

Understanding Fraud in the Silver Mining Districts of the Western United States in the Second Half of the 19th Century

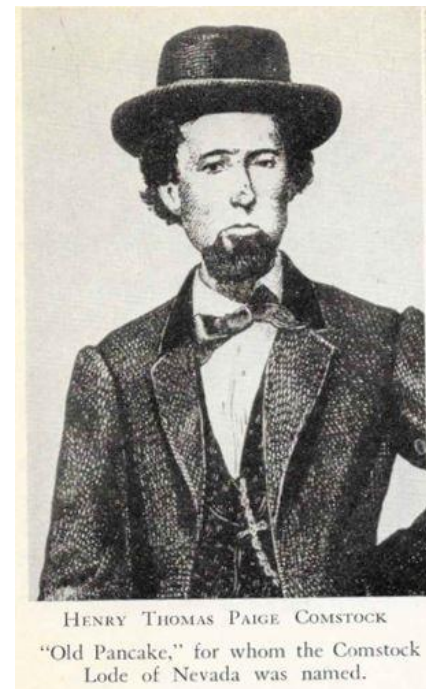
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Abstract

The mining industry has recorded many events of large fraud. The Comstock Lode in particular had several different types of fraud committed at different stages in the time frame of a mine in operation. The history of the Comstock Lode is important to understanding how lies can be believed, and has an impact on current day investments. Enormous cases of fraud have occurred since the Comstock Lode, and the methods of fraud are largely similar. Identifying where and how fraud occurs that leads to it going unnoticed is necessary for prevention. Additionally, rules and regulations need to be made and followed to ensure that claims are indeed what they appear to be. The Comstock Lode will be the main area of focus due to the typical occurrence of fraud in this region during its development.

1. Introduction

Most people have heard of the Gold Rush that occurred in the western portion of the United States of America in the mid-1850s. However, not many people are aware of the Comstock Lode, which is the largest source of silver ore in the United States. The Comstock Lode was discovered in 1859 and initially mined for gold, and silver ore was not mined out of it until it was determined by Henry Comstock, John Bishop, Aleck Henderson and Jack Yount that the blue color in the sand was silver ore (Glasscock, pg. 36). Once this was learned many people rushed to Virginia City to cash in on the potential profits. The process of mining silver ore begins with prospection. Mining engineers performed assays to judge the quality and quantity of ore in a given area. Based upon the result of the assay, the area was then mined or deemed to be of too poor quality to make a profit from. Extraction of ore was done underground using pick axes and also using square set timbering to prevent the mine from collapsing inwards after material was removed. After the ore was removed, it was refined in mills and then sent off to be used in various products. While mining is based on the extraction and refinement of ore, profits could be made in other aspects such as the stock market and giving loans to mine and mill owners. William Ralston is one man who mastered the business aspect of the mining industry, becoming the founder of the Bank of California and



Above: Henry Comstock, *The Big Bonanza*

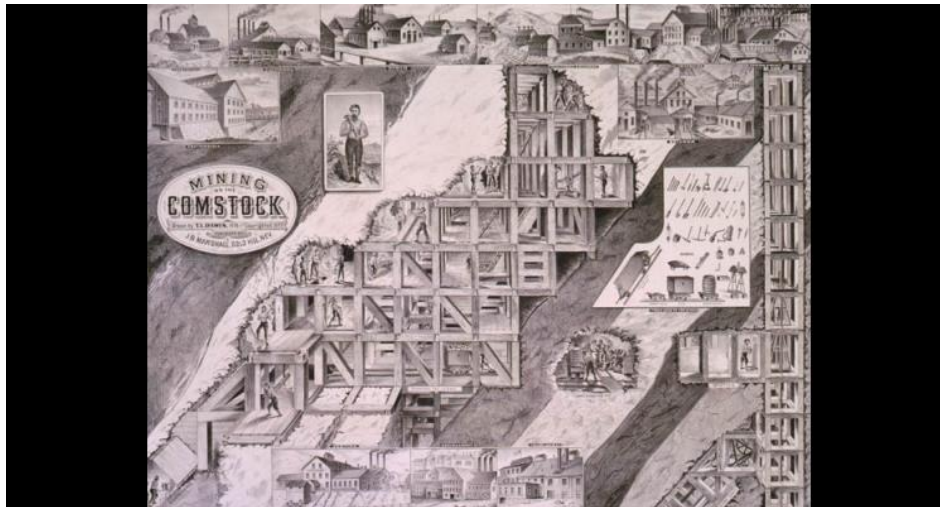
becoming the treasurer of the Ophir and Gould and Curry Mines (Drabelle 94). Ralston made money from giving loans to mines at a rate of 2% per month, and often times acquired some of those mines when they default on their payments and lead him to great wealth (Drabelle 95). But not all of those who made profits from the Comstock Lode did so in an ethical manner. Many people conducted fraud due to the lack of laws and regulations in the mining industry.

2. Timeline

In order to describe the plentiful and diverse methods of fraud used in the Comstock Lode, it is best to describe the timeline of a mine and give known cases of fraud throughout its stages. A spreadsheet is attached to this document and shows types of frauds, the perpetrators, victims, how the fraud occurred, and how the fraud was able to occur.

2.1. Prospection

The first and perhaps the most important stage in a mine's timeline is prospection. Often times mine owners will begin to sell stocks before a mining site is prospected. This allows investors to take a gamble on the mine before the mine has even been born, and practices like this are still seen today with new companies selling stocks in the stock market before their business is well known. Mine owners hire mining engineers to assay the rock, putting the future of the mine in the hands of the engineer. Rock from the mine is selected to be assayed, and this is where the first potential fraud can be performed. Mine owners often led the engineers to section of rock



Above: Comstock Mining and Miners, Lord

that they believed was the highest quality within the mine, so that the assay only reviewed good rock and led to a better review of the mine (Grossman 844). Another form of fraud committed with the assays is salting of the ore. Salting of ore is when the ore selected for the assay is

artificially sprinkled with more silver, which makes the ore appear to be richer than it actually is, leading to a good report if the engineer did not identify that the ore had been salted. If an assay comes back showing great potential in the mine, mine owners frequently purchased their own stocks illegally under false names before the report came out (Vent and Birk 79). This was done so that mine owners can make a large and quick profit from a mine before extracting ore, since the price of stocks will raise drastically after a release comes out telling of the promise of the

mine, and can be sold for a quick profit. Since the value of an assay is crucial to potential profits, the reputation of a certain engineer was considered by the mine owners when selecting an engineer to assay the mine. If a mining engineer often times undervalues the mines, not much money can be made from stocks but can still be made from extracting the ore. On the other hand, if a mining engineer commonly overvalues the mines, this would be a desirable engineer for mine owners that are looking to make a lot of profit from stocks. This can be played out further to the mine owners' advantage however. A mine owner may desire a bad first report on their mine so that stocks can be purchased at low prices, then hire another engineer that will produce a better report, thus raising the price of stocks to make a profit. Not all mining engineers were true professionals however, and simply produced a report that the mine owners desired just to get paid (Vent and Birk 70). Fortunately for the mine owners, there were no regulations calling for evidence or double checks on assays, making the act of committing fraud very easy. One of the most famous cases of mining fraud occurred in an area where no mine actually existed. This is known as the Diamond Hoax, and Phillip Arnold, James R. Cooper, and John Slack committed the fraud by elaborately lying about a diamond mine that never existed, yet they managed to swindle hundreds of thousands of dollars from investors before being exposed (McBirney 55). Yaqui Copper Company also committed a similar fraud by releasing promotional copper ore, but it was later discovered that no ore was on sight (Mining Engineers and Fraud, p. 829). Before a mine truly even becomes a mine, there are several ways that fraud can be committed and go unnoticed due to a lack of reconfirming the claims.

2.2. Extraction

Once a portion of rock is determined to be rich in ore and have the potential to make money, the extraction process begins. The ore is extracted, and often times the ore temporarily runs out until another vein is found. Mine owners then levy assessments from their stockholders in order to continue excavating the mine when the revenue from the ore runs out. However, many times mine owners would levy assessments when there was no need, and instead pocket the money



Above: Untitled, O'Sullivan

from the stockholders without the stockholders being aware of it. This was done by several mines including the California Belcher Mine, the Crown Point Mine, the Gould and Curry Mine, and the Kentucky Mine (Drabelle 45). Stockholders did not question these assessments because they were extremely optimistic in the mining industry, and insisted that these assessments need to be paid for in order for their investments to pay off (Vent and Birk 69). The stockholders were not only being tricked by the mine owners,

but often times by the stock brokers. When stocks were purchased on margin, some brokers

would take the claim of the share and take the rest of the payment from the stockholders as profit (Drabelle 233). When true assessments were made, the investments are hopes of hitting a bonanza. If a large, rich vein of ore is discovered in a mine, it is called a bonanza and immediately attracts attention from investors because there is a lot of high quality ore, which equals money. Many mines such as the Savage Mine found ways to make even more money from these bonanzas (Vent and Birk 72). It was not uncommon for a mine to initiate a shut-in when a bonanza was found so that the mine owners could purchase high volumes of their own stock, release the news of the bonanza, and then sell their now highly valued stocks for large, quick profits. Sometimes the bonanzas would be overhyped, and the actual value of ore in the bonanza turned out to be much less than expected, but would still produce a spike in stock values for the mine owners to make profits. The trend of these shut-in was identified by other mine owners, so then mines often times initiated shut-in when there wasn't a bonanza, so that the buzz would drive up the value of their stocks temporarily and again, stocks owned by the mine owners could be sold for large profits (Vent and Birk 72). While silver ore is very valuable by itself, there are many other ways to make profit from it.

3.3. Milling

After ore is extracted from a mine, it needs to be refined in mills before it is in a useful form. There are various techniques for refining ore, but they all follow the path of taking the raw ore extracted from a mine and putting it through several physical and chemical process to purify the ore. Not a lot of fraud is committed in the milling process since the opportunities are not as

numerous, but fraud can still be committed nonetheless. It was documented that John D. Winters, the superintendent of the Yellow Jacket Mill would throw in waste rock with the ore that was being processed in order to increase the profits for the mine owners (Drabelle 98). This profit was possible because the cost of milling the ore was almost more than the value of the ore that was getting refined, and mine owners always got paid before the lower tier workers (Drabelle 98). By adding in waste rock, the same amount of ore was being extracted, but not as quickly, only



Above: Gould and Curry Mine, O'Sullivan

paying out the mine owners because there was not enough revenue to pay the lower tier workers. Additionally, many mines continued to sell stocks for their mines after all ore had been extracted. The buzz from investors still caused stock price fluctuations, which gave mine owners an opportunity to continue to make money even after all of their resources had run dry. The Vulture Mine did just this, as its profits died off after 1872 yet stocks were still offered and being traded in 1901 (Mining Engineers and Fraud, p. 829). While most fraud is typically committed in

the early stages of a mine, new methods were created to ensure that the largest amount of profit would be pulled out of the industry.

4. Conclusion

As seen with the various examples, there appears to be more ways to make money from the mining and milling industries other than just mining the ore. In the case of the Comstock Lode this was true, although it still produced the largest amount of silver ore to date.

The opportunities and degrees of fraud that can be committed are endless. Perhaps many of these cases of fraud could have been exposed or prevented if proper measures were set in place, particularly checking claims and having nonbiased parties perform the assays. The United States has three different branches that protect the safety others: the Legislative Branch, the Executive Branch and the Judicial Branch. In the case of the Comstock Lode, the Legislative leaders were hardly present, if not completely absent. There were few laws created at the beginning of the discovery of the Comstock Lode, and laws were only created after long periods of time and even then, only a few laws were actually useful or enforced. For example, the Felton Acts were created to reduce fraud from purchasing stocks under hidden names, but was not enforced and therefore ineffective (Vent and Birk 76). While there were moral and ethical expectations within society, there was nothing that discouraged people from carrying out such acts. No sort of enforcement team was in place in the mining industry to ensure that laws were being followed, likely because there was a lack of laws that were enforceable. There are beneficial reasons for these systems to be in place, and the Comstock Lode is a perfect example for why they are crucial to have. Perhaps the moral of the Comstock Lode story could be described as checking claims, double checking claims, and to not believe the first thing you hear. No matter what the claim is, who makes the claim or what has been happening recently, trends of past fraud are documented and should be investigated even further to identify potential places where fraud can be committed, and measures that can be taken to prevent such crimes from occurring again.

5. Similar Cases

Cases of fraud before the Comstock Lode are also documented, including Beringer's Lying Stones and Bree-X.

5.1. Beringer's Lying Stones

In 1725 Johann Bartholomeus Adam Beringer discovered stones shaped like creatures that appeared to come from a divine power. At the time, it was unknown how fossils formed, so Beringer had believed he had found some sort of Holy Grail, and committed his career to finding more of these stones and making them known to the world. Unfortunately, Beringer's optimism convinced himself beyond his own reasoning and ignored obvious signs that the stones were created using chisels. Excitement took a hold of Beringer and led to his downfall, similar to those who invested in the Comstock Lode. The people who committed the fraud took advantage of those who were hoping to obtain something great. Although this fraud was committed perhaps

for a personal revenge or gain, it is still a great example of why professionals who are highly trusted should have their work checked by a nonbiased investigator.

5.2. Bree-X

The Comstock Lode was not the first time fraud was committed in the mining field, and it certainly was not the last. While it may be inconceivable, fraud continues to be committed over a century after the Comstock Lode was scraped dry. A famous case of such fraud is the Bree-X story which began in 1993. Bree-X was a compilation of companies and was located in Canada. It mostly focused on gold mining, and in 1993 purchased a section of land in Indonesia. It then released a report to the press in 1995 claiming that it had discovered a massive deposit of gold. Resource estimates from this deposit were released and caused Bree-X's stock prices to shoot up. For over two years people from around the world invested in this company that was thought to be literally sitting on a gold mine, until it was discovered that the entire report had been fraudulent. Investigations in March of 1997 discovered that the samples taken for the estimates were salted with gold that was inconsistent with the claims. Two months later, it was confirmed by an independent company, and the value of Bree-X's stocks were worth less than a small pile of dirt. Harvey Thorleifson describes the context of this fraud and why it was believed for so long by so many. He said that during that time, gold mines were being discovered in the most unlikely places, and investors had missed many previous opportunities due to initial hesitation. When a claim such as the one made by Bree-X came out, investors thought it would be a large mistake if they did not try to cash in. Additionally, the reports that Bree-X released were not checked by a third party until suspicion started arising about the validity of the claims.

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