

## **Sovereign Wealth Funds and Private Equity: Growing Trend**

Financial institutions are turning to sovereign wealth funds, which hold an estimated \$2–3 trillion and could reach \$10 trillion by 2012,<sup>1</sup> for much-needed capital in these increasingly unstable economic times. In recent weeks, regulators and legislators have escalated calls for public policy measures to strengthen sovereign wealth fund oversight, citing concerns that include national security, opaque decision-making and secretive investment strategies.<sup>2</sup> These concerns are perhaps more troubling as sovereign wealth funds have their sights set on private equity buyout firms,<sup>3</sup> which are players in every facet of the US economy, including the “fertile ground” of the nation’s critical infrastructure. The Washington, DC-based Carlyle Group is one of three private equity firms that sold stakes to sovereign wealth funds in 2007,<sup>4</sup> an arrangement that may have problematic implications for national security.

### **The Carlyle Group & Abu Dhabi: A Problematic Partnership for U.S. Security?**

While corporate vehicles controlled by the government of Abu Dhabi have been investors in Carlyle Group funds before,<sup>5</sup> in September 2007, Carlyle announced that the Mubadala Development Company of the Government of Abu Dhabi paid \$1.35 billion for a 7.5% ownership stake in Carlyle.<sup>6</sup> As one of the world’s largest private equity firms, the Carlyle Group has more than \$75.6 billion under management across 55 funds.<sup>7</sup> This transaction represents a coming together of two intensely secretive investment bodies: the Carlyle Group, which is not subject to many of the operational and financial disclosure requirements that apply to public companies, and the Mubadala Development fund, named by the Peterson Institute as one of the least transparent sovereign wealth funds operating today.<sup>8</sup>

As Sen. Evan Bayh has observed, “Sovereign wealth funds are inherently different than private investments. Government-owned entities may have interests that will take precedence over profit maximization.”<sup>9</sup>

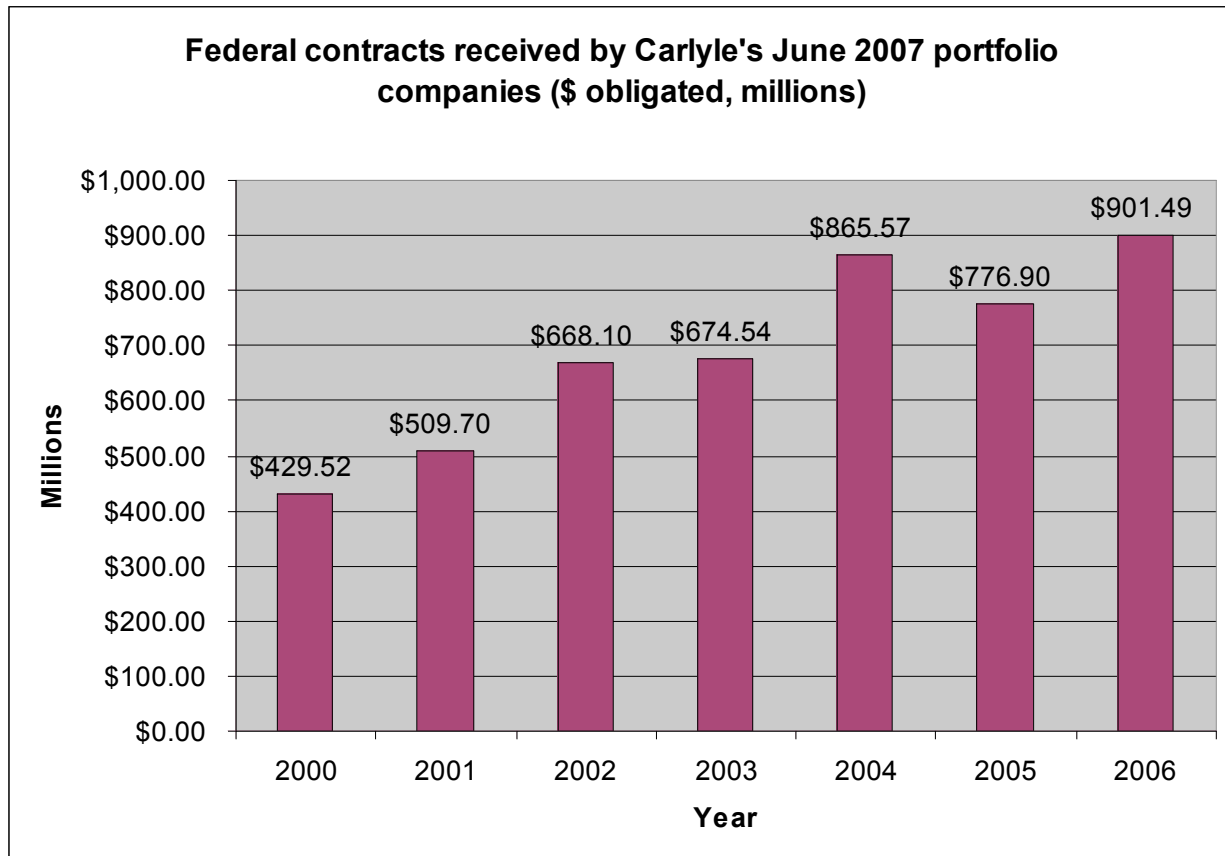
Because of the Carlyle Group’s deep relationship with critical national defense and infrastructure, this partnership raises serious concerns and calls for deeper investigation.

### **A Significant Number of Carlyle Group Portfolio Companies Perform Contracted Work for the U.S. Government**

Many of Carlyle’s portfolio companies reap great profits from federal contracts.<sup>10</sup> Many of Carlyle’s investments in other areas, including automotive, industrial and technology sectors, also have significant defense-related contracts. For example AxleTech, an auto parts manufacturer in which Carlyle invested in 2005<sup>11</sup> with annual sales in 2007 of approximately \$46 million<sup>12</sup>, received over \$50 million in Department of Defense contracts in 2006.<sup>13</sup> CPU Technology, a computer hardware company in which Carlyle invested in 2001,<sup>14</sup> has won over \$217 million in contracts from the Navy, Air Force and Department of Energy since 2000.<sup>15</sup>

According to federal government sources, companies within Carlyle’s portfolio as of June 2007 held thousands of contracts with the federal government during the period from fiscal year 2000 through 2006.<sup>16</sup> Those contracts had an estimated total value of \$4.8 billion, with the value increasing nearly every year between 2000 and 2006. One of Carlyle’s most recent purchases, completed just after the Mubadala investment, is ARINC,<sup>17</sup> a company that provides systems

engineering and communications for the defense and aviation sectors and which has received nearly \$2.9 billion in federal government contracts since 2000.<sup>18</sup>



**74% of Carlyle Portfolio Companies' Federal Contracts Have Been with Defense- or National Security-Related Agencies<sup>19</sup>**

The vast majority of government contracts awarded to Carlyle portfolio companies have been contracts with the Department of Defense, the State Department, and the Department of Homeland Security. Federal records indicate that Carlyle's June 2007 portfolio companies entered into contracts with the Defense Department totaling \$3.3 billion during the period from 2000 through 2006. These companies' State Department contracts totaled \$161 million, while their Homeland Security contracts totaled \$70 million. Together, contracts with the three agencies accounted for approximately 74% of all government contracts that Carlyle's June 2007 portfolio companies entered into during the 2000-2006 period.

The scope of work performed for the federal government by Carlyle portfolio companies has been broad. Carlyle's portfolio companies as of June 2007 have been involved in everything from systems engineering and technical services to constructing turbines and guided missile

components.<sup>20</sup> Because of the nature of these portfolio companies' federal agency clients, many of the contracts these companies have had could be related to national security.

### **Carlyle Portfolio Companies Win No-Bid Contracts and Benefit from Government Earmarks**

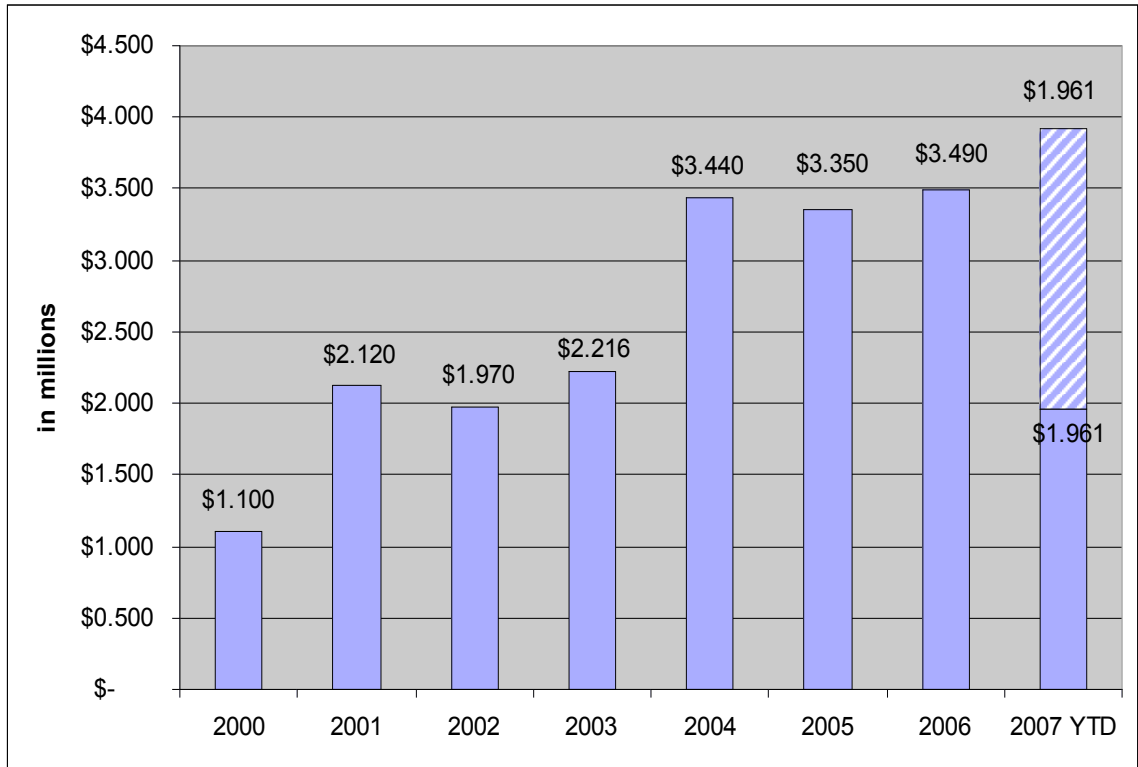
Between 2000 and 2006, some 16% of the contracts awarded to Carlyle's June 2007 portfolio companies were awarded on a non-compete/no bid basis. The number of non-compete federal contracts awarded to these companies has increased from 161 in 2000 to 471 in 2006.

Further, the Seattle Times recently revealed that British company QinetiQ Group and its subsidiaries, in which Carlyle held an ownership stake from 2003 until February 2007,<sup>21</sup> received 2007 defense earmarks valued at over \$11 million.<sup>22</sup> (Recently, QinetiQ management has been accused of bilking UK taxpayers in its separation from the Ministry of Defense.<sup>23</sup>)

### **Carlyle and Its Portfolio Companies Enjoy Significant Access to Lawmakers**

The Carlyle Group and other private equity firms have garnered much attention for their lobbying of elected officials concerning tax issues. Carlyle is estimated to have spent at least \$260,000 on lobbying in 2007 and recently hired its first in-house lobbyist.<sup>24</sup> Carlyle announced that their new man on the Hill, David Marchick, was brought onto the Carlyle team the day before the Mubadala investment was announced. The hire was timely; Marchick has significant experience in global regulatory issues and co-authored a 2006 report for the Council on Foreign Relations warning that Congress should not go too far in strengthening federal rules governing foreign investment in US companies.<sup>25</sup>

But these efforts are far outweighed by the money spent by Carlyle and Carlyle's June 2007 portfolio companies from 2000 through 2006, which totals more than \$17 million. From \$1 million in 2000, lobbying by Carlyle and June 2007 Carlyle portfolio companies more than doubled to \$3.3 million in 2006. Interestingly, Carlyle and its June 2007 portfolio companies spent a record \$3.92 million on lobbyists in 2004; that same year the portfolio companies received more than \$865 million in federal contracts, surpassing 2003 by nearly \$200 million dollars.<sup>26</sup>



*As of Mid-Year 2007, Carlyle and its portfolio companies spent nearly \$2 million on lobbying. If they continue spending at the current rate of nearly \$11,000/day, Carlyle will surpass its 2004 record of \$3.44 million and spend just under \$4 million.*

### **The Carlyle Group Partnership with Abu Dhabi Calls for Greater Government Oversight of Carlyle Portfolio Companies and Federal Contracting**

In 2007, Congress passed significant amendments to the statute governing review of foreign investment in American companies.<sup>27</sup> However, the statute, even as amended, limits its reach to transaction that could result in foreign-government “control” of a U.S. firm. It is unclear how an arrangement like that between Abu Dhabi and the Carlyle Group will be dealt with by government agencies. The announcement of a proposed Dubai acquisition of the NASDAQ exchange – nearly simultaneous with the announcement of Abu Dhabi’s Carlyle investment – triggered vows from the Bush administration for close scrutiny.<sup>28</sup> But even with all its holdings in the defense sector, the Carlyle transaction does not appear to have been subject to the same investigation.

Although Abu Dhabi’s investment is reportedly a non-voting stake, the lack of transparency that characterizes both Carlyle and Mubadala makes it nearly impossible to determine or monitor the extent to which Abu Dhabi’s fund may weigh in on operational decisions of the private equity firm. This lack of transparency is of particular concern because Carlyle, as a private company, is not subject to many of the detailed reporting requirements that enable oversight of public companies’ conduct.<sup>29</sup>

Further, Carlyle has reported that Abu Dhabi's Mubadala fund now holds a 7.5% stake in the private equity firm. Because the Carlyle Group is a private company, however, there are no required public disclosures that permit a complete and independent assessment of Carlyle's real worth. The 7.5% calculation of Abu Dhabi's stake is tied to a \$20 billion valuation of the company negotiated and agreed to by Carlyle and Mubadala themselves. Without adequate and independent publicly available data, how can we know that the \$20 billion valuation is accurate and that this and other valuations are not affected by the parties' interest in ensuring that a sovereign wealth fund's stake appears to be below 10% (and, therefore, of less interest to government regulators)?

It has already been reported that Carlyle's Middle East investment fund will boycott Israel, apparently in deference to current and potential oil-rich Middle Eastern investors, and concerns have already been expressed about the possibility that defense companies within Carlyle's portfolio could decide not to subcontract or sell to Israeli firms in deference to Carlyle's new part-owner or other potential Mideast investors.<sup>30</sup>

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<sup>1</sup> IMF magazine article, "The Rise of Sovereign Wealth Funds," Sept. 07, Vol. 44

<sup>2</sup> Webb speech

<sup>3</sup> <http://www.pionline.com/apps/pbcs.dll/article?AID=/20071224/PRINTSUB/795063123/1031/TOC>

<sup>4</sup> <http://www.pionline.com/apps/pbcs.dll/article?AID=/20071224/PRINTSUB/795063123/1031/TOC>

<sup>5</sup> "TAQA Targets more North American Deals," Platts Oilgram News, October 5, 2007.

<sup>6</sup> <http://carlyle.com/news/news%20archive/2007/item9873.html>

<sup>7</sup> <http://carlyle.com/news/news%20archive/2007/item9873.html>

<sup>8</sup> Edwin Truman, "A Scoreboard for Sovereign Wealth Funds," October 19, 2007.

<sup>9</sup> Quoted in "Foreign buyers eye U.S. firms, court Congress," by Loewenberg, Samuel, USA Today, 12/13/07

<sup>10</sup> Ibid.

<sup>11</sup> <http://www.carlyle.com/Portfolio/item7438.html>

<sup>12</sup> [http://www.hoovers.com/axletech-international/--ID\\_138743--/free-co-factsheet.xhtml](http://www.hoovers.com/axletech-international/--ID_138743--/free-co-factsheet.xhtml)

<sup>13</sup>

[http://www.fedspending.org/fpds/fpds.php?fiscal\\_year=2006&company\\_name=axletech&sortby=r&datatype=T&reptype=r&database=fpds&detail=-1&submit=GO&sum\\_expand=A](http://www.fedspending.org/fpds/fpds.php?fiscal_year=2006&company_name=axletech&sortby=r&datatype=T&reptype=r&database=fpds&detail=-1&submit=GO&sum_expand=A)

<sup>14</sup> <http://www.carlyle.com/Portfolio/item7196.html>

<sup>15</sup> [http://www.fedspending.org/fpds/fpds.php?company\\_name=cpu+technology&sortby=u&sum\\_expand=A&detail=-1&datatype=T&reptype=r&database=fpds&fiscal\\_year=&submit=GO](http://www.fedspending.org/fpds/fpds.php?company_name=cpu+technology&sortby=u&sum_expand=A&detail=-1&datatype=T&reptype=r&database=fpds&fiscal_year=&submit=GO)

<sup>16</sup> To conduct this analysis, SEIU first downloaded a list of Carlyle portfolio companies from the Capital IQ database in June 2007. SEIU then searched the federal government's contracts information available at fedspending.org for contracts made with those companies and their affiliates during the period from 2000 through 2006. This analysis does not track whether those contracts were made during the period of Carlyle's ownership. It is important to note that the figures reported here are a best estimate, rather than a perfect data set. The Capital IQ database is routinely used as a source in the financial sector, but it may not always be perfectly up-to-date or it may include portfolio companies for which deals have been announced but have not yet closed. The fedspending.org database also depends on reports submitted by federal agencies, and those reports may in some cases be under- or over-inclusive. As used throughout this report, references to Carlyle's June 2007 portfolio companies " or "June 2007 portfolio companies" refers to companies listed in connection with Carlyle in the Capital IQ database as of June 2007.

<sup>17</sup> <http://www.carlyle.com/portfolio/item9917.html>

<sup>18</sup> <http://www.arinc.com/news/2007/07-05-07.html>;

[http://www.fedspending.org/fpds/fpds.php?parent\\_id=22501&sortby=u&detail=-1&datatype=T&reptype=r&database=fpds&fiscal\\_year=&submit=GO&sum\\_expand=A](http://www.fedspending.org/fpds/fpds.php?parent_id=22501&sortby=u&detail=-1&datatype=T&reptype=r&database=fpds&fiscal_year=&submit=GO&sum_expand=A)

<sup>19</sup> Added totals for the Department of Defense, the State Department, and the Department of Homeland Security Juan Maya's database on Carlyle portfolio companies from <http://www.fedspending.org>

<sup>21</sup> Daley, James, "Carlyle quits Qinetiq with 240m profit," The Independent, February 9, 2007.

<sup>22</sup> "The Favor Factory: QinetiQ Group PLC," The Seattle Times, printed January 22, 2008.

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- <sup>23</sup> <http://www.ft.com/cms/s/0/202f949e-a1f3-11dc-a13b-0000779fd2ac.html>,  
[http://business.timesonline.co.uk/tol/business/industry\\_sectors/engineering/article2926151.ece](http://business.timesonline.co.uk/tol/business/industry_sectors/engineering/article2926151.ece)
- <sup>24</sup> [http://www.forbes.com/businessinthebeltway/2007/08/28/washington-lobbying-congress-biz-beltway\\_cx\\_bw\\_0829blackstone.html](http://www.forbes.com/businessinthebeltway/2007/08/28/washington-lobbying-congress-biz-beltway_cx_bw_0829blackstone.html) (on in-house lobbyist, see <http://www.washingtonpost.com/wp-dyn/content/article/2007/09/18/AR2007091801791.html>)
- <sup>25</sup> <http://www.washingtonpost.com/wp-dyn/content/article/2007/09/18/AR2007091801791.html> and <http://www.cfr.org/content/publications/attachments/CFIUSreport.pdf>
- <sup>26</sup> <http://www.fedspending.org>, All info in this paragraph taken from Juan's analysis of lobbying records.
- <sup>27</sup> Foreign Investment and National Security Act of 2007, (July 26, 2007) (amending 50 U.S.C.A. app. § 2170).
- <sup>28</sup> "Dubai's Plan to Acquire NASDAQ Stake to be Examined by CFIUS," The Frontrunner, September 21, 2007.
- <sup>29</sup> <http://www.iht.com/articles/ap/2007/11/28/business/NA-FIN-US-Foreign-Investment-Politics.php?page=2>
- <sup>30</sup> <http://www.nytimes.com/2007/09/27/business/worldbusiness/27dubai.html?pagewanted=print> and "Dubai In, Israel Out?" Israel Business Arena, October 10, 2005.