

THE SPY AGENCY SHOULD CLOSE ITS VENTURE CAPITAL FIRM



-- IF former National Security Agency chief Michael Hayden hangs in there as President Bush's nominee to head the CIA and makes it to a Senate confirmation hearing, one of the panel's members should ask him this:

"Sir, please tell the committee how much further you anticipate allowing the CIA to expand its presence on Wall Street via the private venture capital firm known as In-Q-Tel, Inc."

Hayden came under withering fire in Washington last week as word spread that the ex-NSA chief had presided over the White House's post-9/11 surveillance program of monitoring domestic U.S. telephone calls. The White House, politically weakened from a year of setbacks both at home and abroad, may decide to withdraw Hayden from consideration and submit an alternative nominee burdened with less civil liberties baggage.

Yet whoever winds up in the CIA's top job will inherit a developing mess involving In-Q-Tel that was largely ignored by the agency's departing director, Porter Goss. Hints that all is not well with In-Q-Tel have begun seeping into view as this little-known domestic CIA front operation continues to funnel agency money into penny stock and micro-cap companies in Wall Street's murkiest back alleys.

Two In-Q-Tel CEOs have resigned from the six-year-old venture capital fund in just the last four months; the fund is being run on a day-to-day basis by a man from Washington's politically greased Carlyle Group who has been with In-Q-Tel for only a few weeks. Headhunters are said to be having trouble coming up with candidates for a permanent replacement.

And there are even reports, largely unconfirmed, that the Securities and Exchange Commission is looking into several penny stock promoters with ties to In-Q-Tel.

Launched in 1999 by CIA director George Tenet as a Wall Street venture fund to finance new technologies for the spy world, In-Q-Tel quickly found friends on Capitol Hill, where policymakers seized on the fund as a way to remind constituents that the ghost of Vietnam no longer walked the land. The attacks of 9/11 gave In-Q-Tel even more stature in Congress, where the fund came to be seen as an essential element in the war effort.

Yet the public's visceral reaction to last week's NSA revelations suggests that war or no war, a backlash against government snooping may be starting. And that in turn promises to crank up the heat under In-Q-Tel, where at least some of the fund's investments raise questions of judgment regarding how taxpayer money is being spent by the organization, as well as who it is choosing for business partners.

A year ago, this column drew back the curtain on a fishy In-Q-Tel investment, financed out of the black box budget of the CIA, in a defense-sector start-up called Ionatron Inc.

Run by a longtime Wall Street regulatory violator named Robert Howard, Ionatron used a cash infusion from In-Q-Tel to promote itself around Washington as the developer of a laser-equipped, remotely

controlled device the size of a golf cart that could patrol the highways of Iraq, ferreting out and detonating insurgent land mines ahead of troop movements.

We warned in this space that the technology being trumpeted by Ionatron was not only unproven, but had been obtained by Howard and some midlevel researchers at Raytheon Corp. under highly irregular circumstances designed to persuade a West Coast laser researcher into turning over his research to Howard's group.

Nonetheless, Sen. Hillary Clinton and her Democratic colleague from California, Barbara Boxer, quickly embraced the Ionatron program, which eventually devoured more than \$12 million in government funding before the Pentagon finally concluded last week that the devices are not reliable and cancelled plans to deploy them.

Ionatron's stock price has tumbled more than a third in the last three weeks, leaving the company's largest investor - prominent hedge fund SAC Capital Advisors, run by Steven A. Cohen of Connecticut - sitting with millions in paper losses.

SAC Capital has acknowledged that it is under investigation by the SEC in what appears to be a separate matter involving stock trading, and the SEC may soon start taking a look into the hedge fund's buying of Ionatron's shares.

In-Q-Tel's growing portfolio of investments includes a few successes. Yet the fund has more often poured money into companies that were barking dogs long before In-Q-Tel showed up, and have failed to improve since.

Consider a North Carolina outfit called ID Technologies Corp., which began life in 1994 as CardGuard International Inc. to promote a fingerprint identification system no one wanted to buy. In the four years that followed, the company racked up losses of \$3 million on a mere \$92,000 in revenues.

In 1998, the company changed its name to ID Technologies and added \$2.5 million more to the loss column on barely \$100,000 more in revenues.

Along the way, In-Q-Tel popped up with plans to invest \$400,000 more in ID Tech, but the firm collapsed, leaving investors with \$5.58 million in cumulative losses and a stock that now sells for a fraction of a penny per share.

Another In-Q-Tel investment, in a data software company called Convera Corp., may be headed in the same direction, bearing much greater losses. In 2004 the fund took a stake in Convera, which had yet to turn a profit while piling up more than \$1 billion in cumulative losses since its founding in the mid-1980s.

By the end of 2005, a resulting bounce in Convera stock had topped out at \$16, and the shares have since lost half their value. Last week they were trading below \$8 on investor disenchantment with the perennial money loser's latest offering: an Internet search engine for extracting information from video files.

Because its funding comes from the CIA, In-Q-Tel has been an irresistible target for conspiracy theorists who charge that the CIA is somehow linked through it to every penny stock that goes south.

Last week, one left-leaning Web site reported that SEC investigators think the CIA-backed venture fund has been steering money into penny stock "pump and dump" firms in Israel, Dubai and Malaysia.

But a day's worth of phoning around traces these claims to a tireless complainant named Tony Ryals, who has been bombarding the SEC and Internet message boards for years with claims that he has uncovered a submerged world of In-Q-Tel-linked fraud stretching from Kuala Lumpur to the Middle East.

The alleged linkages are bewildering in their complexity and typically impossible to follow, but conspiracy buffs find them irresistible, since they seem to echo some of the CIA's worst excesses from 30 to 40 years ago, and by their nature, they can never be entirely disproved.

WHETHER the SEC has looked into Ryals' charges and found them baseless isn't known, but thanks to In-Q-Tel and the lengthening shadow of the CIA on Wall Street, the most improbable of such claims once again have a whiff of credibility.

Bottom line: There are many sensible ways the CIA could have gone about developing the technologies it needs, but funneling money into Wall Street via an outfit like In-Q-Tel was never one of them. So it will be a good thing for Wall Street - and for America, too - if the CIA's next spymaster simply shuts the operation down.

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