The King of the Alley: William Duer and America’s First Financial Scandal

On April 19, 1792, a mob of angry rioters surrounded the jail near City Hall in New York City, chanting “We will have have Mr. Duer, he has gotten our money!” William Duer, former member of the Continental Congress and once Alexander Hamilton’s right-hand man at the US Treasury, was imprisoned there for playing a key role in the Crash of 1792. The sheriff dispersed the crowd, but the city was in a panic — Duer had attempted to corner the market in government bonds and shares in existing and proposed banks by borrowing as much money as he could, from everyone he could.

In the run-up to the panic credit had been easily available, but when the Bank of the United States, the largest lender at the time, started calling in its loans, Duer’s creditors started asking for their money back. When it became clear that he had no money to pay them with, a panic ensued and the resulting crash left the city reeling. In response, the New York State Legislature enacted a law against public trading, which led to the creation of a private association of traders in 1792 that eventually became the New York Stock Exchange. Duer died in debtor’s prison, having been a prime actor in America’s first financial scandal — a debacle that had elements of corruption, outright fraud and greed on a massive scale.

Betrayals of the Public Trust: Teapot Dome and Credit Mobilier

Deep-rooted conflicts of interest and corruption were at the heart of two of the biggest scandals in US government history. In 1864, the Union Pacific Railroad, America’s first transcontinental railway, awarded valuable construction contracts to a company called Credit Mobilier. Few were aware that the directors of the Union Pacific and the Credit Mobilier were the same people, or that one of these directors and many of Credit Mobilier’s shareholders were members of the federal government — members who were responsible for oversight and continued government backing of the Union Pacific construction project.

In 1929, the Teapot Dome Scandal rocked the Harding administration when it was discovered that the Secretary of the Interior, Albert Fall, had given drilling rights for naval oil reserves to two oil companies in return for bribes and interest-free loans. Fall nearly got away with it, but a two-year investigation led by Senator Thomas J. Walsh uncovered one transaction that he neglected to cover up: a $100,000 interest-free loan from oil tycoon Edward Doheny. Fall was the first member of a Presidential Cabinet to be sent to prison as a result of his actions in office.

Cooking the Books: The Salad Oil Scandal and WorldCom

In the last decade a slew of accounting scandals have caused shockwaves around the world. Firms that manipulated their books to inflate profits and drive up their share prices have found themselves in the hot seat, and in some cases, have collapsed entirely. The spectacular failure of WorldCom in 2002 followed revelations that senior management had used accounting manipulation to inflate the company’s assets by an estimated $9 billion. This debacle was one of several scandals that led to the passage of the Sarbanes-Oxley Act, the most significant corporate accounting regulation in seven decades.
However, accounting scandals predate the 21st century. Allied Vegetable Oil, a little-known company in Bayonne, New Jersey, set off a market panic in 1963 when word spread that it had been taking loans from major banks using nonexistent vegetable oil as collateral. The fraud was audacious — Allied exploited the fact that oil floated on water, fooling inspectors into thinking that the tanks they were measuring were full of oil. The fallout bankrupted several companies, brought down two major Wall Street firms, and caused American Express to lose half its stock value, ultimately leading it to sell its warehousing division.

Failures of Risk Management and Corporate Governance: Enron and Lehman Brothers

Corporate governance and risk management have been thrust into the spotlight in recent years. Good governance can keep a company out of trouble by managing risk and ensuring integrity and accountability in how it operates. A failure of governance can be disastrous for a company; for a major firm with a global reputation, it can shake up entire markets and economies.

Enron, a symbol of innovation and the new corporate management culture that was emerging in the late 1990s, was actually losing money at an alarming rate. Management concealed this truth from shareholders using special-purpose entities, or SPEs, to improperly move debt off its balance sheet. When the truth came out, the firm collapsed in what was then the largest bankruptcy in history.

That record would be broken by another instance of failed governance, Lehman Brothers, in 2008. Lehman was deeply involved in mortgage securities that provided huge, easy profits for years, but whose risks became apparent only after the housing market turned south. By then, the firm could no longer afford to hold those mortgages and maintain their trading business, nor could they sell them to anyone. These toxic securities killed a once-venerable bank.

Robbing Peter to Pay Paul: Ponzi Artists

Ponzi schemes have captured the public’s attention, most recently with the fall of Bernard Madoff’s investment fund, which, at approximately $36 billion, is the biggest financial fraud in history. The principle is simple — Ponzi artists create the illusion of high returns by paying existing investors generously out of funds from new investors. Inevitably, money from new investors can’t keep up with either redemption requests or returns that have been promised to older investors, and the scheme collapses — with disastrous consequences.

The eponymous Charles Ponzi gained his notoriety when he coaxed millions from investors, who were told that their money was being used in a “lucrative” arbitrage of International Reply Coupons. By the time they learned their money was merely being handed out to prior investors, countless people were left holding the bag, and he had ruined six banks.

Ivar Kreuger, the enigmatic “Match King,” orchestrated a complex, global scheme in which he used the proceeds of bonds he sold in the US to sustain the high dividends of his matchstick companies around the world. He concealed the true financial condition of his companies, by cooking his books, until his sources of financing began to dry up. Kreuger shot himself in 1932, when he realized the scheme was falling apart and would soon be exposed.