

Salad Oil Scandal Still

Smells By Albert S. Frank, LL.B.

Most business people are more or less honest, many are more or less dishonest, and some are downright crooked.

Frauds like Bre-X, in which purported massive quantities of gold did not actually exist, are nothing new. A classic example is the Great Salad Oil Swindle.

The Great Salad Oil Swindle

Anthony De Angelis owned Allied, a major exporter of salad oil from the United States.

Allied borrowed millions, based on a sea of salad oil that it did not really have. Allied did this by supposedly depositing the salad oil with American Express's warehousing subsidiary, and with another warehousing company. The warehousemen issued warehouse receipts confirming (incorrectly) that they had the salad oil.

Allied borrowed, pledging the salad oil as collateral. The lenders relied on the warehouse receipts.

After many years, the fraud collapsed under the weight of unwise speculation by De Angelis in the futures market, leaving the loans unrepaid.

The loss was over US\$100 million in 1960s dollars, perhaps as much as US\$200 million. Fifty-one banks and other companies were victims. The American Express warehousing subsidiary went bankrupt. The American Express parent company paid the victims only US\$60 million, which they accepted rather than risking litigation. They knew the parent company would argue in any lawsuit that it was not responsible for the debts of the subsidiary.

Independent Verification

In both the Great Salad Oil Swindle and Bre-X the evidence as to whether the asset existed was, in one way or another, under the control of those who claimed the asset existed.

The warehousers relied on Allied for help in checking the oil inventory. In fact many of the storage tanks were filled with seawater. When certain tanks were to be checked Allied could – and did – secretly pump oil into them from other tanks. If you are to confirm the existence of an asset, or its ownership, make sure the

verification is as independent as possible. Independent, **NOT** based on the information and assistance of the persons you are checking on. Lawyers can verify some things, like registered title and debt, legality of rents, share ownership, etc. Other experts can help with other issues.

Take Danger Signs Seriously

The warehousers and the creditors were strangely complacent. They did not react appropriately to years of danger signs.

For example, the American Express warehousing subsidiary received a series of anonymous telephone calls warning of the swindle, starting years before it became public knowledge. An American Express inspector found major discrepancies between the paperwork and the supposed inventory. An inspector for one of the creditors conducted spot checks and found a shortage, but all that his company did about it was to insist on receiving American Express warehouse receipts for any oil pledged as collateral. The list goes on.

Many frauds come to light as a result of minor discrepancies. These danger signs need to be taken seriously, and investigated carefully. In the Great Salad Oil Swindle even major discrepancies and numerous other danger signs failed to

result in appropriate action. The ultimate result was massive losses.

Wait for Proof?

To convict someone of fraud requires proof beyond a reasonable doubt. Should a company wait for proof before protecting itself?

No. By the time there is a criminal conviction, or a civil judgment, the money could be long gone. But often a company could promptly protect itself by restricting credit, demanding improved controls and verification, tightening payment schedules, and so on.

Blinded by Greed

Norman C. Miller, in his book "The Great Salad Oil Swindle," states that De Angelis was able to carry out his gigantic fraud because of the greed of the victims. Otherwise, why would they have done business with De Angelis, who had such a shady background that the average banker should have refused to give him even a small business loan? De Angelis offered large profits so they held their noses, shaded their eyes, and did the deals. Allied's business made the American Express warehousing subsidiary profitable.

Management was reluctant to endanger that profit, and so was lax.

Big deals and big customers can lead to big losses.

Conclusion

If you are supposed to verify the existence of assets, or their ownership, you must resist the factors that led to the disaster in the Great Salad Oil Swindle.

Remember that fraud is still a popular business activity, as can be verified by looking at any issue of ***The Bottom Line***. Expect fraud.

Make sure your verification is truly independent. Take danger signs seriously, investigate promptly, and do not wait for proof before taking protective steps.

Your firm or your clients might not want you to “rock the boat” where there is a large amount of money at stake, but they will certainly not thank you if you fail to protect them. Do not let your career drown in a sea of salad oil.

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Research has NOT been done to see if this article is still good law. Also, this is general information that might not apply to your particular situation.

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