

BOOK REVIEW: *Frankensteins of Fraud*¹

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During a year of major fraud and deception in the American and world economic systems, a report on a book about fraud might be a little like taking "coals to Newcastle". As this book demonstrates through the telling of its stories, there is little new under the sun when it comes to fraud. The prime ingredients (perhaps it should be spelled ingredients) are 1) an over confident investor, 2) a conman (or con-woman) who has ice water running through their veins, 3) an ideal setup; not too good, not too bad, and 4) time to execute a perfect plan. Students today are just getting their eyes opened to the fact that sometimes, what is stated as fact from a company's side of the ledger is fiction by any other definition.

"Frankenstein's of Fraud" delves into history, the schemes and the lives of the 10 most notorious business frauds of

the 20th century. The first common thread that ran through the book was that most of these individuals did not see themselves as evil; however, they all knew that they had stepped out of bounds. The second common thread was their insatiable appetite for wealth and power to the very end. The third common thread is in some ways they generally may have some inordinate amount of control over their victims.

Although all of the stories were very interesting, in the interest of time and brevity I have summarized the five that I found the most interesting. The approximate decade of their malfeasance is in brackets following their names.

My Favorite Five and Their Claim to Fame

Cassie Chadwick (sec. 1900's). — Cassie was born in Canada in the second half of the 19th century. She was able to convince the bankers in Cleveland, Ohio (one of America's wealthiest cities at that time) that she was the illegitimate daughter of Andrew Carnegie (the wealthiest person in the world at that time). The interesting part about this is that she herself never directly spread the rumor. Instead she left hints and let certain facts slip, so that others would get the impression that it was so.

After a series of failed marriages she eventually married a physician in Cleveland with connections to the "Millionaires' Row" (the Rockefellers, the Hannas, the Hays and the Mathers). In one of her more notorious moves, she "accidentally" dropped a piece of paper so that her husband's banker would find and read it. The paper described a \$2 million inheritance and substantial stock in a railway. She swore the banker to absolute secrecy. All of this documentation

¹ Wells, Joseph T., *Frankensteins of Fraud*. Obsidian Publishing Company, Austin, TX, 2000. ISBN # 1-889277-25-8.

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was of course, fake. However, as her story made its way through the banking community, most of Cleveland's premier could not wait to lend her money based on her inheritance. In all, somewhere in excess of \$20 million dollars, which she spent on "schlock" and keeping her story alive (by hiring and paying the bankers to look after her fake estate).

When it all came crashing down, her trial was covered around the world and was even attended by Andrew Carnegie. He wanted to see the woman who duped some of the most conservative bankers by employing his name.

Charles Ponzi (sec. 1910's). – Born in Logo, Italy, Charles Ponzi name will forever be part of the lexicon of financial landscape. The term "Ponzi Scheme" in which the capital of current investors is used to pay back the promised returns of past investors is derived from his scandal. After numerous small business failures (with questionable ethical behavior) Charles hit upon his "goldmine". This involved in the investing in international reply coupons (IRCs). These were a type of guaranteed return postage, which due to changing exchange rates and inflation could be worth more in the purchased country than the redeemed country. The Ponzi claimed that of the IRCs could bring a huge profit.

Ponzi sold the IRCs paper promising 45% in 45 days and 100% in 90 days. At the height of the scandal he was selling \$250,000 of useless paper a day. Two things prolonged this fraud; 1) Most people did not take the profit but kept reinvesting, so Charles did not have to come up with any money as the contracts ended, and 2) the burden of proof in liable law suits at that time were on the investigators. Any hint of fraud was vigorously pursued by Ponzi's attorneys (he won a \$500,000 suit

against a Boston financial reporter investigating Ponzi's company). Ponzi lived well, mansion, heated swimming pool, air conditioning (both very rare at the time) and a yacht.

It all came "crashing down" in August 1920. The Boston Post estimated that 160,000 IRCs would have had to be issued produce this type of profit. In reality only 27,000 were ever issued. Then the banking commissioner for the State of Massachusetts investigated Mr. Ponzi's company and when the company started bouncing checks, he ordered the banks not to honor the checks. Ponzi was sentenced to five years in prison, was released after 3.5 years and then went on to his next fraudulent scheme; Florida land development. The rest of his life was spent in and out of jails and running from the law. He ended up in Rio de Janeiro where he died, destitute, in ill health and broke. None of the money was ever recovered.

Ivar Kreuger (sec. 1920's). – Born in Sweden and became the first international (world) financier in the 20th century. He founded a construction company in the first part of the 20th century that purchased the patent and employed the "steel in concrete" method of building structures. The money that he made from his worldwide construction companies financed his most lucrative venture and the one he became known for "Swedish Match". In an era where matches were a fact of everyday life, Ivar ended up controlling 75% of the world's supply of not only matches but their inputs wood, sulfur etc. He became known as the "Match King". In his quest to control the world match production Ivar sought out financing and eventually purchase some large banks (in countries with lax banking laws) to facilitate this end. Ivar also controlled some large investment

companies to make sure that his public offerings were successful.

At his zenith in 1929, Ivar Kreuger was estimated to have a personal wealth of \$100B (2006) and control over 200 companies worldwide. These included; Kreuger & Toll AB. (the holding company for the all of Kreuger's corporations), IT&T, Diamond Match, USA; Ericsson Telephone, Alsing Trading Co, England, Deutsch Bank, Union de Banques – Paris, The Bank of Sweden, The Commercial Bank of Holland, and five of the largest top 10 construction companies in the world. He had substantial loans (\$42B in 2006 dollars) to 17 world countries including Italy, Sweden, France, Greece and Turkey.

The market crash in 1929 and the subsequent world economic downturns spelled the end for the Match King. Kreuger was solvent until mid-1931 when fluctuations in the foreign exchange rates dealt a death blow to his companies (he had a huge investment in post WWI Germany and the Mark was becoming worthless). Ivar Kreuger took his own life, in Paris, in the spring of 1932. Some \$250M in claimed assets was never established. Because of this financial debacle, the U.S. enacted some very tough rules and regulations that were enforced until the 1990s. When they were finally relaxed, this opened the door for the Enron and Madoff scandals.

Dr. Frank D. Coster (sec. 1930's). – Dr. Coster was born in Naples, Italy (Philip Musica). He was a small time con who hit the big-time, with the help of his family. He imported groceries from Italy, and bribed tax officials on the NYC docks to under-bill his invoices, thus avoiding importation duties. Got caught; did time. Next, Musica moved into the human hair (wig) business. The company borrowed \$2M on non-existent inventory. Got caught; did time,

but this time he met "Dutch" Schultz in prison and established a loose and on-going partnership.

Phillip Musica was fascinated of how much money could be made in the "bootlegging" trade. He had a plan to get alcohol from the Feds and supply it to the mob. Phillip founded the Adelphi Pharmaceutical Manufacturing Company, under the alias Frank D. Costa. The company was in the hair tonic and cosmetics business, which entitled the company to receive 5,000 gallons of raw alcohol a month, with government blessing. This alcohol was then sold as hair tonic, primarily to bootleggers who bought his tonic and distilled out the alcohol to make beer and liquor. Musica eventually sold the business, changed his name to Dr. Frank D. Coster, and used the profits to purchase McKesson & Robbins Pharmaceuticals which moved him to Wall Street.

During this time the company's auditors, Price Waterhouse, didn't verify inventories. Dr. Coster set up an elaborate ruse of running a fake warehouse and customer list (W. W. Smith) in Montreal, that combined accounted for (a reportedly) \$8M worth of inventory. In fact the Montreal offices were nothing more than a drop box where documents were sent, stamped, and secretly returned to Dr. Coster. The scam was so successful that it allowed Philip Musica (Dr. Coster), to become upwardly mobile, purchase a large mansion, luxury auto, and yachts. He was so successful that he was asked (and declined) to run for President as the Republican in 1936 against FDR. The end came in 1937, when a clerical error forced the company to account for their inventories.

Dr. Frank D. Coster was unmasked as Philip Musica. The good Dr. committed

suicide. It was further established that a majority of his management team was made up of his 4 brothers, (under different surnames and unbeknownst to the corporate board). When told of the fraud and the subsequent suicide, the board decided to fire him anyway. As one board member put it "I guess he just couldn't face the Musica".

Robert Vesco, born in Detroit, Michigan the Fugitive Financier. (sec. 1970's) Robert Vesco dropped out of engineering school to trade in aluminum contracts. He made enough money to buy a small aluminum plant and then borrow money against the plant to International Controls Corp. (ICC), a sprawling miniconglomerate whose subsidiaries included Fairfield Aviation and Moeller Tool Corp. In his never ending search for financing, Robert Vesco ran into Bernie Cornfeld. Cornfeld ran Investors Overseas Services Inc (IOS), a mutual fund in perpetual financial trouble. Vesco did a hostile take over of IOS and proceeded to loot the company's funds.

After the protracted takeover battle, it was estimated that Vesco made off with hundreds of millions of dollars. He did this by parking funds in a series of "dummy" companies (In 1973 the SEC's estimate was \$230 M). Vesco attempted to thwart the SEC investigation by contributing substantial moneys to the Nixon election campaign through Nixon's nephew, Donald Nixon. This did not work, and in February 1973, with criminal charges against him imminent, Vesco took the corporate jet and fled to Costa Rica along with about \$200 million worth of IOS's investments. In Costa Rica Robert Vesco bought freedom, of a sort. Vesco donated \$2.1 million to Sociedad Agricola Industrial San Cristobal, S.A., a company founded by

President Jose Figueres. Figueres passed a law to guarantee that Vesco would not be extradited. This was reversed in 1978, when President Rodrigo Carazo (1978-1982) repealed what was popularly referred to as the "Vesco Law."

On the move once again, Vesco first went to Nassau and then to Antigua. While in Antigua he tried unsuccessfully to buy a nearby island called Barbuda and establish it as his own country.

In 1982 he moved to Cuba. Cuba could provide him with treatment for his painful urinary tract infections. It also would not extradite him to the U.S.

In 1989, while living in Cuba, Vesco was indicted on drug smuggling charges. Then in 1990, Vesco once again crossed paths with Donald Nixon. Nixon went to Cuba seeking to partner with the government in conducting clinical trials drug, called Trixolam. Vesco had the contacts and introduced Nixon to high ranking government officials. The Cuban government agreed to provide laboratory facilities and doctors to conduct the trials. Results from the studies were positive.

Vesco (no quite understanding how the Cuban system worked) attempted to defraud Nixon and the Cuban government (Castro among them) out of the company profits. The Cuban government sentenced Vesco to 13 years in jail. Vesco reportedly died of lung cancer in November 2007 and was buried at Colon Cemetery in Havana. However, these reports of his death have been disputed.

The other five individuals (who had equally intriguing stories) I will leave for the readers to discover. They are:

1) Stanley Goldblum – Creator of the Equity Insurance Funding Fraud. (64,000 fake policy holders)

2) Crazy Eddie Antar – Electronics chain mogul, “I must be crazy to sell for such low prices.”

3) John Bennett – Ponzi scheme, the money was stolen from Christian religious organizations and charities, in the, publicly discovered by an accounting teacher at a college in Michigan.

4) Mark Whitacre – Division president at ADM, FBI whistleblower who was embezzling from the company.

5) Michael Milken - was indicted on 98 counts of racketeering and Securities fraud in 1989 as the result of an insider trading investigation.

The Lesson: (As my grandfather used to say) "As you build better mousetraps, the mice get smarter."

All in all, a fascinating read.