No constructive trust for moneys paid under Judgment alleged to have been obtained by fraud

On 23rd March 2021, Falk J handed down judgment in *Taylor v. Khodabakhsh & ors* [2021] EWHC 655 (Ch) dismissing the claimant's applications, including for proprietary and freezing injunctions against 3 defendants, whom the claimant asserts obtained judgment in *Taylor v. Van Dutch Marine Holdings Ltd.* [2019] EWHC 1951 (Ch) (the "**Original Proceedings**") by fraud. In doing so, Falk J held (among other findings) that monies payable on account of costs under the order of the trial judge in the Original Proceedings would not be held under a constructive trust in favour of the claimant as and when they might be paid.

Background

In July 2015 the claimant advanced US$1,591,040 for a period of six months pursuant to written Heads of Terms to Van Dutch Marine Holdings Ltd. ("**VDMH**"). VDMH is a Maltese company. It has a subsidiary incorporated in England and Wales, Van Dutch Marine Ltd ("**VDML**"). VDMH is co-owned by two individuals, Hendrik Erenstein and Ruud Koekkoek. VDMH, VDML, Mr Erenstein and Mr Koekkoek are referred to below as the "**Original Defendants**". At the relevant time VDML carried on a business of designing, manufacturing and selling luxury leisure yachts under the "Van Dutch" brand.

The Heads of Terms contemplated that a formal loan agreement would be entered into. A loan agreement was produced with all four of the Original Defendants named as parties, and was executed by them. However, it was never executed by

the claimant and it did not take effect. Further, the claimant did not receive the benefit of the security that he had been offered.

The loan was not repaid on maturity. The claimant issued proceedings against the Original Defendants, obtaining freezing orders in advance of judgment, with disclosure obligations. The Original Defendants did not defend the proceedings and judgment was entered in default against all 4 of them. The claimant sought to enforce the disclosure obligations under the freezing order and obtained committal orders against Mr Erenstein and Mr Koekkoek. As part of that procedure, Mr Erenstein and Koekkoek served affidavits, in which they asserted among other things that valuable assets which the claimant claimed to have understood to be owned by VDML were in fact owned exclusively by Rhino Overseas Inc ("**Rhino**"), and that Rhino was not owned by the Original Defendants but was instead owned by Mr Khodabakhsh or New Business Technologies LLC ("**NBT**").

The claimant then made the decision to join Mr Khodabakhsh, NBT and Rhino (together the "**Additional Defendants**") into the Original Proceedings, alleging that the Original Defendants had acted as agents for undisclosed

principals, the Additional Defendants. In addition to the claims for breach of contract, claims were brought for misrepresentation, unlawful means conspiracy, unjust enrichment and constructive trust.

The Original Proceedings were heard by Julia Dias QC in April and June 2019 with judgment being handed down on 22 July 2019, in which the Deputy Judge dismissed all of the claims against the Additional Defendants [2019] EWHC 1951 (Ch). The claimant was ordered to pay the Additional Defendants' costs, including an interim payment on account of £400,000.

The Court of Appeal granted the claimant permission to appeal on limited maters only relating to the agency claims. On 23 January 2020, before the appeal was heard, the claimant applied in the appeal seeking permission to rely on new evidence involving allegations that the judgment in the Original Proceedings has been obtained by fraud, an order staying the appeal and an order remitting the fraud allegations to the High Court. The

allegations of fraud were based on claims by the former COO of Rhino, who had given evidence at trial for the Additional Defendants in the Original Proceedings but had subsequently fallen out very badly with Mr Khodabakhsh, that both he and Mr Khodabakhsh had lied in their evidence in the Original Proceedings and that certain documents relied on at the trial in the Original Proceedings had been forged. These claims are denied by the Additional Defendants. This application was dismissed by Phillips LJ at a hearing on 13 February on the basis that the claimant should instead issue fresh proceedings.

In a decision handed down on 10 March 2020, the Court of Appeal also dismissed the substantive appeal with costs ([2020] EWCA Civ 353). The claimant then filed a further stay application in the Court of Appeal, seeking a stay of the costs order made by the trial judge and costs orders made in the Court of Appeal. On 3 April 2020 that application was dismissed on the papers, the costs of the stay application were awarded against the claimant, and the claimant was ordered to pay £30,000 on account of those costs. In refusing the stay, the Court of Appeal accepted the Additional Defendants' submissions that what the claimant was effectively seeking was a freezing order in support of new proceedings, which he had by then issued against the Additional Defendants only. The Court of Appeal said that the claimant's proper remedy was to seek a freezing order on notice from a Judge at first instance. The Court also expressed the provisional view that there would be no restriction on the Additional Defendants paying the sums they owed to their lender, "*given the absence of any proprietary claim*" by the claimant.

The claimant's injunction application

The claimant failed to pay the £400,000 on account of costs ordered by the trial judge, but rather issued an application for a freezing order for £2.5 million and, having amended the Particulars of Claim to add a claim that monies paid under the payment on account would be held under a constructive trust in favour of the claimant, a proprietary injunction in respect of the £400,000.

The claimant did not progress his applications for injunctive relief with much alacrity and they finally came on for hearing in March 2021, almost a year after the Court of Appeal dismissed the appeal in the Original Proceedings.

The Additional Defendants accepted for the purposes of the application only that the claimant would get over the relatively low "good arguable case" in respect of 2 documents alleged to have been forged, but resisted the application on the basis that the judgment in the Original Proceedings had not been obtained by fraud in the relevant sense as set out by Aikens LJ in *Royal Bank of Scotland v Highland Financial Partners* [2013] 1 CLC 596 at [106] and approved by the Supreme Court in *Takhar v Gracefield Developments Ltd* [2020] AC 450 at [56], [57] and [67].

Falk J was critical of the way in which the claim was pleaded by the claimant, holding that there were some significant difficulties with the claimant's claim as currently pleaded. She came close to concluding that there was no serious issue to be tried or no good arguable case and that she should refuse injunctive relief on that basis. However, she decided it was preferable not to make a decision on that basis but to consider the other requirements for injunctive relief "*which would also remain relevant if (for example) the claim were reformulated*".

Proprietary Injunction

Falk J then considered the claim to a proprietary injunction in respect of the £400,000, it being the claimant's pleaded case that "*any costs paid by him under that order would be transferred pursuant to a fraud and would be held by the [Additional] Defendants as constructive trustees for him*". The claimant relied on the well-known dictum of Lord Browne-Wilkinson in *Westdeutsche Landesbank Girozentrale v Islington London Borough Council* [1996] A.C. 669 about stolen monies being traceable in equity, the proprietary interest arising under a constructive trust. The claimant argued that if he paid money under the order in the Original Proceedings, knowing as now claimed that the Additional Defendants had lied in the Original Proceedings, he would not be consenting to making the payment and the monies would effectively have been stolen from him.

This was roundly rejected by Falk J, saying that she could not see how payment of money pursuant to a court order that has not yet been set aside, and which the court clearly had jurisdiction to grant, could be compared with Lord Browne-Wilkinson's example of stolen money. There could be no doubt that the order of 22 July 2019 is valid unless and until it is set aside. Any money paid pursuant to it would transfer both legally and beneficially to the payee. Whilst the claimant would not be making the payment because he freely chooses to do so, the reason he would be making it is because he is compelled by a court order, and not because someone has wrongly taken his property without his consent. The circumstances were entirely different from the theft referred to by Lord Browne-Wilkinson.

The Judge referred to the judgment

of Lewison LJ in *Rashid v Nasrullah* [2020] Ch 37 at [53]-[54] in which he had approved the passage in *Snell's Equity* at 26-012 in the 34th edition drawing the distinction between "fraudulent taking" and "fraudulently induced transfer". She said that if there was any analogy with the 2 scenarios, the facts were closer to the second. A court order is valid until set aside. As a result, payments made pursuant to it will vest both legally and beneficially in the payee, just as with a voidable transaction.

However, and significantly, she was not persuaded that a payment pursuant to a regular court order does fall into the same category as a payment pursuant to a fraudulently induced transfer. A court order is only ever regular or irregular and is not appropriately described as void or voidable (Isaacs v Robertson [1985] 1 AC 97 (PC), at 103E). A regular court order is valid and binding until it is set aside (also referred to as "rescinded") by a further decision of the court. It is not open to a litigant who considers that he has been defrauded simply to elect to rescind an order against him. Instead he must persuade the court that it is required.

If and when the claimant establishes to the court's satisfaction that set aside is required, the consequences will depend on the terms of the further court order. In the normal course that further order may well include provision for repayment of any amounts paid pursuant to the order that has been set aside. But it seemed highly unlikely to the Judge that it would involve any form of proprietary relief in respect of monies paid, particularly in circumstances where the concept of a remedial constructive trust is not part of English law (*FHR European Ventures LLP v Cedar Capital Partners LLC* [2015] AC 250 at [47]).

She therefore refused to make a proprietary injunction.

Freezing Order

The Judge also refused to make the freezing order application. First, she noted that there was no clear evidence to support the figure of £2.5 million claimed for the freezing order. She then went on to hold that the claimant had failed clearly to identify assets that required to be effectively protected from dissipation (applying *Ras al Khaimah Investment Authority v Bestfort Developments llp* [2018] 1 WLR 1099). Thirdly, she applied the principles in *Lakatamia Shipping Company Ltd v Morimoto* [2020] 2 All ER (Comm) 359 at paragraph [34] and held that there was no evidence at all of a risk of dissipation of any assets of any of the Additional Defendants, notwithstanding the claimant's attempt to rely on the alleged fraud as evidence of dissipation.

Falk J considered in this respect the issue of delay and the decisions in *Cherney v Newman* [2009] EWHC 1743 (Ch) at [73], [77] and *Madoff Securities International Ltd v Raven* [2012] 2 All ER (Comm) 634 at [156]. She accepted that the mere fact of delay or that the application is first heard *inter partes* does not mean that, without more, there is no risk of dissipation: the court may be satisfied on other evidence that there is such a risk. Further, even if the delay demonstrates that the claimant does not consider that there is a risk of dissipation, that is only one factor to be weighed in the balance. However, she added that it may, nevertheless, be an important factor. In this case, the period during which there would have been a risk of dissipation was, in reality, far longer than the date when these proceedings were brought but went back (at least) to the date the Additional Defendants were joined to the Original Proceedings. On the facts of this case, Falk J was of the view that the delay was important - if the defendants are as dishonest as the Claimant maintained that they are (and it were the case that the dishonesty is directly relevant to the risk of dissipation) then it was hard to see why any damage would not already have been done.

Accordingly, taking all the matters into account, including her concerns as to the strength of the claimant' case as pleaded, the Judge held that it was not just and convenient to grant freezing relief.

The Additional Defendants were represented both in the Original Proceedings and in the applications before Falk J by Lance Ashworth QC and Dan McCourt Fritz.

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