Cuckoo smurfing – judicial disagreement

Cuckoo-smurfing - Simpson J disagrees with the approach of Allanson J

On 19 April 2017, Allanson J delivered the decision in *Commissioner of the AFP v Kalimuthu (No 3)* [2017] WASC 108 (**Kalimuthu**). That decision was the subject of *Asset Confiscation Update - Edition 1 / 2017*. Kalimuthu was a landmark decision because it contained the first judicial analysis of cuckoo smurfing in a contested application for exclusion under the *Proceeds of Crime Act* 2002 (**Act**).

In Kalimuthu, Allanson J made an exclusion order by relying on section 330(4) of the Act.

However, last week in *Commissioner of the Australian Federal Police v Lordianto* [2017] NSWSC 1196 (**Lordianto**) Simpson J refused to follow Allanson J's construction of s.330(4) of the Act and dismissed the application for exclusion. Based on the reasoning of Simpson J, every application for exclusion in a cuckoo smurfing setting is doomed to fail.

That said, whilst shutting out any prospect of succeeding in an exclusion application, in a separate decision delivered by Simpson J last week, namely Commissioner of the *Australian Federal Police v Fernandez* [2017] NSWSC 1197 (**Fernandez**), Simpson J refused the Commissioner's forfeiture application on the basis that it was not in the public interest to forfeit property of the victim of cuckoo smurfing.

The disharmony between the decisions in Kalimuthu and Lordianto certainly causes difficulty for practitioners in determining how best to approach cuckoo smurfing cases.

The Commissioner has appealed the decision in Kalimuthu and the appeal is likely to be heard early next year. Only then will the path for practitioners and clients become clearer.

What is cuckoo-smurfing?

Cuckoo-smurfing is said to be "*another emerging form of money laundering*". AUSTRAC observes that "*Australia's AML/CTF professionals need to become familiar with this organised, transactional and highly coordinated process*".[1]

The expression "cuckoo smurfing" originated in Europe because of similarities between this topology and the activities of the cuckoo bird, which lays its eggs in the nests of other species of birds which then unwittingly take care of the eggs believing them to be their own.

In Kalimuthu, Allanson J described cuckoo-smurfing as follows at [71]:

> *In short, it relies on identifying a person offshore who wishes to transfer funds to a bank account in Australia using a money remitter. The remitter withholds amounts corresponding to the amount of money he has been told is to be laundered in Australia. The customer's bank account details are provided to people in Australia. A team of depositors in Australia deposits cash into the bank account, generally at a series of bank branches and below the threshold for reporting transactions involving physical currency. The account holder sees deposits that match the amounts they intended to remit. Because the amounts of each deposit are below the threshold, there is generally no record that could enable regulatory agencies to intervene.*

The issue arising under the POCA

Where cuckoo smurfing occurs, the deposits into the Australian victims' bank accounts are generally made in cash and commonly below the $10,000 reporting limit. Depositing funds in such manner with the intention to avoid the reporting obligations constitutes a contravention of section 142 of the *Anti-Money Laundering and Counter-Terrorism Financing Act* 2006 (Cth) (**AML/CTF Act**). That offence is commonly known as "structuring".

The Commissioner has obtained numerous restraining orders under section 19 of the *Proceeds of Crime Act* 2002 (**POCA**) throughout Australia, relying upon the fact that structured deposits were made into Australian bank accounts. In such cases, the Commissioner contends that the assets constitute "proceeds" and/or an "instrument" of structuring and are thereby liable to restrained and, subsequently, forfeiture.

Reasoning in Kalimuthu

In *Kalimuthu*, the Commissioner had obtained a restraining order under section 19 of the POCA over various bank accounts. The restraining order had been obtained on the basis that structured deposits were made into Australian bank accounts in contravention of section 142 of the AML/CTF Act. There was little dispute that the applicants for exclusion were victims of cuckoo-smurfing.

The critical issue for determination was whether, by operation of section 330(4)(a) of the POCA, the money placed into the Australian bank accounts had ceased to be proceeds and an instrument of structuring.

That section relevantly provides as follows:

> *(4) Property only ceases to be *proceeds of an offence or an *instrument of an offence:*
>
> *(a) if it is acquired by a third party for *sufficient consideration without the third party knowing, and in circumstances that would not arouse a reasonable suspicion, that the property was proceeds of an offence or an instrument of an offence (as the case requires);*

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[1] http://www.austrac.gov.au/typologies-2008-methodologies

Allanson J determined (at [117]-[121]) that the applicants for exclusion were third parties because:

- they were not in any legal relationship with anyone involved in the money remitting transaction that would make the money remitting transaction one between related parties;
- the applicants for exclusion had no interest in the Australian physical currency, or any property derived from it, before the cash was deposited into their accounts; and
- the applicants for exclusion were in no different position from that of a person who sells property to a stranger and is paid by direct debit into his bank account.

Allanson J also determined (at [124]) that the property (the chose in action) was acquired for sufficient consideration. Firstly, the bank was paid an amount equal to the credit balance of the account and, secondly, the applicants for exclusion had provided funds in foreign currency of equivalent value to a money remitter.

Lastly, Allanson J addressed the question whether the applicants for exclusion had acquired their interests in circumstances that would not arouse a reasonable suspicion that the funds deposited in their bank accounts were the proceeds of an offence or an instrument of an offence.

His Honour observed that:

> *The question posed by the section is objective: would the circumstances arouse that reasonable suspicion in a person in the position of the respondents, knowing what they knew: see Director of Public Prosecutions v Le [2007] VSCA 18; (2007) 15 VR 352 [24]. The decision was overturned in the High Court, but the approach of the Court of Appeal to 'reasonable suspicion' was approved: see Director of Public Prosecutions (Vic) v Le [2007] HCA 52; (2007) 232 CLR 562 [1] (Gleeson CJ), [127] (Kirby and Crennan JJ).*

Allanson J concluded that he was satisfied that no reasonable suspicion would be aroused in the circumstances known to the exclusion applicants. His Honour pointed to the following matters in reaching that conclusion:

- that it was not alleged that any applicant for exclusion was involved in the offending;
- that the applicants for exclusion had lived their lives in Malaysia;
- that the applicants for exclusion believed that they could send money offshore through a money remitter;
- that the amounts remitted matched the amounts which the applicants for exclusion believed ought to be deposited into their accounts based on what was provided to the money remitter in Malaysia;
- that not all of the deposits into the accounts were below the reporting threshold;
- that the period of time over which the transactions took place was relatively short;
- that at the time of the deposits, the applicants for exclusion were not aware of the multiple locations at which the transactions took place or that the deposits were made in different States;
- that there was no evidence to support a finding that the applicants for exclusion were aware that structuring deposits in this way was linked to criminal activity, either in Australia or Malaysia.

Accordingly, Allanson J allowed the application for exclusion.

Reasoning in Lordianto

Simpson J stated (at [31]) that there are five elements to section 330(4)(a), namely:

- that property is acquired;
- by a third party;
- for sufficient consideration;
- without knowledge that the property was the proceeds or an instrument of a relevant offence; and
- in circumstances that would not arouse a reasonable suspicion that the property was the proceeds or an instrument of a relevant offence.

As was the case in Kalimuthu, a money remitter was used to transfer funds from overseas (here Indonesia) to Australia. The money was deposited into the accounts of the Lordianto family in structured (less than $10,000) deposits.

It was accepted on behalf of the applicants for exclusion that their interests in the restrained bank accounts were proceeds or instruments of a relevant offence by reason of the structured deposits. However, the question was whether the funds standing to the credit of the bank accounts had ceased to be proceeds and an instrument, in reliance upon section 330(4)(a) of the Act.

Simpson J noted (at [55]) that the applicants claimed that they were:

> *innocent victims of cuckoo smurfing; that their legitimate transactions in Indonesia had been subverted in such a way that the deposits in their Australian CBA accounts were sourced, not from their own funds, but from proceeds, in Australia, of criminal activity*.

Simpson J then considered each of the five elements which her Honour had identified as comprising the test in section 330(4)(a).

Acquisition: Simpson J found that there was no relevant "acquisition".

Simpson J reasoned that the relevant property in question in the exclusion application was the applicants' interest in bank accounts. That property (which was a chose in action) was created when the account was *opened*. Thereafter, the value of that chose in action increased and decreased from time to time, but the property (being the chose in action) never changed. Put another way, the relevant property (i.e. the chose in action) pre-existed the criminal conduct. Therefore, it was not "acquired" within the meaning of section 330(4)(a).

Her Honour (at [83]-[84]) expressly refused to follow the reasoning of Allanson J in *Kalimuthu* and Mitchell J in *Commissioner of the Australian Federal Police v Fitzroy All Pty Ltd* (2015) 299 FLR 439.

Third Party:

Her Honour posed the question:

> *"third parties" to what?*

Simpson J found that the third-party test is:

> *the statutory enactment of the equitable notion of a purchaser for value without notice. A third-party is a person to whom property passes – third party to the ownership of the property. It is the party by whom the property is acquired. The paragraph is concerned with the transfer of property. A person is not a third party only because he or she had no connection with the offence that causes the property to be tainted.*

Because Simpson J found that third party is the party by whom the property is acquired, and her Honour had already found that there was no relevant acquisition, the applicants failed also on this limb of the exclusion test (at [105]).

Sufficient consideration:

Maybe surprisingly, her Honour found (at [107]) that:

> *If the deposits were made in the course of a cuckoo smurfing operation, they were deposited without consideration passing from the applicants to the depositors (or to anybody on their behalf). They were simply gratuitous deposits, and the applicants maintain whatever rights they had (under Indonesian law) against the Indonesian money remitters to whom they had paid the money. The payments made to the Indonesian money remitters were made in consideration of the transfer to the CBA accounts, a transfer that did not eventuate.*

Accordingly, her Honour found that there was not "sufficient consideration" for the chose in action.

Knowledge that property was tainted:

This element will be a question of fact in each case. Here, her Honour found that:

> *The applicants were well aware, over a period of years, of the unorthodox manner in which deposits were made into their accounts. The onus lies on them to prove that they did not know, and they have not discharged that onus.*

Reasonable suspicion:

Simpson J acknowledged that the test to be applied was objective (at [124]). However, having already found that the applicants had not discharged their onus in respect of knowledge, it followed that they could not discharge their onus concerning a reasonable suspicion.

Her Honour stated:

> *… the bank statements demonstrate a pattern of activity that would arouse a reasonable suspicion in any reasonable person.*

Hence, on her Honour' is reasoning, structured deposits into bank accounts would always arouse a reasonable suspicion in a reasonable person (which may be seen to be at odds with the observations on the Victorian Court of Appeal in *Director of Public Prosecutions v Le* (2007) 15 VR 352, [24]).

Reasoning in Fernandez

It is perhaps unsurprising that, having foreclosed any possibility of a successful exclusion application in a cuckoo smurfing situation, Simpson J found a different path to ameliorate the hardship that otherwise would flow to a victim of cuckoo smurfing.

Notwithstanding the fact that an application for exclusion is dismissed, where there is no conviction the Commissioner must still succeed with an application for forfeiture. If such application for forfeiture is refused, the restraining order ceases to operate and the property is returned to the property owner.

Fernandez was yet a further cuckoo smurfing case, involving a section 19 restraining order. No application for exclusion had been made under section 29 of the Act. Instead, the property owners opposed forfeiture on the basis that it was not in the public interest to make a forfeiture order (see section 49(4) of the Act).

As is common in cuckoo smurfing cases, the Commissioner did not allege that the property owners had any involvement in, or were party to, the money laundering offences or structuring transactions.

Simpson J stated (at [92]):

> *I appreciate the gravity of offences of money laundering and structuring, and that they protect the profits of criminal activity; I fully appreciate the need for the confiscation system to operate to short-circuit the use of those means of criminal profit protection. Forfeiture of the property of an innocent victim does not achieve that, and does not in any way operate as deterrent to those who use the property of innocent victims to achieve their criminal ends.*

Her Honour concluded (at [94]):

> *I have concluded that the public interest is not served by ordering forfeiture of the defendant's interest in the property.*

Where to from here

The present position for practitioners advising clients in cuckoo smurfing cases is unsatisfactory. Two inconsistent approaches have been adopted by single judges of Supreme Courts in different Australian jurisdictions.

Based on the reasoning of Allanson J in *Kalimuthu*, applications for exclusion in cuckoo smurfing cases can succeed in reliance upon section 330(4). Based on the decision of Simpson J in *Lordianto* (the reasoning of which was affirmed in *Fernandez*) applications for exclusion in cuckoo smurfing cases have no prospects of success. Instead, the focus must be on opposing forfeiture orders.

Having regard to the fact that the Kalimuthu decision will shortly be the subject of consideration by the WA Court of Appeal, it would appear to be prudent to await the outcome of that appeal before proceeding to hearing with any further applications. It would be unsurprising if the matter reaches the High Court before too long, having regard to the large value of assets restrained on the basis of cuckoo smurfing activity.

About the author

Christian Juebner is a barrister at the Victorian Bar and practices extensively in confiscation and proceeds of crime litigation in various Australian jurisdictions.

He was admitted to practice in 1996 and, prior to coming to the Bar in 2004, was a partner with Deacons (now Norton Rose Fulbright).

He can be contacted as follows:

- by email on juebner@vicbar.com.au
- by phone on (03) 9225 8203 or 0410 657 177.

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