of the sums spent from the Contingent Fund with no

⁴² See, e.g., ANDREW, *supra* note 16, at 156–61; see also AGOSTINO VON HASSELL & SIGRID MACRAE, *ALLIANCE OF ENEMIES: THE UNTOLD STORY OF THE SECRET AMERICAN AND GERMAN COLLABORATION TO END WORLD WAR II* 292–95 (2006).

⁴³ *U.S. Intelligence Held Inadequate*, N.Y. TIMES, Feb. 26, 1947, at 6.

⁴⁴ *Id.*

⁴⁵ ANDREW, *supra* note 16, at 168.

⁴⁶ National Security Act of 1947, ch. 343, § 102(d), 61 Stat. 496, 498 (current version at 50 U.S.C. § 403-4(b) (2006)).

⁴⁷ See Gates, *supra* note 19, at 233.

⁴⁸ Cent. Intelligence Agency Act of 1949, ch. 227, § 8(a), 68 Stat. 208, 212 (codified as amended at 50 U.S.C. § 403(j) (2006)).

⁴⁹ *Id.*

⁵⁰ Act of Feb. 9, 1793, ch. 4, § 2, 1 Stat. 299, 300 (codified at 31 U.S.C. § 3526 (2006)).

need for an explanation of the purposes or recipients, the Central Intelligence Agency Act of 1949 required the same for the CIA's expenditures.⁵¹ Both acts even conclude with the same sentence: "[E]very such certificate shall be deemed a sufficient voucher."⁵² Thus, with the Central Intelligence Agency Act, Congress "merely continued a longstanding practice of secret expenditures for foreign intelligence matters."⁵³

Although the CIA of the Cold War era derived from its predecessor of the Revolutionary War era, it also broke new ground—especially with respect to the role of R&D. The CIA began to view R&D and the technology it produced as a significant contributor to CIA's overall mission. The U-2 reconnaissance plane, the SR-71 reconnaissance plane, and the Corona spy satellite program emerged from this new focus on funding cutting-edge R&D programs.⁵⁴ Indeed, in recognition of their technological feats during the Cold War, the members of the CIA's Directorate of Science and Technology earned the nickname the "Wizards of Langley"⁵⁵—a reference to the CIA's headquarters in Langley, Virginia.

But the end of the Cold War would challenge the need for the CIA's continued existence,⁵⁶ not to mention the funding of its expensive R&D programs.⁵⁷ Indeed, when he began his tenure as Director of Central Intelligence (DCI)⁵⁸ in July 1997, George Tenet took the helm of a CIA that faced an identity crisis. The Cold War no longer served as the justification for the CIA's mission and massive budget. "During the 1990s," recalled Tenet in 2007, "the conventional wisdom was that we had won the cold war and it was time to reap the peace dividend."⁵⁹ As a result, the federal government slashed the CIA's budget and workforce.⁶⁰ In Tenet's view,

⁵¹ 50 U.S.C. § 403(j)(b).

⁵² *Id.*; Act of Feb. 9, 1793 § 2.

⁵³ Halperin v. Cent. Intelligence Agency, 629 F.2d 144, 160 (D.C. Cir. 1980).

⁵⁴ See Rick E. Yannuzzi, *In-Q-Tel: A New Partnership between the CIA and the Private Sector*, 9 DEF. INTELLIGENCE J. 25, 26 (2000).

⁵⁵ See generally JEFFREY T. RICHELSON, *THE WIZARDS OF LANGLEY: INSIDE THE CIA'S DIRECTORATE OF SCIENCE AND TECHNOLOGY* (2001).

⁵⁶ Gates, *supra* note 19, at 234 ("[A] handful of voices question[ed] the need for intelligence in a post-Soviet, post-Cold War world . . .").

⁵⁷ TENET WITH HARLOW, *supra* note 3, at 25–26.

⁵⁸ *George John Tenet*, CENT. INTELLIGENCE AGENCY, <https://www.cia.gov/library/center-for-the-study-of-intelligence/csi-publications/books-and-monographs/directors-and-deputy-directors-of-central-intelligence/tenet.html> (last visited Jan. 23, 2013). In a 2004 restructuring of the intelligence community, the position of Director of the Central Intelligence Agency (D/CIA) replaced the position of DCI. *History of the CIA*, CENT. INTELLIGENCE AGENCY, <https://www.cia.gov/about-cia/history-of-the-cia/index.html> (last visited Mar. 1, 2013).

⁵⁹ TENET WITH HARLOW, *supra* note 3, at 14.

⁶⁰ *Id.* As Tenet recalled: "The entire intelligence community, not just CIA, lost billions

“the supposed ‘peace dividend’ was devastating to the spy business at a time when its vitality was most needed.”⁶¹ As a result, morale at the CIA was low. Worse, as the fifth DCI in only seven years, Tenet realized the CIA faced the “critical problem” of “episodic leadership.”⁶²

The state of the CIA’s Directorate of Science and Technology had also deteriorated, as the rise of the internet age challenged the CIA’s preeminence in the area of R&D. “As limited as our human resources were when I took over as DCI in 1997,” wrote Tenet, “our technological capacity might have been even worse.”⁶³ As he put it, the CIA had once been a “giant” in the area of science and technology, but “the dot-com revolution was passing us by. Private-sector technology was far outstripping our ability to keep pace with our targets.”⁶⁴

In one of his first moves as DCI, Tenet launched a strategic direction study to address these problems and assess how the CIA should approach (and fund) twenty-first century operations.⁶⁵ Not surprisingly, “[t]he study made a direct link between the Agency’s future technology investments and improving its information gathering and analysis capabilities.”⁶⁶ At that time, it had become apparent that technology would play a major role in the new landscape faced by the CIA—not the space-age military technology developed in secret labs for the Cold War, but information technology (IT) and computer systems developed by young entrepreneurs for the commercial marketplace. Writing for *Foreign Affairs* in 1990, for example, one commentator observed that “American intelligence analysts now have to cope with a torrent of information and data. Amid an exponential proliferation of satellites and fiber optics, interlinked computers and data bases . . . these analysts are becoming information junkies.”⁶⁷ He concluded: “If effectively harnessed and channeled, then astutely exploited, this new information and data flood can dramatically improve the quality and accuracy of American intelligence assessments and estimates . . . but it creates new complexities as fast as it clarifies old mysteries.”⁶⁸

The CIA under Tenet faced the serious problem of how to deal with these new complexities. A novel approach suggested by Dr. Ruth David, the head of the Directorate of Science and Technology, caught Tenet’s

of dollars in funding. Our workforce was slashed by almost 25 percent.” *Id.*

⁶¹ *Id.*

⁶² *Id.*

⁶³ *Id.* at 25–26.

⁶⁴ *Id.* at 16.

⁶⁵ Yannuzzi, *supra* note 54, at 25.

⁶⁶ *Id.*

⁶⁷ George A. Carver, Jr., *Intelligence in the Age of Glasnost*, 69 FOREIGN AFF. 147, 159 (1990).

⁶⁸ *Id.*

eye.⁶⁹ David proposed that the CIA outsource a portion of its R&D efforts to the private sector.⁷⁰ After all, according to one former CIA official, “[a]s an information-based agency, the CIA must be at the cutting edge of information technology in order to maintain its competitive edge and provide its customers with intelligence that is both timely and relevant.”⁷¹ The problem, according to the official, was “the CIA did not, and could not, compete for IT innovation and talent with the same speed and agility that those in the commercial marketplace, whose businesses are driven by ‘Internet time’ and profit, could.”⁷²

After much discussion within the CIA and talks with leaders in the private sector,⁷³ the concept of a CIA-backed venture capital firm charged with “harness[ing] the brilliance of young innovators in the IT industry”⁷⁴ came to fruition. While the concept was new, it fit within the exceptionally broad discretion granted to the intelligence community since 1775.⁷⁵

The CIA approached Norman Augustine, the former chief executive officer (CEO) of the aerospace and defense company Lockheed Martin, to serve as the firm’s founder, since Augustine had “the experience and passion necessary to start the Corporation.”⁷⁶ Augustine accepted.⁷⁷ In February 1999, the CIA chartered In-Q-Tel⁷⁸ as “a private, independent, nonprofit corporation”⁷⁹ incorporated in Delaware.⁸⁰ The original corporate charter described In-Q-Tel’s mission as follows: “[T]o exploit and develop new and emerging information technologies and pursue R&D that produce innovative solutions to the most difficult problems facing the CIA and Intelligence Community.”⁸¹ A month later, In-Q-Tel received its first contract from the CIA.⁸² Thus, concluded a former CIA official, “In-Q-Tel was in business.”⁸³

In-Q-Tel represents the twenty-first century fusion of U.S. spy efforts with the venture capital industry. The broad grant of discretionary authority

⁶⁹ TENET WITH HARLOW, *supra* note 3, at 26.

⁷⁰ *Id.*

⁷¹ Yannuzzi, *supra* note 54, at 26.

⁷² *Id.* at 27.

⁷³ *Id.* at 26.

⁷⁴ TENET WITH HARLOW, *supra* note 3, at 26.

⁷⁵ BENS REPORT, *supra* note 1, at 31.

⁷⁶ Yannuzzi, *supra* note 54, at 26.

⁷⁷ *Id.*

⁷⁸ The initial name of the corporation was Peleus; it was soon changed to In-Q-It and finally to In-Q-Tel. BENS REPORT, *supra* note 1, at 6.

⁷⁹ TENET WITH HARLOW, *supra* note 3, at 26.

⁸⁰ BENS REPORT, *supra* note 1, at 6.

⁸¹ *Id.*

⁸² Yannuzzi, *supra* note 54, at 26.

⁸³ *Id.*

afforded to the CIA traces directly to the Committee of Secret Correspondence. Today, the Director of the CIA is enabled under a statutory catchall provision to “perform such other functions and duties related to intelligence affecting the national security as the President or the Director of National Intelligence may direct.”⁸⁴ The provision mirrors the language used by Congress in 1775. The similarly broad grant of power to the CIA to expend funds with little or no reporting requirements traces back to George Washington’s “competent fund”—the Contingent Fund of Foreign Intercourse. Today, the CIA’s funds “may be expended without regard to the provisions of law and regulations relating to the expenditure of Government funds.”⁸⁵ Lastly, the decision by the CIA to approach the private sector to tap into civilian ingenuity traces to William Donovan’s innovative approach to staffing the OSS.⁸⁶

Thus, the CIA’s decision to form In-Q-Tel fit within the parameters for funding intelligence operations established more than two centuries ago. However, In-Q-Tel also brought the CIA into the unchartered territory of venture capital—a business model this Comment will now discuss.

III. VENTURE CAPITAL AND THE U.S. GOVERNMENT

When the Second Continental Congress created the Committee of Secret Correspondence in 1775 and thereby paved the way for the CIA, the modern venture capital industry did not exist.⁸⁷ The concept of a market for equity investments, whereby an investor exchanges capital for an ownership stake in a company and is then able to trade that stake with other investors, had been around since 1602, when the Dutch East India Company made the first initial public offering (IPO) of corporate stock.⁸⁸ But the first real venture capital firm did not come to existence until more than three centuries later, when a group of investors, led by the president of the Massachusetts Institute of Technology and a professor at Harvard Business School, founded American Research and Development (ARD) in 1946.⁸⁹

⁸⁴ 50 U.S.C. §§ 403-4(a) (2006).

⁸⁵ *Id.* § 403(j).

⁸⁶ Examples abound of the CIA’s partnerships with the private sector, especially during the Cold War. In 1951, for example, the CIA spent \$300,000 to establish a Harvard-based think tank charged with “research[ing] worldwide political, economic and social change . . . in the interest of the entire intelligence community.” KAI BIRD, *THE COLOR OF TRUTH: MCGEORGE BUNDY AND WILLIAM BUNDY: BROTHERS IN ARMS* 138–39 (1998).

⁸⁷ See Kenneth W. Rind, *The Role of Venture Capital in Corporate Development*, 2 STRATEGIC MGMT. J. 169, 170 (1981) (discussing the origins of the venture capital industry).

⁸⁸ NIALL FERGUSON, *THE ASCENT OF MONEY: A FINANCIAL HISTORY OF THE WORLD* 128–33, 343 (2008).

⁸⁹ Paul Gompers & Josh Lerner, *The Venture Capital Revolution*, 15 J. ECON. PERSP. 145, 146 (2001).

Although the success of ARD's investments "ranged widely,"⁹⁰ the firm gained notoriety when its initial investment of \$70,000 in Digital Equipment Company in 1957 ballooned to a reported value of \$355 million upon the company's IPO about a decade later.⁹¹ From the ARD model grew the modern venture capital industry.⁹²

A. Venture Capital in the United States

Today, private-sector venture capital fund managers (i.e., venture capital firms) serve as "financial intermediaries between sources of funds (typically institutional investors) and high-growth and high-tech entrepreneurial firms"⁹³ that otherwise have limited access to capital.⁹⁴ The fund managers often play "a significant role in enhancing the value of their entrepreneurial investments as they provide financial, administrative, marketing, and strategic advice."⁹⁵ In order to play such a leading role, venture capital fund managers usually take relatively large equity positions in their portfolio companies and exert high-level control.⁹⁶ Indeed, according to the National Venture Capital Association: "Venture capital partners become actively engaged with a company, typically taking a board seat. With a startup, daily interaction with the management team is common."⁹⁷

The goal of the venture capital firm is to "grow the company to a point where it can go public or be acquired by a larger corporation (called an 'exit') at a price that far exceeds the amount of capital invested."⁹⁸

⁹⁰ *Id.*

⁹¹ *Id.*; see generally David H. Hsu & Martin Kenney, *Organizing Venture Capital: The Rise and Demise of American Research & Development Corporation, 1946–1973*, 14 *INDUS. & CORP. CHANGE* 579–616 (2005).

⁹² But note that while the venture capital model "is a fairly recent phenomenon, 'private risk capital' investing has existed in one form or another in every society that had significant commercial activity." JACK S. LEVIN & DONALD E. ROCAP, *STRUCTURING VENTURE CAPITAL, PRIVATE EQUITY, AND ENTREPRENEURIAL TRANSACTIONS* 1–13 (2012).

⁹³ DOUGLAS J. CUMMING & SOFIA A. JOHAN, *VENTURE CAPITAL AND PRIVATE EQUITY CONTRACTING: AN INTERNATIONAL PERSPECTIVE* 3–4 (2009).

⁹⁴ Typically, banks do not finance entrepreneurial projects, since the risk of default is especially high. This often leaves the entrepreneur turning to his or her own savings account or family and friends for the capital needed to get the project off the ground. Venture capital funds take on these high-risk projects and provide start-up capital; in return for assuming such high risk, these investors expect to be compensated handsomely. *Id.* at 10–11.

⁹⁵ *Id.* at 4.

⁹⁶ *Id.* at 11.

⁹⁷ NAT'L VENTURE CAP. ASS'N & THOMSON REUTERS, *NATIONAL VENTURE CAPITAL ASSOCIATION YEARBOOK 2011*, at 7 (2011), available at http://www.slideshare.net/Rachid_Sefrioui/venture-capital-2011-nvca-yearbook-2011.

⁹⁸ *National Venture Capital Association, VC INDUSTRY OVERVIEW*, http://www.nvca.org/index.php?option=com_content&view=article&id=141&Itemid=589

Typically, the investment is held for multiple years before the exit.⁹⁹ For their highly specialized services, venture capital fund managers are compensated with an annual management fee (generally 2% of the fund's committed capital) plus a performance fee called "carried interest" (generally 20% of capital gains from the exit sales of the fund's investments).¹⁰⁰ This compensation structure is known colloquially as "2 and 20."¹⁰¹

The unusual taxation of the 2 and 20 structure has recently become the subject of intense political debate.¹⁰² "The general partners [of a venture capital fund] typically claim the 2% fee as compensation, so it's subject to ordinary income and payroll taxes," notes the *Wall Street Journal*.¹⁰³ "But they often classify the 20% share of profits—where the big money can be—as an investment producing a capital gain or loss."¹⁰⁴ The difference is important because the highest tax rate applied to capital gains is slightly more than half the highest rate applied to ordinary income.¹⁰⁵

But not all venture capital firms earn huge profits. Indeed, many are not profitable at all. The venture capital market is notoriously complex and challenging, and success is rare.¹⁰⁶ The National Venture Capital Association cautions: "Approximately one-third of portfolio companies [held by venture capital funds] fail, so those that do succeed must do so in a big way."¹⁰⁷ Otherwise, the fund managers will run out of capital as investors move to other managers. On the other hand, successful venture capital firms and other financial intermediaries continue to attract investors. Indeed, "[m]any recent . . . funds have capital exceeding \$1 billion (and a few exceeding \$10 billion)."¹⁰⁸ The success of these firms traces in large part to the industry's ability to attract the best and brightest with the potential to obtain substantial compensation under the 2 and 20 model.¹⁰⁹

(last visited Nov. 2, 2011).

⁹⁹ CUMMING & JOHAN, *supra* note 93, at 5; LEVIN & ROCAP, *supra* note 92, at 1–4.

¹⁰⁰ CUMMING & JOHAN, *supra* note 93, at 4.

¹⁰¹ See, e.g., Laura Saunders, *Billionaires Decry "Carried Interest"*, WALL ST. J. TOTAL RETURN BLOG (Feb. 18, 2012, 9:32 AM), <http://blogs.wsj.com/totalreturn/2012/01/20/billionaires-decry-carried-interest/>.

¹⁰² *Id.*

¹⁰³ *Id.*

¹⁰⁴ *Id.*

¹⁰⁵ *Id.*

¹⁰⁶ See generally Ronald J. Gilson, *Engineering a Venture Capital Market: Lessons from the American Experience*, 55 STAN. L. REV. 1067 (2003).

¹⁰⁷ National Venture Capital Association, *supra* note 98.

¹⁰⁸ LEVIN & ROCAP, *supra* note 92, at 1–15.

¹⁰⁹ See generally Gilson, *supra* note 106.

B. Strategic Venture Capital and Recent Government Projects

As the CIA grew in influence within the U.S. government, its staff did not miss the concurrent rising influence of the financial sector. When the National Security Act of 1947 created the CIA, the financial sector contributed 2.3% to U.S. gross domestic product.¹¹⁰ By 2007 that figure had increased by almost four times to 8.1%.¹¹¹ “In other words,” observed historian Niall Ferguson, “approximately \$1 of every \$13 paid to employees in the United States now went to people working in finance.”¹¹² Commenting on this trend, one CIA official concluded “the flow of capital and talent has irresistibly moved to the commercial sector, where the prospect of huge profits from initial public offerings and equity-based compensation has become the norm.”¹¹³

While venture capital is primarily considered a profit-driven industry,¹¹⁴ its “unique link between finance and innovation”¹¹⁵ also positions it to function as a sort of incubator for R&D. Indeed, for the past few decades, a handful of corporations have made strategic venture capital investments in promising start-ups as part of broader attempts to supplement internal R&D efforts.¹¹⁶ Under this model, generating profits often takes a back seat to fueling innovation. Whereas the strictly financial model seeks to buy stakes in the start-ups that will generate the highest profits from large growth, the strategic model primarily seeks to buy stakes in start-ups that will generate relevant new technology. Through the investment process, the strategic venture capitalist hopes to gain early access to cutting-edge technology.

Although it is difficult to assess the overall success of strategic venture capital investments with respect to R&D, a 2000 study published by the prominent think tank RAND concluded “a dollar of venture capital appears to be about three times more potent in stimulating patenting than a dollar of traditional corporate R&D.”¹¹⁷ The study suggested “venture capital, even though it averaged less than 3% of corporate R&D from 1983 to 1992, is responsible for a much greater share—about 8%—of U.S. industrial

¹¹⁰ FERGUSON, *supra* note 88, at 6.

¹¹¹ *Id.*

¹¹² *Id.*

¹¹³ Yannuzzi, *supra* note 54, at 26.

¹¹⁴ “Private [venture capital] investors are intensely driven by financial motivations, whereas [government venture capital] programs are primarily driven by strategic concerns.” Mara, *supra* note 6, at 11.

¹¹⁵ Gilson, *supra* note 106, at 1068.

¹¹⁶ See Rind, *supra* note 87, at 179 (discussing venture capital as “a useful tool for corporate development”).

¹¹⁷ Samuel Kortum & Josh Lerner, *Assessing the Contribution of Venture Capital to Innovation*, 31 RAND J. ECON. 674, 675 (2000).

innovations in this decade.”¹¹⁸

The U.S. federal government paid careful attention to the rising role played by venture capital in the context of R&D.¹¹⁹ Seeking to act as a catalyst for innovation, the government created the Advanced Technology Program (ATP) in 1990.¹²⁰ From 1990 to 2007, ATP provided “research funding to universities and colleges, government-owned laboratories, and for-profit enterprises.”¹²¹ As a public-private partnership, ATP funded projects that promised commercial applications and broad economic benefits.¹²² Although not a venture capital firm itself, ATP sought to produce a “halo effect”¹²³ with the investments it made in order to draw the attention of private-sector venture capital funds, thus encouraging the private-sector funds to invest.

In 2007, the Technology Innovation Program¹²⁴ (TIP) replaced the Advanced Technology Program.¹²⁵ Although TIP is a continuation of what has been termed “public venture capital,”¹²⁶ TIP broadens the scope of funding to include “high-risk, high-reward, transformative research, . . . targeted to key societal challenges that are not being addressed elsewhere.”¹²⁷ TIP defines a societal challenge as “a problem or issue confronted by society that when not addressed could negatively affect the overall function and quality of life of the Nation and as such justifies government attention.”¹²⁸ To address such challenges, TIP “works closely with the private sector to understand where private resources are not

¹¹⁸ *Id.*

¹¹⁹ See generally IAN MACMILLAN ET AL., NAT’L INST. OF STANDARDS & TECH., CORPORATE VENTURE CAPITAL: SEEKING INNOVATION AND STRATEGIC GROWTH (2008), available at http://www.atp.nist.gov/eao/gcr_08_916_nist4_cvc_073108_web.pdf (examining strategic corporate venture capital as a generator of innovation in a report prepared for the U.S. Department of Commerce).

¹²⁰ Maryann P. Feldman & Maryellen R. Kelley, *Leveraging Research and Development: Assessing the Impact of the U.S. Advanced Technology Program*, 20 SMALL BUS. ECON. 153, 154 (2003).

¹²¹ *Id.* at 153.

¹²² *Id.* at 161.

¹²³ *Id.* at 161–62.

¹²⁴ See generally TECHNOLOGY INNOVATION PROGRAM, <http://www.nist.gov/tip> (last visited Nov. 3, 2011).

¹²⁵ ADVANCED TECHNOLOGY PROGRAM, <http://www.atp.nist.gov> (last visited Nov. 3, 2011); see also America Competes Act, Pub. L. No. 110-69, § 3012, 121 Stat. 572, 593 (2007).

¹²⁶ Josh Lerner, *When Bureaucrats Meet Entrepreneurs: The Design of Effective “Public Venture Capital”*, 112 ECON. J. F73, F80 (2002).

¹²⁷ NAT’L INST. STANDARDS & TECH., U.S. DEP’T OF COMMERCE, TECHNOLOGY INNOVATION PROGRAM: TRANSFORMING AMERICA’S FUTURE THROUGH INNOVATION 1 (2009), available at http://www.nist.gov/tip/upload/tip_2009_annual_report.pdf.

¹²⁸ *Id.*

available.”¹²⁹ When private resources are not available to address a societal challenge, TIP may step in to provide funding.

Reviews of ATP and TIP have been mixed, with some finding such programs successful¹³⁰ and others finding them unsuccessful.¹³¹ Supporters often argue that funding entrepreneurial ventures “will transform depressed economic regions, generate innovation, and create jobs.”¹³² This notion, according to opponents, “may be politically appealing, but . . . is naïve.”¹³³ A 2005 study prepared for the Department of Homeland Security identifies the source of tension. The report advises that while “[s]tructuring venture capital activity within the private sector is challenging enough,”¹³⁴ the participation of the government poses even greater challenges, since “[f]ederal agencies do not normally run businesses, make commercial investments, or develop commercial products.”¹³⁵ Beyond the practical challenges of the government participating in an industry as unfamiliar as venture capital, critics argue such programs cause “an erosion in political accountability, [which is] a crucial element in democratic governance.”¹³⁶

In 1999, amid the backdrop of this debate, the CIA took the concept of government-backed, strategic venture capital investing to a new level.

IV. THE RELATIONSHIP BETWEEN THE CIA AND IN-Q-TEL

Unlike TIP, which is a public-private partnership that functions more as a pool of government grant money than a venture capital fund, In-Q-Tel is arguably a true, independent venture capital firm. This Part examines the In-Q-Tel model more closely.

A. What Is In-Q-Tel?

Shortly after In-Q-Tel opened for business, an article in the *Los Angeles Daily Journal* described the partnership between the firm and the CIA as “an out-of-the-box marriage between the federal government and

¹²⁹ *Id.* at 2.

¹³⁰ See, e.g., Feldman & Kelley, *supra* note 120; CUMMING & JOHAN, *supra* note 93, at 256–57.

¹³¹ See, e.g., SCOTT SHANE, ILLUSIONS OF ENTREPRENEURSHIP: THE COSTLY MYTHS THAT ENTREPRENEURS, INVESTORS AND POLICY MAKERS LIVE BY 88–90 (2008).

¹³² Scott Shane, *Why Encouraging More People to Become Entrepreneurs Is Bad Public Policy*, 33 SMALL BUS. ECON. 141 (2009).

¹³³ *Id.* at 147.

¹³⁴ HOMELAND SEC. INST., VENTURE CAPITAL CONCEPT ANALYSIS 7 (2005), available at <http://www.dtic.mil/cgi-bin/GetTRDoc?AD=ADA502019>.

¹³⁵ *Id.*

¹³⁶ KEVIN R. KOSAR, CONG. RESEARCH SERV., RL30533, THE QUASI GOVERNMENT: HYBRID ORGANIZATIONS WITH BOTH GOVERNMENT AND PRIVATE SECTOR LEGAL CHARACTERISTICS, at summary (2011), available at <http://www.fas.org/sgp/crs/misc/RL30533.pdf>.

Silicon Valley.”¹³⁷ As the writer put it, “This is a tale of James Bond meets venture capitalist.”¹³⁸ True, the CIA wanted to play up the mystique of James Bond—the “Q” in the firm’s name, placed between “Intel” (shorthand for “Intelligence”), refers to James Bond’s fictional inventor of high-tech spy gear and other gadgets.¹³⁹ However, characterizing In-Q-Tel solely as a venture capital firm is somewhat inaccurate. Indeed, In-Q-Tel has variously (and correctly) been called a “technology accelerator,”¹⁴⁰ a “private nonprofit venture capital company,”¹⁴¹ as well as “the ‘venture capital arm’ of the CIA.”¹⁴² Reflecting its focus on R&D, In-Q-Tel refers to itself as a “strategic investment firm.”¹⁴³

But the best definition of In-Q-Tel’s business model is supplied by an independent report prepared by Business Executives for National Security (BENS), an organization that fosters an exchange of ideas between the private and public sectors.¹⁴⁴ “In-Q-Tel has been mischaracterized as a private venture capital firm,” observes the 2001 report.¹⁴⁵ “More precisely . . . In-Q-Tel is an evolving blend of various business, nonprofit, and government research and development (R&D) models. It is most analogous to a corporate strategic venture capital entity—like those maintained by major technology firms.”¹⁴⁶ The BENS report notes that, while profit is important, In-Q-Tel primarily “seeks enhanced innovation, earlier discovery of relevant technologies, and more direct information on market developments.”¹⁴⁷

Regardless of the label, the important point is that In-Q-Tel, legally independent of the CIA, makes equity investments in private-sector firms using government-supplied funds. In the years prior to In-Q-Tel’s formation, many observers had called for the CIA and the broader intelligence community to do some “radical rethinking about its missions

¹³⁷ Leslie A. Gordon, *Venturing Out*, L.A. DAILY J., Mar. 13, 2000, at S10.

¹³⁸ *Id.*

¹³⁹ *Id.*; Neil King, Jr., *With a Nod to 007, the CIA Sets Up Firm to Invest in High Tech*, WALL ST. J., April 3, 2000, at A1, available at <http://online.wsj.com/article/SB954709328708352542-search.html?KEYWORDS=Neil+King+Jr&COLLECTION=wsjie/6month>.

¹⁴⁰ BENS REPORT, *supra* note 1, at viii.

¹⁴¹ Amy Cortese, *Suddenly, Uncle Sam Wants to Bankroll You*, N.Y. TIMES, Dec. 30, 2001, at 1.

¹⁴² Terence O’Hara, *In-Q-Tel, CIA’s Venture Arm, Invests in Secrets*, WASH. POST, Aug. 15, 2005, at D01, available at <http://www.washingtonpost.com/wp-dyn/content/article/2005/08/14/AR2005081401108.html>.

¹⁴³ *IQT Corporate Fact Sheet*, *supra* note 2.

¹⁴⁴ *About BENS*, BUS. EXEC. FOR NAT’L SEC., <http://www.bens.org/page.aspx?pid=406> (last visited Jan. 23, 2013).

¹⁴⁵ BENS REPORT, *supra* note 1, at viii.

¹⁴⁶ *Id.* at viii–ix.

¹⁴⁷ *Id.*

and the approaches, methods and techniques employed in discharging them.”¹⁴⁸ As the first government-sponsored venture capital firm, In-Q-Tel was certainly radical.

One of the driving factors in this radical new structuring was the concern that it would be nearly impossible for traditional CIA staffers to bridge the gap between the culture of the CIA and the culture of Silicon Valley. “We had to find a way to harness the brilliance of young innovators in the IT industry,” recalled George Tenet.¹⁴⁹ The problem was that “[t]o them, we were their fathers: stiff, buttoned up, wearing suits. They wanted nothing to do with us. We needed to bridge that generation gap.”¹⁵⁰

In its first move to create a generation-bridging familiar face, the CIA decided to charter In-Q-Tel as an independent entity, since it would then be able “to operate in the market place on equal footing with its commercial peers and with the speed and agility that the IT world demands.”¹⁵¹ The government, reasoned the CIA, is generally too sluggish to attract the attention of many innovators.¹⁵²

Next, In-Q-Tel needed a CEO with credibility in Silicon Valley, where many of In-Q-Tel’s investments would be made. Gilman Louie, a charismatic thirty-nine-year-old video game developer¹⁵³ who had just sold his own company for millions,¹⁵⁴ seemed to fit the bill. Louie, according to the *Washington Post*, is “a genuine Silicon Valley entrepreneur, who started his first company in his mother’s garage in San Francisco when he was 22.”¹⁵⁵

After assuming his position as CEO, Louie went to work bridging the generation gap. He noted approvingly that, although In-Q-Tel and the CIA would be partners, In-Q-Tel would “not [be] tied to the CIA’s organizational style and structure.”¹⁵⁶ Elaborating on this point, Louie commented: “Because In-Q-Tel is a private company, we will be able to work in Internet time and structure ourselves in a manner that will be familiar to many of the information technology companies we hope to attract as partners.”¹⁵⁷

¹⁴⁸ Carver, *supra* note 67, at 156.

¹⁴⁹ TENET WITH HARLOW, *supra* note 3, at 26.

¹⁵⁰ *Id.*

¹⁵¹ Yannuzzi, *supra* note 54, at 28.

¹⁵² TENET WITH HARLOW, *supra* note 3, at 26.

¹⁵³ David Ignatius, *The CIA as Venture Capitalist*, WASH. POST, Sept. 29, 1999, at A29, available at <http://www.washingtonpost.com/wp-srv/WPcap/1999-09/29/071r-092999-idx.html>.

¹⁵⁴ Gordon, *supra* note 137, at S10.

¹⁵⁵ Ignatius, *supra* note 153, at A29.

¹⁵⁶ Gordon, *supra* note 137, at S10.

¹⁵⁷ *Id.*

At the announcement of In-Q-Tel's formation in September 1999, Louie formally assumed his role as spokesman for the new venture. "In many ways," he declared, "the needs of business and the CIA are quickly converging."¹⁵⁸ Accordingly, the CIA and In-Q-Tel would "look for ways to find answers to similar problems."¹⁵⁹ Louie concluded: "In-Q-Tel will work to be the bridge that will allow our brightest minds to work on some of our nation's toughest problems to foster creativity."¹⁶⁰

B. How In-Q-Tel Works

Critics of hybrid organizations such as In-Q-Tel "tend to consider the governmental and private sectors as being legally distinct, with relatively little overlap in behavioral norms."¹⁶¹ Yet, this is the point of In-Q-Tel: the CIA recognizes the public and private sectors function very differently, particularly with respect to procurement. Traditionally, if the CIA had a need for which private-sector assistance was required, the Agency would initiate a bidding process.¹⁶² The winning bidder would earn the contract and deliver the product. The product would eventually become obsolete, at which time a new process would begin again. With the creation of In-Q-Tel, the CIA aimed to establish a more efficient procurement process. A case study endorsed by In-Q-Tel¹⁶³ states: "As its primary goal, In-Q-Tel [seeks] to provide the CIA with solutions that [will] be supported by a competitive marketplace, not government funding."¹⁶⁴ Thus, the objective is to foster procurement relationships that are continuous rather than transactional and to secure technology that will be updated according to the constantly developing needs of the commercial market rather than the intermittent needs of a single government agency.

Of course, In-Q-Tel requires funding. Whereas financial venture capital funds raise money by securing committed capital from passive investors such as pension funds, In-Q-Tel receives annual funding¹⁶⁵ for

¹⁵⁸ *Id.*

¹⁵⁹ *Id.*

¹⁶⁰ *Id.*

¹⁶¹ KOSAR, *supra* note 136.

¹⁶² Josh Lerner et al., *In-Q-Tel*, in VENTURE CAPITAL AND PRIVATE EQUITY: A CASEBOOK 483, 489 (3d ed. 2005).

¹⁶³ *IQT History*, IN-Q-TEL, <http://www.iqt.org/about-iqt/history.html> (last visited Nov. 2, 2011).

¹⁶⁴ Lerner et al., *supra* note 162, at 483.

¹⁶⁵ Recently, In-Q-Tel received additional funding from other government agencies, including: the National Geospatial-Intelligence Agency (NGA); the Defense Intelligence Agency (DIA); and the Department of Homeland Security Science and Technology Directorate (DHSS&T). *Intelligence Community Partners*, IN-Q-TEL, <http://www.iqt.org/about-iqt/ic-partners.html> (last visited Nov. 2, 2011).

investment purposes of about \$37 million¹⁶⁶ as part of the CIA's budget for the Directorate of Science and Technology.¹⁶⁷ While this may seem an odd use of taxpayer dollars, it fits within the broad discretionary authority afforded to intelligence operations since 1775.¹⁶⁸

An office within the CIA, called the In-Q-Tel Interface Center (QIC), serves as the link between the CIA and In-Q-Tel.¹⁶⁹ QIC communicates unclassified problem sets to In-Q-Tel,¹⁷⁰ for which In-Q-Tel is then charged with combing the private sector for potential fits with the technologies being developed by promising start-ups. Typically, In-Q-Tel makes twelve to fifteen investments per year.¹⁷¹ When In-Q-Tel finds a company that seems poised to deliver, it will usually invest between \$500,000 and \$3 million, with about 15-20% of that figure going toward an equity position in the company and the remaining sum covering licensing agreements and contracts to develop the company's technology to fit the specific needs of the CIA.¹⁷²

Like other venture capital firms, In-Q-Tel typically assumes an advisory position on a portfolio company's board of directors.¹⁷³ From this vantage point, In-Q-Tel acts as a general advisor to the company. The perceived benefit of being an investor in the company rather than simply a customer is that, if any changes are made to the company or its product(s), In-Q-Tel will promptly find out. As one of In-Q-Tel's senior directors put

¹⁶⁶ O'Hara, *supra* note 142. Since O'Hara's article revealed In-Q-Tel's annual investment funding figure, no further information has been released; the current funding figure dedicated to investments may be more or less than \$37 million per year. As *Forbes* noted, "[t]he operation's budget is classified." Kashmir Hill, *Startups Backed by the CIA*, *FORBES* (Nov. 22, 2010, 6:00 AM), <http://www.forbes.com/2010/11/19/in-q-tel-cia-venture-fund-business-washington-cia.html?boxes=Homepagechannels>.

¹⁶⁷ Lerner et al., *supra* note 162, at 495.

¹⁶⁸ In-Q-Tel's outside counsel, Jeffrey H. Smith of Arnold & Porter LLP, remarked that "one of the major legal questions was: could the government give appropriated money to a company knowing this company would then invest it in start-up companies? We got over that hurdle, although there were skeptics for some time." *Id.* at 489; *see also Jeffrey H. Smith, ARNOLD & PORTER LLP*, <http://www.arnoldporter.com/professionals.cfm?action=view&id=109> (last visited Feb. 15, 2012).

¹⁶⁹ Lerner et al., *supra* note 162, at 493-95.

¹⁷⁰ BENS REPORT, *supra* note 1, at 8.

¹⁷¹ TIM SHORROCK, *SPIES FOR HIRE: THE SECRET WORLD OF INTELLIGENCE OUTSOURCING* 147 (2008).

¹⁷² O'Hara, *supra* note 142 (reporting that "In-Q-Tel spends \$500,000 to \$2 million on a company with technology of interest to the CIA. But only 15 percent of that is in form of an equity investment."); SHORROCK, *supra* note 171, at 147 (quoting an In-Q-Tel vice president stating the firm's investments "tend to be in the \$1 million to \$3 million range" with some 80% of that figure funding "specific technology advancement work driven by identified Intelligence Community needs" and the remaining sum covering an equity investment).

¹⁷³ BENS REPORT, *supra* note 1, at 60; Lerner et al., *supra* note 162, at 495.

it in 2004, “When you are [only] a customer, you are often the last to know anything is going wrong with the company.”¹⁷⁴

Ostensibly not-for-profit, any returns In-Q-Tel generates from its portfolio companies flow back to In-Q-Tel.¹⁷⁵ Although In-Q-Tel does not regularly disclose the financial performance of its portfolio,¹⁷⁶ Gilman Louie stated in late 2005 that the firm had managed a cumulative rate of return of 26% up to that period.¹⁷⁷ When In-Q-Tel realizes a profit from the exit of a portfolio company, the board of directors may then re-allocate the funds to new projects.¹⁷⁸ As for compensation, between 20 to 40% of an In-Q-Tel employee’s salary is put into a mandatory fund; for every three dollars In-Q-Tel invests, one dollar from the employee fund is also invested.¹⁷⁹ Overall, In-Q-Tel managers are compensated differently than managers of traditional venture capital funds (which use the 2 and 20 structure described earlier in Part III.A), but they still have a direct stake in the companies in which In-Q-Tel invests.

In terms of In-Q-Tel’s potential investments, a senior director explained:

We are out there combing the woods, working with entrepreneurs all over the United States, and for that matter, even worldwide. We get business plans in, and we continually evaluate new technologies in a variety of different areas, of which knowledge management tools are one, and other technology areas tangential to knowledge management.¹⁸⁰

Since its founding, In-Q-Tel has invested in companies that develop or have developed a range of technologies, including portable power sources, tiny cameras, tracking devices, encryption software, and data analysis tools.¹⁸¹ Although Silicon Valley is the focal point of In-Q-Tel’s investing

¹⁷⁴ Hugh McKellar, *Inside In-Q-Tel: Exclusive Interview*, KMWORLD (July 1, 2004), <http://www.kmworld.com/Articles/News/News-Analysis/Inside-In-Q-Tel-exclusive-interview-9563.aspx>.

¹⁷⁵ Lerner et al., *supra* note 162, at 490.

¹⁷⁶ “In-Q-Tel is a rather secretive group.” Kashmir Hill, *How the C.I.A. Perfects its Social Media Monitoring Technologies*, FORBES (Nov. 24, 2010, 10:22 AM), <http://www.forbes.com/sites/kashmirhill/2010/11/24/how-the-c-i-a-perfects-its-social-media-monitoring-technologies/>.

¹⁷⁷ Jay Solomon, *Investing in Intelligence*, WALL ST. J., Sept. 12, 2005, at A4, available at http://online.wsj.com/public/article/SB112649119163137691-v3hOitqG_UmQt3vwwFp_B3wWrc4_20060912.html?mod=tff_main_tff_top.

¹⁷⁸ Sarah Lacy, *Meet the CIA’s Venture Capitalist*, BLOOMBERG BUS. WK. (May 9, 2005), <http://www.businessweek.com/stories/2005-05-09/meet-the-cias-venture-capitalist>.

¹⁷⁹ *Id.*

¹⁸⁰ McKellar, *supra* note 174.

¹⁸¹ Hill, *supra* note 166; *Alumni Portfolio Companies*, IN-Q-TEL, <http://www.iqt.org/portfolio/alumni.html> (last visited Feb. 21, 2013).

activities, since 1999 the firm has invested in companies with operations throughout North America, Europe, and Asia.¹⁸²

George Tenet, under whose direction In-Q-Tel came to life, reflected in 2007 that “[t]he In-Q-Tel alliance has put the [CIA] back at the leading edge of technology, a frontier we never should have retreated from in the first place.”¹⁸³ Whether or not this assertion is true, another question altogether is whether an independent venture capital firm is the best vehicle to accomplish such a mission.

V. ANALYSIS

The current In-Q-Tel model has been touted as a success. In March 2012, for example, David Petraeus, then Director of the CIA, declared that “our partnership with In-Q-Tel is essential to helping identify and deliver groundbreaking technologies with mission-critical applications to the CIA and to our partner agencies.”¹⁸⁴ According to Petraeus, the private sector’s “ability to rapidly prototype new products and get them to market—especially our market—is a skill that government simply cannot match.”¹⁸⁵

But might the potential risks of In-Q-Tel be greater than the benefits? The 2001 BENS report concludes the opposite: “In-Q-Tel’s potential advantage to the CIA outweighs the risk.”¹⁸⁶ Yet, this study was performed with relatively minimal data—In-Q-Tel had existed for only two years at the time. The study seems to endorse In-Q-Tel more as a novel experiment than a true success. The study advises: “Except for required audits and oversight, In-Q-Tel should be allowed to complete its initial business cycle without additional reviews. A full business case assessment should be required at the end of the charter agreement [in] July 2004.”¹⁸⁷ But the CIA extended In-Q-Tel’s initial five-year charter without the recommended study, and since 2001 no independent study or panel has fully assessed In-Q-Tel’s successes or reevaluated its potential risks.¹⁸⁸ “In-Q-Tel remains an

¹⁸² See, e.g., Press Release, In-Q-Tel, Asankya Launches Company at Demo Conference (Jan. 28, 2008), http://www.iqt.org/press/2008/Asankya_01-28-08.html; Press Release, In-Q-Tel, In-Q-Tel Signs Strategic Agreement with Endeca to Bring Power of Guided Navigation to Government Agencies (Oct. 7, 2009), https://iqt.org/press/2003/Endeca_10-07-03.html.

¹⁸³ TENET WITH HARLOW, *supra* note 3, at 26.

¹⁸⁴ David H. Petraeus, Director, Cent. Intelligence Agency., Remarks by Director David H. Petraeus at In-Q-Tel CEO Summit (Mar. 1, 2012), *available at* <https://www.cia.gov/news-information/speeches-testimony/2012-speeches-testimony/in-q-tel-summit-remarks.html>.

¹⁸⁵ *Id.*

¹⁸⁶ BENS REPORT, *supra* note 1, at v.

¹⁸⁷ *Id.* at vi.

¹⁸⁸ The terrorist attacks of September 11, 2001 seemed to garner support for In-Q-Tel; perhaps the War on Terror has caused Congress to leave In-Q-Tel alone for the time being. See Cortese, *supra* note 141, at BU1; Lerner et al., *supra* note 162, at 490.

experiment,” reported the *Washington Post* in 2005, “that even its most ardent backers say has yet to prove its full potential.”¹⁸⁹ A follow-up study, similar to the BENS report, would help add some objectivity to the discussion. Indeed, “little is publicly known about In-Q-Tel, or about how the CIA defines ‘success’.”¹⁹⁰ A recent article in the *Virginia Law Review* concluded: “Given the scarcity of publicly available information, it is difficult to say anything definitive as to whether the enterprise is truly effective, let alone more effective than were it housed entirely within the spy agency.”¹⁹¹

This Part proceeds by examining various issues associated with the effectiveness of the current In-Q-Tel model. It then suggests an alternative model by which the CIA may maintain or increase the effectiveness of In-Q-Tel while reducing potential risks.

A. Internal Issues: Staffing and Technology Integration

1. Staffing In-Q-Tel and QIC

In-Q-Tel still faces many of the same practical issues that existed when it opened for business in 1999, including recruiting, hiring, and retaining talent. For a potential candidate, In-Q-Tel has the advantage of what one commentator has described as the “sexy CIA-Silicon Valley combination”¹⁹²—an angle played up by the CIA with firm’s reference to the character known as “Q” from the *James Bond* franchise. But compensation might be another story. “Bright young people . . . go to Silicon Valley and get a whole load of stock options,” observed Norman Augustine, the former CEO of Lockheed Martin who was recruited by the CIA to help form In-Q-Tel.¹⁹³ Augustine also noted: “The CIA doesn’t give stock options.”¹⁹⁴

In fact, In-Q-Tel appears to pay¹⁹⁵ more than the federal government¹⁹⁶

¹⁸⁹ O’Hara, *supra* note 142.

¹⁹⁰ Jon D. Michaels, *The (Willingly) Fettered Executive: Presidential Spinoffs in National Security Domains and Beyond*, 97 VA. L. REV. 801, 816 (2011).

¹⁹¹ *Id.* at 817.

¹⁹² Gordon, *supra* note 137, at S11.

¹⁹³ Kambiz Foroohar, *CIA Venture Fund Focuses on Spy Gadgets ‘Q’ Adores*, BLOOMBERG (Oct. 25, 2007, 1:44 PM), <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=arSqdOLQVK9g>.

¹⁹⁴ *Id.*

¹⁹⁵ IN-Q-TEL FORM 990 FOR 2010, *available at* http://990s.foundationcenter.org/990_pdf_archive/522/522149962/522149962_201103_990.pdf (last visited Feb. 10, 2013). “The compensation system is approved by the board or a committee of independent directors who are not employees of, or independent contractors to, [In-Q-Tel] and who do not have a conflict of interest with respect to anyone covered by these [compensation] policies.” *Id.* at 33. The committee “ensures that [In-Q-Tel’s] compensation

but significantly less than many leading venture capital firms. The most recently available public filings show that, for 2010, In-Q-Tel's CEO earned total compensation (including bonuses) of \$965,023.¹⁹⁷ The firm's managing partner earned slightly less: \$870,094.¹⁹⁸ Compensation dropped considerably, however, for In-Q-Tel's chief financial officer, who earned \$473,447.¹⁹⁹ On the other hand, a "typical managing partner" at a successful venture capital firm in Silicon Valley might command between \$1 million to \$5 million annually *before* receiving a bonus, according to a veteran of that market.²⁰⁰ Notably, while In-Q-Tel employees are compensated in part with equity holdings in the firm's portfolio companies,²⁰¹ In-Q-Tel's equity investments are relatively small.²⁰² Thus, In-Q-Tel employees stand to earn less in the aggregate from a successful IPO or sale of a portfolio company than do employees of other venture capital firms.²⁰³

With this in mind, why would an ideal candidate choose to join In-Q-Tel as opposed to a leading venture capital firm? Perhaps the candidate might have the opportunity to participate at a higher level earlier at In-Q-Tel, or perhaps the candidate would prefer In-Q-Tel out of a sense of national service. Certainly, individuals capable of commanding extremely high compensation in the private sector have opted instead for government service. One prominent example is Robert S. McNamara, who left his job as president of Ford Motor Company to serve as Secretary of Defense under

program and other employee benefits are comparable to the high-tech and other appropriate markets." *Id.* at 34. Finally, the committee "determines, with input from the CIA, an overall annual company 'performance score' that reflects the extent and manner in which [In-Q-Tel] has been successful in pursuing its mission." *Id.*

¹⁹⁶ See generally *Pay & Leave*, U.S. OFF. OF PERSONNEL MGMT: PAY & LEAVE, <http://www.opm.gov/policy-data-oversight/pay-leave/> (last visited Feb. 18, 2012).

¹⁹⁷ IN-Q-TEL FORM 990 FOR 2010, *supra* note 195, at 7.

¹⁹⁸ *Id.*

¹⁹⁹ *Id.*

²⁰⁰ Evelyn M. Rusli, *In Flip-Flops and Jeans, An Unconventional Venture Capitalist*, N.Y. TIMES DEALBOOK (Oct. 6, 2011, 8:36 PM), <http://dealbook.nytimes.com/2011/10/06/in-flip-flops-and-jeans-the-unconventional-venture-capitalist/>.

²⁰¹ See *supra* text accompanying note 179.

²⁰² As one In-Q-Tel associate noted: "[T]he size of our equity investments tends to be very small." Lerner et al., *supra* note 162, at 495.

²⁰³ As discussed, In-Q-Tel's fund has historically been less than \$50 million. See *supra* note 166 and accompanying text. Compare this to the funds managed by Andreessen Horowitz, a venture capital firm also focused on Silicon Valley. See Evelyn M. Rusli, *Andreessen More Than Doubles His Firm's Assets*, N.Y. TIMES DEALBOOK (Jan. 31, 2012, 2:06 PM), <http://dealbook.nytimes.com/2012/01/31/andreessen-more-than-doubles-his-firms-assets/> ("Set up in 2009 by Mr. Andreessen and his longtime friend Ben Horowitz, Andreessen Horowitz has raised a total of \$2.7 billion in the last three years.").

President John F. Kennedy.²⁰⁴

In-Q-Tel seems to have recruited the first group of employees on the CIA-Silicon Valley combination, plus a sense of national service.²⁰⁵ Augustine, the founding chairman from Lockheed Martin, and Louie, the founding CEO who had been a successful entrepreneur, were independently wealthy when they signed up. But Louie, having served as CEO since the formation of In-Q-Tel in 1999, left in January 2006 to form a new venture capital firm “to invest in early-stage technology companies.”²⁰⁶ While Louie’s work thus remains much the same, one can only speculate his compensation has increased. After Louie’s departure, In-Q-Tel seemed to have trouble finding a successor. In-Q-Tel initially recruited Amit Yoran to serve as CEO, but Yoran’s tenure lasted only four months.²⁰⁷ Scott Yancey served as interim CEO until Christopher Darby, who had previously been with Intel, took over as CEO in September 2006.²⁰⁸ Darby has been with In-Q-Tel since then.²⁰⁹

As the initial glamour of the CIA-Silicon Valley combination begins to wane, In-Q-Tel’s sub-market compensation,²¹⁰ relative to other venture

²⁰⁴ McNamara discussed Kennedy’s recruiting of him in a 2003 documentary: “I was the first president . . . in the history of the company . . . other than a member of the Ford family. And after five weeks, I quit.” *THE FOG OF WAR: ELEVEN LESSONS FROM THE LIFE OF ROBERT S. MCNAMARA* (Sony Pictures Classics 2003). Commenting on the economics of his decision, McNamara said:

My total net worth at the time was on the order of \$800,000, but I had huge unfulfilled stock options worth millions. And I was one of the highest paid executives in the world, and the future was of course brilliant. . . [My wife and I] called our children in. Their life would be totally changed. The salary of a cabinet secretary then was \$25,000 a year.

Id. When Kennedy introduced McNamara in a televised press conference, he declared: “Mr. McNamara leaves the presidency of the Ford Company at great personal sacrifice.” *Id.*

²⁰⁵ They almost certainly did not sign up with In-Q-Tel in order to make a lot of money, since “In-Q-Tel’s primary goal was never financial independence, or even to make money.” Steve Henn, *In-Q-Tel: The CIA’s Tax-Funded Player In Silicon Valley*, NAT’L PUB. RADIO (July 16, 2012, 9:43 AM), <http://www.npr.org/blogs/alltechconsidered/2012/07/16/156839153/in-q-tel-the-cias-tax-funded-player-in-silicon-valley> (quoting Jeff Smith, former General Counsel to the CIA).

²⁰⁶ Rebecca Buckman, *Alsop, Louie Plan Venture Fund for Early-Stage Development*, WALL ST. J., Jan. 5, 2006, at C4.

²⁰⁷ Erica Davis, *CIA Venture Group In-Q-Tel Names Intel Executive Its CEO*, WALL ST. J., Aug. 29, 2006, at B9.

²⁰⁸ *Id.*

²⁰⁹ *Management Team: Christopher Darby*, IN-Q-TEL, <http://www.iqt.org/about/management.html#darby> (last visited Feb. 10, 2013).

²¹⁰ BENS REPORT, *supra* note 1, at 41–44. Employee compensation at In-Q-Tel derives from three components: (1) base salary; (2) annual cash bonus; and (3) an employee investment program. *Id.* at 41. Base salaries are determined by averaging the salaries of comparable positions in the following four industries: high technology, nonprofit,

capital firms,²¹¹ may reduce the overall talent In-Q-Tel is able to acquire. As Louie himself put it, “The most important thing [for In-Q-Tel] is the technology return. Of secondary importance is the financial return.”²¹² Even if financial return were the most important thing for In-Q-Tel, the firm would not be able to compete on the same footing as many other venture capital firms. Often, the funds managed by leading venture capital firms exceed \$100 million of committed capital,²¹³ and many exceed \$1 billion.²¹⁴ In-Q-Tel, on the other hand, operates with far less capital. Investment opportunities and aggregate returns are therefore restrained, possibly reducing the interest levels of potential employees.

2. *Technology Integration at the CIA*

Beyond the practical issues surrounding the operation of In-Q-Tel itself, further issues exist with respect to the successful integration of technologies generated by In-Q-Tel’s portfolio companies. The conclusion of the 2001 BENS report is illustrative. The CIA’s Director, it noted, “must make the CIA leadership accountable for encouraging and nurturing a cultural change that accepts solutions from the ‘outside world’.”²¹⁵ Apparently, this had been a struggle. But acceptance of solutions delivered by In-Q-Tel is not the only problem. QIC—the CIA department charged with serving as the liaison between In-Q-Tel and the CIA—is an administrative layer through which In-Q-Tel’s technologies must move to reach the larger CIA.²¹⁶ The right staffing of QIC is therefore critical to the ultimate success of In-Q-Tel’s investments.²¹⁷ Unfortunately, the initial

government contractors, and venture capital. *Id.* Cash bonuses, which are based largely on individual performance, are calculated as a percentage of base salaries. *Id.* The investment program allows In-Q-Tel employees to benefit directly from the IPO or sale of a portfolio company. *Id.* at 44.

²¹¹ See CUMMING & JOHAN, *supra* note 93, at 129–61 (discussing various compensation structures among venture capital firms).

²¹² Nicholas Johnston, *Intelliseek Gains \$1.4 Million From CIA-Backed Firm*, WASH. POST, June 25, 2001, at E05.

²¹³ CUMMING & JOHAN, *supra* note 93, at 4.

²¹⁴ LEVIN & ROCAP, *supra* note 92, at 1–15.

²¹⁵ BENS REPORT, *supra* note 1, at v.

²¹⁶ Concerns about the proper functioning of QIC have existed since the formation of In-Q-Tel. “In 1999, Congress believed that In-Q-Tel’s biggest obstacle would not be to find or invest in technologies, but to transfer In-Q-Tel’s technology to [CIA] users.” Lerner et al., *supra* note 162, at 493.

²¹⁷ See BENS REPORT, *supra* note 1, at 23 (“Individuals interviewed by the [BENS] Panel expressed concerns about the structure of QIC and its personnel experience set. Some suggested that QIC be staffed with employees having a strong IT background, while others recommended QIC be staffed with those having significant Agency experience and capable of speaking for their organizational sponsors. The Panel concluded that QIC needs an appropriate mix of both.”).

CIA employees charged with running QIC apparently viewed the assignment as less than “career enhancing.”²¹⁸ Attracting the right people to a department with such a reputation would, of course, be difficult.

Whether the CIA resolved the staffing issues with QIC since the 2001 BENS report suggested the problem is unclear.²¹⁹ Apparently the CIA attempted to address the problem in 2000, when it sent the original group of QIC staff on a team-building retreat. The *Washington Post* reported, rather dryly: The members of QIC “built rope bridges and hauled each other over rivers. At night, to loosen things up, they all wore Hawaiian shirts.”²²⁰ But a corporate-style team-building retreat might be an ill-suited remedy. Perhaps the awkward, unaddressed issue is that QIC is staffed by CIA employees who are paid significantly less than their counterparts at In-Q-Tel—this disparity may negatively affect cooperation between QIC and In-Q-Tel.

While the image of CIA employees wearing Hawaiian shirts on a team-building retreat may be somewhat humorous, this speaks to another, basic point: the CIA is not a for-profit organization. Subjecting CIA employees to programs inspired by corporate America may well fail. Indeed, during his tenure as Director, George Tenet observed the CIA was “an organization that seemed to pride itself on its unbusinesslike methods.”²²¹ Concerned with this attitude, Tenet hired a former executive from an investment bank to bring “business savvy” to the CIA.²²² “I was no Jack Welch and I knew it,” remarked Tenet, referring to the well-known former Chairman and CEO of General Electric.²²³ The comment of a former CIA employee, who in fact supported the In-Q-Tel experiment, is illustrative. “The CIA’s mission was intelligence collection and analysis,” he wrote, “not IT innovation.”²²⁴ Of course, innovations delivered by In-Q-Tel’s portfolio companies will never assist the CIA with its mission if QIC does not function properly and efficiently.

B. External Issues: International Security and Foreign Entanglements

As the U.S. government’s principal spy agency, the CIA has long been exposed to issues of public international law. Most recently, the CIA’s use of unmanned drones in targeted killings has implicated questions of territorial sovereignty and the laws of war.²²⁵

²¹⁸ *Id.* at 21–25.

²¹⁹ *Id.* at 23.

²²⁰ King, *supra* note 139, at A1.

²²¹ TENET WITH HARLOW, *supra* note 3, at 19.

²²² *Id.*

²²³ *Id.* at 17.

²²⁴ Yannuzzi, *supra* note 54, at 27.

²²⁵ See Jack M. Beard, *Law and War in the Virtual Era*, 103 AM. J. INT’L L. 409, 413–25

In-Q-Tel, on the other hand, takes the CIA beyond public international law. In-Q-Tel's investments in private-sector firms expose In-Q-Tel, and vicariously the CIA, to issues arising from contract disputes, patent rights, and securities laws.²²⁶ Indeed, in a 2005 article, *BusinessWeek* noted In-Q-Tel "is always walking a fine line between the public and private sector."²²⁷ For example, in 2006 In-Q-Tel invested in a data management firm whose operations included Chicago, Toronto, London, and Sydney.²²⁸ Canadian hospitals used the firm's software to track patients' medical records. Prompted by concern the CIA may somehow have obtained access to these records, the provincial government in Ontario investigated the In-Q-Tel investment.²²⁹ "Canadians can rest easy," remarked the *Washington Post* at the conclusion of the investigation, "[t]he CIA is not using its venture capital arm to snoop into the medical records of our northern neighbors."²³⁰

Future exchanges may not end so amicably. What would happen, for instance, if the company were to have been supplying records-tracking software to clients in China? It is unclear that disputes or investigations would be contained with In-Q-Tel alone. Notably, while In-Q-Tel is chartered as a corporation independent from the government, QIC occupies an observer role on the In-Q-Tel board of directors²³¹ and thereby exerts control over the firm. Indeed, before investing in a target company, In-Q-Tel "considers [QIC's] insight."²³² Further, In-Q-Tel's primary client and source of funds is the CIA.²³³ It is thus entirely possible that the CIA and larger U.S. federal government would be approached by concerned foreign governments or private-sector companies with respect to investment decisions made by In-Q-Tel. This could cause serious foreign relations issues with nations that may have good reason to believe the CIA is using

(2009).

²²⁶ See generally CUMMING & JOHAN, *supra* note 93, at 51–57, 464–65 (discussing general issues associated with resolving contract disputes among venture capital firms and entrepreneurs in an international context).

²²⁷ Lacy, *supra* note 178.

²²⁸ Press Release, Globe Newswire, Initiate Systems' Software Ranked EMPI Category Leader by KLAS Enterprises, LLC (Dec. 29, 2008), <http://globenewswire.com/news-release/2008/12/29/390285/156904/en/Initiate-Systems-Software-Ranked-EMPI-Category-Leader-by-KLAS-Enterprises-LLC.html> (discussing the geographical operations of Initiate Systems). Initiate Systems, Inc. was later acquired by IBM in 2010. Press Release, Int'l Bus. Mach. Corp., IBM To Acquire Initiate Systems (Feb. 3, 2010), <http://www-03.ibm.com/press/us/en/pressrelease/29305.wss>.

²²⁹ Griff Witte, *Canadians' Medical Records Still Safe from the CIA*, WASH. POST, Sept. 4, 2006, at D02.

²³⁰ *Id.*

²³¹ BENS REPORT, *supra* note 1, at 40.

²³² *Id.*

²³³ The CIA is not the only supplier of funds. See *supra* note 165 (discussing governmental agencies outside the CIA that supply In-Q-Tel with funds).

In-Q-Tel as a platform for espionage rather than R&D.

Recent political angling in South Korea further highlights this point. In February 2012, a South Korean newspaper revealed that “Kim Jeong-hun, nominee for Minister of Future Creation and Science, sat on an advisory committee for the US Central Intelligence Agency in 2009.”²³⁴ The article pointed out that “[t]he news comes on the heels of revelations that Kim also served as a director for In-Q-Tel, a company established by the CIA in 1999.”²³⁵ This information prompted one South Korean politician to declare that President-elect Park Geun-hye “needs to explain why she nominated [Kim] as Minister of Future Creation and Science while knowing his background.”²³⁶ As the newspaper explained, “The concern is what position Kim, who has expressed strongly patriotic sentiments toward the [United States], might take in the event of a conflict between that country’s interests and South Korea’s if he serves as a Cabinet minister.”²³⁷

Another scenario to consider is the possibility of In-Q-Tel being targeted for purposes of industrial espionage. If a foreign firm were to succeed in stealing trade secrets from In-Q-Tel or one of its portfolio companies, to what extent would the CIA or larger federal government become involved? As one CIA official observed: “The open affiliation between the CIA and In-Q-Tel undoubtedly attract[s] the interests of foreign persons, some with questionable motives.”²³⁸ However, the CIA ultimately determined “the risks are manageable and, in many ways, are similar to those faced by any high-tech company trying to protect its [intellectual property] and trade secrets.”²³⁹ Commenting around the time of In-Q-Tel’s formation, the CIA official emphasized: “In-Q-Tel and the Agency will be working closely to ensure [In-Q-Tel] operates with a high degree of security awareness and support.”²⁴⁰

While on the one hand the increasing interconnectedness of the world²⁴¹ has blurred the distinction between public and private international law, the entry of the U.S. government via the CIA and In-Q-Tel into the world of venture capital marks a significant—perhaps unprecedented—mixing of the public and private sectors. When In-Q-Tel takes an equity stake in a company with operations outside the United States, should

²³⁴ Lee Tae-hee, *Questions Raised over Kim Jeong-hun’s Loyalty Due to Background of Close Involvement with US Interests*, HANKYOREH (Feb. 20, 2013, 4:20 PM), <http://english.hani.co.kr/arti/ENGISSUE/105/574747.html>.

²³⁵ *Id.*

²³⁶ *Id.*

²³⁷ *Id.*

²³⁸ Yannuzzi, *supra* note 54, at 35.

²³⁹ *Id.*

²⁴⁰ *Id.*

²⁴¹ See generally THOMAS L. FRIEDMAN, *THE WORLD IS FLAT: A BRIEF HISTORY OF THE TWENTY-FIRST CENTURY* (3d ed. 2007).

foreign governments be concerned about the CIA's role in the exchange? The answer is unclear, but certainly this issue merits greater attention than it has received thus far.

C. Recommendations

Structuring venture capital activity within the private sector is challenging enough; it becomes a different matter altogether when the government is involved. A 2002 article by Harvard professor Josh Lerner asked whether government involvement with venture capital may ever be successful. His somewhat optimistic conclusion: "Certainly, this possibility is not implausible."²⁴² On the other hand, Stanford professor Ronald Gilson concluded such collaboration is ultimately fruitless. "The U.S. venture capital market developed organically," argued Gilson, "largely without government assistance and certainly without government design."²⁴³ At the very least, another independent report on In-Q-Tel's activities would help shed light on some of the issues addressed above. As discussed, the follow-up report recommended by BENS in 2001 was never made.

Beyond a follow-up report, the CIA should restructure the In-Q-Tel model to limit its exposure to private sector disputes. Gilman Louie correctly surmised that "[i]f we want a CIA that performs better, we'll need to take more risks—and give our government the freedom to fail."²⁴⁴ But the potential for CIA involvement in major disputes arising from In-Q-Tel's investments is a failure that should be deemed an unnecessary risk.

As an alternative to the current model, In-Q-Tel should discontinue making equity investments²⁴⁵ and instead use its funds solely to cover licensing agreements and to pay for contracts to develop technology to fit the specific needs of the CIA. Such activity covers the majority of what In-Q-Tel already does, and cutting out the equity investments would drastically reduce the CIA's exposure to private-sector disputes. While it may be true that "the best software around is more likely to be developed in Silicon Valley than in the Pentagon,"²⁴⁶ such a modified arrangement would retain the CIA-Silicon Valley relationship but with a reduced level of risk.

Further, In-Q-Tel's equity investing—the riskiest component of the current model—is also the firm's least effective service to portfolio companies. A recent survey of thirty-four of In-Q-Tel's portfolio companies revealed that "[o]nly roughly a third of surveyed In-Q-Tel companies indicated that the equity investment was highly or extremely

²⁴² Lerner, *supra* note 126, at F78.

²⁴³ Gilson, *supra* note 106, at 1070.

²⁴⁴ Ignatius, *supra* note 153, at A29.

²⁴⁵ In-Q-Tel generally invests \$1 in portfolio companies for every \$9 invested by the other partnering venture capital firms. Petraeus, *supra* note 184.

²⁴⁶ Hill, *supra* note 176.

important for developing their technology.”²⁴⁷ The survey results showed that:

[M]ore than half of the companies found equity investments to be the least valuable asset of their interactions with In-Q-Tel. Furthermore, 59 percent of companies reported that they were very likely to have received sufficient funding for their business ventures without any In-Q-Tel investment. Given that In-Q-Tel is not focused on financial gains, these results question whether equity investments are a crucial part of the In-Q-Tel process. Indeed, some interviewed companies observed that In-Q-Tel seemed insistent on an equity investment . . . even if the company was not particularly interested in it.²⁴⁸

In addition to discontinuing In-Q-Tel’s equity investing activities, the CIA should remove QIC from the observer seat on In-Q-Tel’s board. Granting greater autonomy to In-Q-Tel will create further distance between the firm and the CIA, which may reduce the suspicions of foreign governments and companies. Moreover, since the CIA employees of QIC appear to have no background or expertise with the “extremely challenging”²⁴⁹ activity of venture capital investing (or contracting with private companies for the acquisition of various technologies), it is not clear that their involvement at this level with In-Q-Tel is necessary.

VI. CONCLUSION

The CIA should be congratulated for spearheading a bold and innovative new approach to its mission, but In-Q-Tel has much to prove before it may be deemed a success. While collaboration between the R&D efforts of the public and private sectors is indeed vital and should be encouraged, the risks of In-Q-Tel’s government-sponsored equity investments in private companies outweigh the benefits. Gilman Louie got it right when he said “[t]he CIA and the rest of the government need to catch the entrepreneurial, risk-taking spirit that’s driving the Silicon Valley technology revolution.”²⁵⁰ It is not clear, however, such a spirit should be embodied in a government-sponsored venture capital firm.²⁵¹ Accordingly,

²⁴⁷ Mara, *supra* note 6, at 6.

²⁴⁸ *Id.*

²⁴⁹ Lerner, *supra* note 126, at F80.

²⁵⁰ Ignatius, *supra* note 153, at A29.

²⁵¹ According to the analysis of respected professor and industry commentator Ronald Gilson, such collaboration is ultimately fruitless: “The U.S. venture capital market developed organically, largely without government assistance and certainly without government design.” Gilson, *supra* note 106, at 1070. Another article identifies the differing incentives: “A valid concern often raised when discussing government venture capital programs . . . is whether the government should be involved in such a highly competitive, private sector activity. Private [venture capital] investors are intensely driven by financial motivations,

the recommendations of this Comment suggest a framework by which In-Q-Tel may continue to contribute to the CIA, but with a reduced level of risk.

whereas [government venture capital] programs are primarily driven by strategic concerns.”
Mara, *supra* note 6, at 11.