



Bre-X Minerals: How to Make, and Detect, Fool's Gold

When the economy faces huge questions and uncertainty, the prices for precious metals can take off because investors want what's perceived as a safe haven, something tangible and real they can hold on to. With recent global economic instability and the weakening of the U.S. dollar, gold has reached record prices of well over \$1,000 an ounce. As gold prices spike to record highs, it's time to revisit one of the greatest gold scams ever, so that we can learn from it and see if investors are vulnerable to such frauds right now.

Gold is unique because it glitters, it captures the imagination, and it kindles greed like nothing else, even more than a roaring stock. At this precarious moment in the U.S. and global economy, gold scamsters will be coming for you. All you have to do is listen to AM radio or watch late-night cable television to hear the latest gold offerings.

The *appearance* of legitimacy is a key part to any scam, and is essential to a gold or mining scam. In a fraud, the smoke screen of legitimacy is sometimes so dense and dark that investors, along with professionals such as bankers and journalists, simply fail to see through the fog.

One of the biggest gold scams of all time had such layers of bogus legitimacy. In 1995 Bre-X Minerals Ltd., a Canadian mining company, declared it had discovered the biggest deposit of gold ore in history in Busang, Indonesia, on the island of Borneo.

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Watch out for the hyperbole of the con man or group con—hype and fizzy talk of riches can be enticing, but be on full alert if something is pitched to you as being the *biggest* and *best* deal ever.
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Bre-X appeared to have an outstanding pedigree. It had been endorsed by analysts at the largest and best-known Wall Street investment banks and journalists from respected news organizations. The mine drew the intense interest of the Indonesian government and the adult children of the country's dictator, Suharto, as well as from legitimate mining companies in Canada and the United States—all vying to control Bre-X because of its supposed gold discovery.

Intense greed surrounded the gold mine, which only appeared to grow larger over time. After the site was first explored in 1995 the company said it discovered at least 2.3 million ounces of gold. The next year, that number shot up to 30 million ounces, and then shortly thereafter that doubled to 60 million ounces. Finally, in 1997, the company announced the discovery had grown to 70 million ounces. The shareholders saw the company's stock value top \$4 billion in September 1996, for a growth rate of 100,000 percent in three years.

It all came tumbling down just a few months later when the stock price evaporated in March 1997. The Indonesian government had dispatched an independent mining company to verify the enormous find, but their tests showed that there was no gold in the ground. The claim of a vast discovery underground had been one gigantic hoax.

Four specific contributors buttressed the con: Bre-X's large and impressive mining operations, the news media, investment banks, and the mining industry. Each played a significant role in convincing investors the wonderland of Bre-X was real.

The Bre-X exploration camp on the Indonesian island of Borneo was a bustling enterprise with an army of workers. The site had been cleared deep in the jungle and buildings erected where the forest once stood. There were barracks that served as home to hundreds of workers, from miners to geologists. Alongside them was a commissary, a testing laboratory, and a geology room housing the maps that marked the locations of the hidden treasure below the ground. In addition to this setup were the trucks, drilling rigs, and tools of the mining trade. The company had even carved "Bre-X" into a huge swath of grass to mark the operation site. The size and the physicality of the place were extremely convincing parts of the fraud.

Bre-X received a tremendous boost from the press, and this proved to be vital to the success of the fraud.

The media were enchanted with the story of the upstart mining company that stumbled upon one of the largest gold finds in history. The story had all the rags-to-riches elements that journalists look for. The founder and president of Bre-X, David

Walsh, personified the Horatio Alger qualities of a man who began working in his basement, then through hard work and a little luck made the record-setting discovery.

Walsh himself was the consummate promoter. He fiercely defended his company against anyone who doubted its discovery. He wrote up the early press releases for the company. He knew how to work the hype. At his core he was a promoter, a gambler, and a hustler.

On reflection, the involvement of Walsh alone should have raised red flags. He was a former stockbroker who started Bre-X in 1989. He searched for both gold and diamonds in the Northwest Territories of Canada, but had no luck. He filed for personal bankruptcy, took the last of his money and flew to Indonesia. There he met up with an old friend, John Felderhof, who seemed to have the knack for finding minerals deep under the ground, and the two of them raised some money to buy a plot of land on the island of Borneo in 1993. Walsh and Felderhof invited Michael de Guzman, a Filipino geologist, to join their team. After some exploring on Borneo, they discovered the Busang gold site.

Walsh ensured positive press for the company by targeting young reporters and sending them his press releases. The journalists who took the bait were generally inexperienced and hungry for a good story that could make their name. One young reporter later expressed regret for his role in promoting the scam.

He had not been skeptical of the Bre-X story at all; he felt that he was getting a break because this company called *him* and said that they had found a huge gold discovery. He had done no independent investigation to determine whether the story was true, yet wrote the story and sent it out to the news wires. In

retrospect, he realized that he was a pawn in the Bre-X plan, and that he helped fuel the manic pumping up of the stock.

Other sources of information reinforced the Bre-X claims of its Indonesian El Dorado. Investors often rely on newsletters to learn more information about a company. There are thousands of newsletters that cover certain stocks—and there are newsletters that cover the mining industry. Walsh and his team cozied up with the people who publish these supposedly independent newsletters.

Many of these industry newsletters hyped the Bre-X story. In 1993, one of these newsletters, *Carter's Choice*, wrote about a little company that had made some “very promising” gold discoveries. The author of *Carter's Choice* told his readers that he himself had bought some stock in the company.

What the author of the newsletter failed to divulge was that he had known David Walsh for many years; that Walsh was his old drinking buddy, and that Walsh had a terrible track record in the mining industry. After the collapse, the *Carter's Choice* editor told one writer that he considered Walsh to be a “heavy drinker” who “never appeared destined for great success.” Unfortunately for Bre-X investors, this side of Walsh was never revealed while the stock was being hyped.

The mining and metals industry helped boost Bre-X's tremendous credibility. In 1996, gold fever surrounding Bre-X was intensifying, and large multinational companies started to show interest in buying out the company because of the massive gold deposits. Executives from companies such as Barrick Gold, the world's second largest gold producer, and Placer Dome flew to Indonesia to find a way to buy Bre-X and gain control of the

biggest gold discovery in the history of the world. Barrick hired private detectives to dig up dirt on Bre-X in order to launch a hostile takeover of the company. Barrick even enlisted former President George H.W. Bush to lobby Indonesian dictator Suharto, and retained Suharto's daughter as a consultant to get an edge in the Bre-X takeover attempt.

The crowd on Wall Street cheered Bre-X on.

The big Wall Street investment banks analyzed the stock and issued written recommendations to buy Bre-X shares. Lehman Brothers analysts claimed to have visited the Bre-X gold mining site on Borneo. They reported that they had personally observed the gold operations, and wrote a series of highly detailed analyses, including descriptions of independent testing that had been performed on core samples taken from the mines. The analysts highly recommended the shares, right up to a few months before the company collapsed.

The Busang gold discovery "is enormous," Lehman wrote in a report to investors in December 1996. Lehman expected this "growth story to continue in a major way for the rest of this decade." The Lehman analyst, Daniel McConvey, was well-regarded in the industry. A former employee of Barrick Gold, McConvey traveled to the Busang gold site to make an on-the-scene inspection. He called it "the find of the century."

Another analyst, Bob Sibthorpe of Yorkton Securities, wrote: "Arriving at a final gold resource number for Busang is difficult since the deposit is beyond the scope of anything seen to date. . . . A visit to the property is necessary to grasp the magnitude of what is going on and to justify throwing out the rule book." Yet another claimed that "the Busang deposit will continue to

grow,” although he gave no basis for this grandiose prediction. An analyst at J.P. Morgan & Co., David Neuhaus, made the most outlandish prediction when he proclaimed, “I’d say 150 million ounces is a conservative guess as to what Bre-X will ultimately come up with” at the Busang mine. It comes as no surprise that two months later, J.P. Morgan was anointed as one of Bre-X’s new financial advisers.

Among all these glowing reports that exhorted investors to load up on the stock, not a single analyst reported that he had ever independently tested the soil for gold. Each analyst had taken Walsh and Felderhof at their word verifying their claims.

At the Busang site, analysts had gathered in a small map room where Felderhof reviewed the drilling results. He pointed out the drill holes and described how they were turning up incredible grades of gold. After gold samples were pulled from the ground they were sent to a gold testing lab about an hour from the site.

None of the major Wall Street houses were willing to ruin this party. Bre-X was growing, the stock was soaring, and there was money to be made from several angles. Bre-X needed the investment banks to help it raise money, and large fees would follow. Clients were getting richer by the day as the stock continued to climb. The last thing any analyst wanted to do was question these claims of expanding gold finds. That could lead to investors dumping the stock, which in turn would trigger declining stock prices, lost fortunes, and ultimately a company that could no longer afford to pay its bankers. A negative report, or one that questioned the company’s claims, could potentially cause Bre-X to deny banking business to the violator.

Lehman, J.P. Morgan, and the other Wall Street titans were motivated by the fees that they earned, or hoped to earn, from underwriting and trading Bre-X stock. The analysts who work for these firms are paid from the profits generated from all this banking activity, providing them with an incentive to be optimistic about a company that is paying them fees.

J.P. Morgan was Bre-X's key financial adviser at the time of the collapse. In February 1997, weeks before the collapse, J.P. Morgan bankers talked up the Busang mine in a conference call during which Bre-X's top geologist predicted the deposit could contain a staggering 150 million ounces of gold, worth \$70 billion at the time. Despite these astonishing forecasts, industry watchers continued to buy in to the story.

Indirectly, and likely without knowing it, many Main Street investors owned a piece of Bre-X. The company's shares were bought by top mutual funds, the most common and popular way for people to invest in the stock market. Fidelity Investments, at the time the world's biggest mutual fund company, owned 7.3 percent of Bre-X at the end of 1996.

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The media, brokerage firms and investment newsletters
play a large role in the hype of a stock.
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As gold fever emanating from Busang mounted, some investors in Bre-X were growing apprehensive. A group of investors hired me, coauthor Tom Ajamie, to act as its watchdog. The group wanted me to make sure Bre-X was serving the interest of its longtime shareholders, many of whom had bought the stock for pennies.

I made several trips to Indonesia, at the stockholders' request, to try to speak to Bre-X management and government officials who had authority over the company. For years, the top executives at Bre-X had been extremely accessible to these investors, fielding their phone calls, meeting with them regularly, and giving updates about the company's progress. At the time I was hired, this shareholder group had begun having difficulty getting the Bre-X management to return their phone calls. After having been so open for years, management was clamming up—sending a red flag to the investors.

Rumors were spreading that Indonesian dictator Suharto and two of his children wanted a piece of the action. The investors wanted to make sure that Bre-X remained independent and was not taken over by the Indonesian government, or sold for a pittance to a rival mining company. They wanted to protect their investment in the stock, which was worth millions.

These investors were paying attention to their investment, keeping an eye on the activities of the company, and taking proactive measures to protect their investment. One would say that they were really doing everything right. They never imagined that they were about to lose everything and fall victim to a huge con.

The Bre-X scam began to fall apart in early 1997. In late January, as one mining company was about to seize control of the project, a fire destroyed a map room at Busang containing all the geologists' records.

My first trip to Indonesia was over the Christmas and New Year's holiday in 1996. I went a second time a few weeks later in January 1997. Over a period of several weeks I interviewed government mining officials, mining industry executives,

journalists, and others who could shed some light on the Bre-X phenomenon and reveal information about this historic discovery. I was trying to determine, for my clients, whether the Bre-X mine would be acquired by a major mining company or be taken over by the Indonesian government. The Indonesian government had delayed giving Bre-X complete control over the site. The major mining companies were jockeying to be selected as the operator—or owner—of the operation.

Senior government mining officials agreed to meet with me. Those meetings took place in the lobby bars of five-star hotels in the capital city of Jakarta. These glittering hotels are the cleanest and most exclusive meeting places in Jakarta, a city of almost 10 million people that is plagued by pollution and squalor. Stray cats and dogs run alongside bumper-to-bumper cars and motorized *tuk-tuks* that creep along the narrow, jammed roadways. The smell of exhaust is overwhelming. The scene in Jakarta is one of constant chaos, desperation, and danger.

Nothing is what it seems. Two government officials agreed to meet with me to discuss Bre-X. The men arrived at my hotel wearing traditional *batik* shirts of muted brown. They reeked of the omnipresent clove cigarettes. They spoke in riddles, saying Bre-X might remain independent but then it might not. They wanted to know what I knew about the discovery and pumped me for information. Did I know what the major mining companies were planning? Could I verify the amount of gold in the ground at the mine? What was the value of the mine? After a little while I realized that these government representatives—who were deans of the Indonesian mining department—either knew very little about the Bre-X discovery or knew a lot but would never reveal it.

The government angle took another odd turn when I was visited at my hotel room by someone who claimed to be its representative. The insider looked me straight in the eye and told me to leave the country now or risk being killed. This made no sense. It seemed odd that asking questions about a gold mine would engender this type of threat. When a second messenger arrived the next day to deliver the same warning, I decided it was time to change hotels and use a different name.

I also realized that I needed to be more cautious in my investigative activities. The bearers of this threatening news had somehow learned my hotel and room number. I recounted the threats to some American friends in the local press corps. They told me that the Indonesian government had eyes and spies everywhere, and that it cost only a few thousand rupiah (the equivalent of one dollar) to pay off someone working at the front desk of a hotel. Such a small “tip” would yield a fully printed copy of my hotel charges and a duplicate key to my room.

The information that couldn’t be bought from the hotel clerks could be purchased from any cabdriver who had taken me from here to there. My skin color and dress tagged me immediately as a foreigner. I was someone who should be watched carefully, and whose monitored activities could command a price. Indonesia is a country of over 240 million people, where nearly half of the population lives on less than \$2 per day. Hiring a network of spies might cost \$40 per week. It was likely that my movements were being watched and reported.

To keep up my investigation while trying not to anger the wrong people I decided to shift into counterespionage mode. I would take a cab halfway to my destination and then pay the driver to drop me off. I would hail a second cab to shuttle me to

my destination. That way no single cab driver would know where I started and ended.

Most documents that I received would eventually need to be shredded. I had no shredder in my hotel room. Even if I could have acquired one, it would really be of no effective use. I recalled vividly the stories of the insurgent students who during the Iranian Revolution in 1979 had stormed the U.S. embassy in Iran and took Americans hostage. The occupying Iranians had gathered up all the scraps of shredded classified documents that U.S. embassy personnel had left behind. The Iranians enlisted local carpet weavers who then painstakingly pieced the documents back together by hand over a number of years. The Iranians were then able to read the reams of classified documents that our embassy had seemingly stored and destroyed in confidence.

Every hotel room has a device that is much more effective than a shredder. It's what we commonly refer to as a toilet. I ripped up all the most sensitive papers daily, and flushed them. They commingled with the contents of the hundreds of other flushing commodes in the hotel and were swept away to a sewage depot somewhere far afield.

The government angle was proving to be unfruitful, and a little dangerous. So I set my sights on trying to talk to some of the Bre-X management that was ensconced at the ritzy Shangri-La hotel. They were holed up there to discuss a possible sale of the company to one of the major mining companies. Despite repeated visits to the hotel and numerous phone calls, Bre-X management refused to speak to me. Again, this was somewhat strange considering that I was representing major shareholders who, until just a few months ago, had been able to call management and speak to them directly.

Next in line for interviews were some of the journalists in Jakarta who had been covering the Bre-X story. They, unlike their peers outside Jakarta, had been able to spend time with the Bre-X executives and geologists, and had toured the Busang mine. Jay Solomon, a *Wall Street Journal* reporter who covered the Bre-X story, helped me out by steering me in the right direction. John McBeth at the *Far Eastern Economic Review* was one of the most knowledgeable and helpful. A seasoned reporter, McBeth was a New Zealander who had spent many years in Jakarta. He was on a first-name basis with all the businessmen and government officials who mattered. He was intimately familiar with the Bre-X story. McBeth proved to be a fountain of information, and what he didn't know he could learn by picking up the phone and calling one of his contacts.

McBeth was able to shed some light on who was in contention to purchase Bre-X. Both Barrick Gold and Placer Dome, two majors, were the leading contenders. The executives of both companies were in Jakarta for negotiations with Bre-X. The jockeying by Barrick and Placer Dome to buy Bre-X legitimized the company's claims. If these two majors were willing to throw money at Bre-X, certainly it must be the gold find of the century.

Let's not forget the charitable largesse that Bre-X bestowed on the local community. Bre-X had spent more than \$1 million on a social development program for the indigenous tribes near Busang. It had built churches and schools and even organized sewing classes for the local women. Bre-X planned to open a fishery and poultry farming venture where the local tribes could raise and sell food to the mine. These contributions bought goodwill from supporters who wanted the venture to succeed. These advocates were also willing to quash any detractors of the project.

What were the red flags—waving in plain view—that everyone ignored?

Walsh, himself, for one. He had never had any success in mining; he had no track record at all. His personal bankruptcy and lack of success should have been considered.

How about the outrageous discovery numbers? From 70 million ounces to 200 million to 400 million, the numbers continued to climb. (To put this in perspective, the world's largest legitimate gold deposit had been discovered eight years earlier on another remote Indonesian island. That deposit contained 50 million ounces.) It was as if the Bre-X crowd could throw out any number that came to mind without the analysts and media questioning it.

The history of the Busang property showed little likelihood of gold. It had been explored by more than a dozen companies before Bre-X purchased it for \$10,000. The other companies had found no gold and said the property was worthless. Why would anyone believe that Walsh, with no track record, would find what all the others never found?

There was the “accidental” fire at Busang in January that destroyed the building containing chief geologist de Guzman’s geological map records. Then, just after the first independent verification of the gold was made, de Guzman mysteriously fell 600 feet from an enclosed helicopter to his death.

No one, *not one* of the Wall Street analysts who were telling their customers to buy the stock had actually seen gold at the site.

Finally, an independent mineral audit of the site revealed that only trace amounts of gold were found in the ground and there was “virtually no possibility of an economic gold deposit.” The

audit firm further revealed that the supposed gold deposit was “based on tampering and falsification without precedent in the history of mining.”

Bre-X is similar to Enron, which in 2001 was the seventh largest company in America. There were literally hundreds of articles about Enron in publications from the *New York Times* to *BusinessWeek* to *Time* magazine—all about what a great company it was. *Fortune* magazine named Enron one of “American’s Most Admired Companies” for six consecutive years. It all turned out to be a big scam. These scams are so ubiquitous, it seems like they’re almost impossible to avoid.

The common element in both Enron and Bre-X, in hindsight of course, was the fact that it was not possible to verify the true business of either company.

Enron used a variety of accounting tricks to make it appear that it was more financially large and sound than it really was. Enron fooled a gullible media into hyping the company and it schmoozed Wall Street analysts to promote the company’s stock. Both Enron and Bre-X managed to create a lot of smoke, but ultimately there was no hint of fire.

With Bre-X, investment and mining professionals (as well as journalists) simply accepted the fact that there was gold under the ground. Gold, oil, and gas exploration are sectors in which scams are likely to occur because you can’t really see the product. You are trusting someone to tell you the gold is really 20 feet below the surface, or the oil and gas is really thousands of feet below the surface. The investor can’t independently verify the product’s existence.

Does white-collar financial crime pay? You bet it does. When the Bre-X scam was exposed, Walsh took off for the Bahamas,

where he lived in his luxurious home until he died in 1998 of an apparent aneurysm. He died before he could be prosecuted and had kept the millions that he made selling his stock at its height. As for John Felderhof, he gained \$50 million from his stock sales and retired to the tropical and expensive Cayman Islands. A blundering sort of prosecution was brought against him in Canada, but his aggressive defense humiliated those authorities to defeat.

Felderhof was charged by the Canadian authorities at the Ontario Securities Commission with insider trading. No other officers, directors, or people associated with Busang were ever charged or arrested. The Canadian authorities acknowledged that they had no evidence that Felderhof was personally involved in the fraud. After prosecuting Felderhof over a seven-year period for insider trading, he was found innocent. It appears that the Canadian authorities, like the SEC in the United States, couldn't make a case against anyone involved in Bre-X. The fraud had happened in Indonesia and neither the Canadian nor U.S. authorities had any desire, ability, or experience to put together a case that emanated from overseas. So now Felderhof travels freely around the world, enjoying the fruits of his fraud.

Apparently, even death can't stop some financial serial killers. Michael de Guzman, supposedly dead from his helicopter fall, was recently reported to be alive and well, sipping cocktails in South America and enjoying the sun.

Postscript

After Bre-X collapsed, and investors lost billions of dollars, I, Tom Ajamie, went to the SEC's headquarters in Washington, D.C., to share all the facts from my investigation and to give

them a road map on how to prosecute the Bre-X wrongdoers and some of the banks that I believed were complicit in the fraud. I was welcomed into a meeting room at the SEC where several SEC officials listened as I set forth the evidence. After I made a presentation over several hours, the leader of the SEC group told me that he would be in contact as the agency proceeded with its investigation.

I heard from the SEC only twice after that meeting. One of the agents called me to ask for the phone numbers of some of the Bre-X workers in Indonesia who might have some factual knowledge about the fraud. I told the SEC agent that he needed to travel to Indonesia to do his investigation; no one was going to talk to him by phone.

The second, and last, call I received from the SEC was from the same investigator. He complained to me that no one in Indonesia was taking his calls. He was surprised, but why should he have been? If you were involved in a fraud, and you lived on the other side of the world, would you return a call from some pencil pusher in Washington? Of course not. So the SEC's investigation (if it can even be called that) never gained ground, and the SEC never brought charges against any of the individuals involved.