



KICSS2023

Kedah International Conference on Social Science and Humanities
UiTM Kedah (Online), Malaysia, 21-22 June 2023:
International Conference on Contemporary Legal and Policy Issues
(ICCLPI)



Equity Perfecting an Imperfect Gift of Shares: A Comparative Study on the Rulings of the Malaysian Federal Court and English Common Law

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Abstract

This paper aims to ascertain how the latest Malaysian apex court applied English trust law for equity to perfect an imperfect gift of shares as encapsulated in the leading case of *Pennington v Waine*. A comparative research methodology reveals that there must be detrimental reliance on the part of the donee of shares, which cannot be justified from the company law perspective. It must also be unconscionable for the donor of shares to deny the donee. This subjective test is too broad and confers the court an unfettered discretion to perfect an imperfect gift.

Keywords: Company Shares; Equity and Trust

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DOI: <https://doi.org/10.21834/e-bpj.v8iS113.5037>

1.0 Introduction

In a transfer of shares, whether as a gift or settlement, the owner of the shares (donor) must adhere to the procedures of transfer stated in the constitution of the company, which usually entails the registration of the duly executed share transfer form accompanied by the share certificates which were lodged with the company. If the donor fails to observe the same, the transfer fails, and the equitable title cannot pass to the transferee (donee) since the applicable maxim is equity will not perfect an imperfect gift. Under certain circumstances, equity will render the imperfect transfer valid, by holding that the equitable title of the shares would pass to the donee and the legal title of the shares is held by the donor as constructive trustee and the leading English case decided at the Court of Appeal is *Pennington v Waine* [2002] 1 WLR 2075 (hereinafter called *Pennington's case*).

In *Pennington's case*, the donor (Ada) wanted to transfer 400 shares to the donee (Harold) and proceeded to execute the share transfer forms. Ada gave the documents to her agent (Pennington) and instructions to register the same, but the agent forgot. The said share certificates were always at the company. When Ada died, the shares were not transferred to the donee. The donee acted on the representation of the donor and executed a consent form to become a director, which is the requirement before a person could become a shareholder. The court held that the equitable title of the shares had passed to the donee despite the failure to transfer the legal title. In *Milroy v Lord* (1862) 4 De GF & J 264, the donor is not legally required to do everything necessary to affect the transfer. The donor needed to do what was required in his power to complete the gift, short of registration of the transfer forms and delivery of the transfer forms can be waived provided there is a clear intention to make the gift by the donor. In *Pennington's case*, the actions of the donor had reached a stage where it would be unconscionable for her to rescind the gift, and the donee could enforce his rights against third parties without the need to compel the donor to do anything more.

The requirements of *Pennington's case* as construed by the newest Malaysian Federal Court case at the time of writing of *Abdul Ravuff bin Datuk AS Dawood & Ors v Dr Abdul Rahiman bin Datuk AS Dawood* [2022] MLJU 830 (hereinafter called *Abdul Ravuff's case*) are detrimental reliance suffered by the donee and whether it would be unconscionable for the donor to renege the transfer of shares. The court held that the principle of *Pennington's case* did not apply to the facts of *Abdul Ravuff's case* but should be confined to its peculiar facts without stating what these facts were. The problems addressed in this paper revolve around the requirement of

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DOI: <https://doi.org/10.21834/e-bpj.v8iS113.5037>

detrimental reliance which arose because of the onerous duties of a director. This was never mentioned in *Pennington's* case. The subjective test premised on the donor's conscience is arguably too broad and could open floodgates on when equity can perfect an imperfect gift. The question arises whether a more objective approach is desirable to mitigate the problem.

Before *Pennington's* case, the law hinges on a more objective approach embodied in the two cases, collectively called the rule in *Re Rose*. In *Midland Bank Executor and Trustee Co Ltd v Rose* [1949] Ch 78, Jenkins J held, at p 89, that for the equitable title to pass, the donor must have done everything in his power to divest himself of the shares, and the execution of the correct share transfer forms together with the certificates and handing them to the donee. The fact that the directors have the discretion to refuse registration was not something the donor could control and thus did not affect the passing of the equitable title. In *the case of Rose v IRC* [1952] 1 All ER 1217 Jenkins LJ said that the donor was required to equip the donee with all the necessary documents to enable him to perfect the transfer before the equitable title can pass. Thus, the delivery of executed transfer forms and certificates was sufficient to transfer the equitable title, and the further act of the donee required to register the said transfer did not negate the passing of the equitable title. The objective test can evaluate both cases if equity should perfect an imperfect gift by ascertaining the donor's actions. The research objective of this paper is to ascertain whether the rulings of the Malaysian Federal Court on the requirements of *Pennington's* case can be justified.

2.0 Literature Review

Pennington's case has been subjected to various criticisms. Ying (2021) provides that in *Pennington's* case, the concept of unconscionability is merely a guise for the requirements of proprietary estoppel, and such analysis avoids the rule in *Re Rose* from being unfairly criticized in that there is an unjustified departure from the maxim that equity will not perfect an imperfect gift. Sutherland (2020) maintains that *Pennington's* case is so vague and broad in its scope that it should be rationalized as a case of proprietary estoppel as this will cause less erosion to the maxim, equity will not perfect an imperfect gift. Freeman & Pullar (2022) opine that Arden LJ, in *Pennington's* case, failed to offer any guidance as to how to evaluate what it means to be unconscionable for a donor to insist on his actions trying to transfer property but fails to do so and unless the English Supreme Court decides on this issue, the use of the unconscionability as a tool of equity to perfect imperfect gifts will persist. Ladds (2003) argues that in *Pennington's* case, Arden LJ's judgment suggested that she may have thought that proprietary estoppel was an alternative ground for her decision, by invoking equity when there is detriment on the donee. The rule in *Re Rose* cannot fully explain *Pennington's* case. It does not follow equity's traditional strict approach to validating gifts when the requisite formalities were not followed.

3.0 Research Methodology

This paper employs a legal comparative methodology. Darpo & Nilsson (2010) provide that the comparative study seeks to address the legal problems that should be studied. Mehren (1991-1992) stated that in comparative legal research, the rules, principles, and theories that serve similar purposes can be meaningfully compared. This paper will compare the rulings of the English and Malaysian courts on the problems surrounding how equity allows the transfer of imperfect gifts of company shares. The judgment of *Abdul Ravuff's* case will be critically examined to ascertain how it interprets *Pennington's* case. The doctrinal research method is then used to construct coherent and rational legal rules by traditional methods of case and statutory analysis (Schneider & Teitelbaum, 2006). The sources of law elicited are from the library and its online databases. These research methods are employed because the content analysis entails primary and secondary sources of law.

4.0 Findings

4.1 The Requirement of Detrimental Reliance on the Donee of Shares

The author submits that the requirement of detrimental reliance suffered by the donee in *Pennington's* case, as stated by *Abdul Ravuff's* case, cannot be substantiated from *Pennington's* case. In the recent Malaysian High Court case of *Tan Sri Dato' Kam Woon Wah v Dato' Sri Andrew Kam Tai Yeow* [2022] MLJU 794, there was no mention of the requirement of detrimental reliance as a requirement to apply *Pennington's* case. The case applied *Pennington's* principle to the extent that the execution of a share transfer form would create a trust in which the donee could compel the donor to procure registration for him. The author submits that none of the judges in *Pennington's* case mentioned the requirement of detrimental reliance, expressly or impliedly. In *Pennington's* case, the donee accepted the post of director in the company as mandated by the articles before he could hold any shares. The donee would have to vacate office as a director on 30 October 1998 if he had not obtained his share qualification as required by section 291 of the English Companies Act 1985 (*Pennington's* case). Teong (2021) believes that *Pennington's* case was decided wrongly, and this was implicitly explained away by Briggs J in *Curtis v Pullbrook* [2011] EWHC 167 (Ch) as a form of estoppel. The said judge, regarding *Pennington's* case, stated that 'On its facts, *Pennington's* case appears to have been an example of a sufficient detrimental reliance by the donee, who had agreed to become a director of the subject company upon an assumption that he had received an effective gift of qualifying shares in it.' Nothing truly concrete in Briggs J's statement could be deduced as the wordings used was that there appears to be detrimental reliance suffered by the donee, as opposed to detrimental reliance.

In contrast, in *Abdul Ravuff's* case, the words used were, the donee must have suffered detrimental reliance is much stronger than Briggs's version which provides that the donee appeared to have suffered detrimental reliance. The issue in *Curtis v Pullbrook* was

whether the equitable title of the shares had passed to the donees in which the court applied *Pennington's* case. The court held that three requirements must be satisfied before the equitable title can pass in the absence of a settlement. Firstly, the donor must have done everything necessary to enable the donee to enforce a beneficial claim without any further assistance from him. Secondly, there appeared to be some detrimental reliance suffered by the donee, so it is binding on the donor's conscience for the imposition of a constructive trust. Thirdly, the gift can be construed by a benevolent construction or implied declaration of trust, judging by the donor's words. When these requirements are met, equity will perfect the imperfect gift. In *Curtis v Pullbrook*, the donor (Pullbrook) was not authorized by the company to issue or register share certificates to his wife and daughter (donees). The donor had failed to take the necessary steps to enable the donees to obtain the transfer without further assistance from him. The donor had been unable to send the donees the share certificates and executed transfer forms. Instead, the share certificates were sent to his solicitor for safekeeping in the company. The donor could not be treated as a constructive trustee since the donees did not suffer any detrimental reliance. It follows that the shares cannot pass to the intended donees. The author submits that if the donees had suffered any detrimental reliance, then the title would have passed under the doctrine of proprietary estoppel as opposed to *Pennington's* case.

Sutherland (2020) maintains that the donee in *Pennington's* case hardly suffered any detriment as he received a handsome remuneration of 400 shares. He opines that since there was a distinct lack of detriment, it was not viable for the court to award the highest possible remedy of expectation. Under the company's constitution, the articles required its directors to hold at least one share. Arguably, for most laypeople earning an average wage, the chance to become a director and a majority shareholder constitutes a substantial benefit. The donee also received the disposition from the donor, who was a family member, without any consideration.

The detrimental reliance suffered by the donee also cannot be substantiated from the perspective of Malaysian or English company law. The facts of *Pennington's* case reveal that via the gift of the 400 shares, the donee would hold 51% of the company's shareholding. The disposition would make him the majority shareholder and effectively control the company. The donee's father would hold the remaining balance of the shares. Together, they were the only shareholders and directors, effectively putting them in complete control of the company. Arjunan & Low (1995) state that such share qualification constitutes an added incentive to ensure the financial success of their companies.

Under section 192(1) of the Malaysian Companies Act 2016, a person shall not be liable for the obligations of a company just because he is a member of the company. Further, under section 192(2), a member's liability is subject to the type of company in which he is a shareholder. In *Pennington's* case, the 400 shares transferred to the donee are from Crampton Bros. (Coopers) Ltd, which indicates that it is a company limited by shares. It follows that under section 192(2)(a), the liabilities of the donee and his father are the amount of unpaid shares they hold. They are not responsible for the company's debts under the concept of a separate legal entity unless the constitution expressly states otherwise under section 192(2)(c). There is nothing in *Pennington's* case to indicate any type of liabilities attached to the shareholders according to the constitution of Crampton Bros. (Coopers) Ltd. Under section 206(1)(a) of the Companies Act 2016, a director can only be removed from office by an ordinary resolution in a private company and a public company. Further, nothing in the constitution or the agreement between the company and directors can override the said resolution as stated under section 206(1)(b) and section 206(2) of the Companies Act 2016. Since the donee holds 51% of the shares in Crampton Bros. (Coopers) Ltd, any ordinary resolution to remove him is unlikely. The same argument applies in England as under section 168 of the Companies Act 2006, an ordinary resolution at a meeting is also required to move a director. In the recent English case of *Khan v Mahmood* [2021] EWHC 597 (Ch), where the principle in *Pennington's* case was applied, the court did not mention that the donee suffered any detrimental reliance even though he paid for the stamping duties of the transfer.

4.2 The Test of Conscience of the Donor

In *Abdul Ravuff's* case, the requirement that it must be unconscionable for the donor to deny the donee the gift follows *Pennington's* case. The said requirement is subjective, as it is for the courts to decide whether it is unconscionable for the donor to resile the gift. Lady Arden LJ, in *Pennington's* case, stated that there is no comprehensive list of factors that render it unconscionable for the donor to change his mind as it must depend on the court's evaluation of all the relevant facts. The subjective test risks opening the floodgates in situations when equity will perfect an imperfect gift. Further, the donor need not do everything required of him to perfect the transfer. Clarke LJ, in *Pennington's* case, pointed out that the donor could have done more, like delivering the transfer form to the donee (*Pennington's* case).

5.0 Discussion

The unconscionable test in *Pennington's* case, which was approved in *Abdul Ravuff's* case, is arguably too broad, and the effect of this subjective test is exemplified in the recent English case of *Khan v Mahmood* (Ch). Marcus Smith J stated that the test in *Pennington's* case is not whether everything necessary has been done to affect the transfer according to the nature of the property, but whether it is unconscionable to allow the donor to resile her gift. *Khan v Mahmood* decided that it would be unconscionable for the donor to resile from his imperfect gift, though the transfer form executed was defective and was not forwarded to the donee. The donor intended to divest himself of his interest in the property with no consideration to avoid complications pending his criminal investigation. In 1862, when *Milroy v Lord* was decided, the court nullified the gift of shares when the wrong transfer forms were used by the donor, by strictly enforcing the maxim that equity will not perfect an imperfect gift. In 2021, when *Khan v Mahmood* was decided, the wrong transfer forms were used by the donor, but this is no longer a barrier to transfer. The court in the latter case had stretched matters farther than before in allowing equity to perfect an imperfect gift using the subjective unconscionable test stated in *Pennington's* case. Beyond this current research, the possibility of linking the concept of proprietary estoppel should be considered in *Pennington's* case.

6.0 Conclusion and Recommendations

Abdul Ravuff's case provides that detrimental reliance suffered by the donee by his onerous duties as a director is required to apply the principle of *Pennington's case*. However, under the English Companies Act 2006 and Malaysian Companies Act 2016, the purported onerous duties of the said donee as a director cannot arguably be substantiated. The majority shareholding enjoyed by the donee in that case, and his appointment as one of the two directors of the company insulated him from any removal as a director. The only other shareholder in the company is his father. Together, they were in effective control of the company. The conscionable test in *Pennington's case* is highly subjective and may open the floodgates as to when equity can perfect an imperfect gift.

The author recommends that emphasis should be placed on the judgment of Clarke LJ in *Pennington's case*, which is more objective in its approach. Morris (2021) states Clarke LJ, in *Pennington's case*, focused on the effective equitable assignment of the shares instead of the unconscionable test. Clarke LJ held that the donor would have done everything she could to perfect the gift of the shares if she had delivered the transfer form to the donee or the company. In this situation, equity would assist the donee to become the legal owner. On the facts of *Pennington's case*, the donee did not have the necessities required to register the transfer without the assistance of the donor or the court. The judge, however, held that in the absence of any negating factors, the equitable assignment to transfer the shares in equity to the donee would be effective. The assignment occurs when the donor executes the share transfer form (either by itself or coupled with the delivery by the transferor) and intends to make the transfer his own. Clarke LJ, in *Pennington's case*, regarded the execution of the correct transfer of shares form as the critical moment in which the equitable assignment took place and not the subsequent delivery, as the donor intended to affect the transfer at the execution. It was at the execution point in time that the donor had done everything that he could to transfer the equitable interest in the shares to the donee. Clarke LJ's approach hinges on the actions of the donor, which can be evaluated objectively. It is premised on the rule in *Re Rose* mentioned above. It thus creates greater consistency in future cases. As things stand, the Federal Court indicated that *Pennington's case* should be confined to the peculiarities of its own facts but did not point out what these crucial factors were. When using Clarke LJ's approach, there is no need to ascertain the parameters of each case to ascertain if it falls within the scope of *Pennington's case* since the objective test could be employed in any situation. The perceived limitation of this paper is that the English Supreme Court may overrule *Pennington's case* in the future. However, this would open up new avenues of research in this area of law. The main areas of law contributed by this paper are equity and trust, and corporate law.

Acknowledgments

This research has the support of the Institute of Research Management Innovation (IRMI) and the Faculty of Law UiTM, Shah Alam.

Paper Contribution to Related Field of Study

This paper reveals the latest requirements and problems under Malaysian common law in the transfer of company shares as gifts or settlements when the proper procedures of transfer have not been complied with.

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