CHAPTER I

THE PERIOD BEFORE THE INTRODUCTION OF STRATA TITLES

In the early days, when development was slow, buildings in West Malaysia were never higher than three storeys. To a large extent, the buildings were built on ground level. It was not surprising therefore, that when the F.M.S. Land Code[1] was enacted in 1926, it contained no provisions for Strata Titles or Subsidiary Titles. But as the country progressed and became more and more developed, higher and higher buildings were constructed in response to constantly growing urbanisation and the need to resettle squatters in the urban areas. These multi-storeyed buildings were made possible by the use of modern technology.

Since there were no provisions in the F.M.S. Land Code, 1926,[2] for separate subsidiary titles, developers had to resort to various devises to meet the demand from the public for ownership-rights for home-units, office suites, and for premises occupied for professional and industrial purposes. All the devises were aimed at securing to flat-

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[1] Cap. 138.

[2] Ibid.

dwellers, the nearest equivalent to ownership since the issue of a title was not possible. The devises commonly employed were:

A. The Lease.

B. The Home-unit Company.

C. The Sale of an Undivided Share.

A. THE LEASE

Before a lease of a flat is registered, the normal practice is for the parties to enter into a contract called an agreement for a lease. In the agreement it is provided that in return for the payment by the lessee of a substantial premium, equivalent to the estimated market value of the leased premises, the lessee is given a lease of the flat for a specified term of years. Where the lessee is unable to discharge the premuim in one payment, he is usually allowed to do so in a specified number of installments. When this happens there is attached to the lease agreement, another agreement called the licence agreement. The latter agreement gives the lessee a licence or a right to occupy the flat until such time when the premium is completely paid off, whereupon, a lease will be executed in his favour.

The leasing method suffers from a number of disadvantages. A lease runs for a specified term of years only. Once the lease determines or the term expires, the reversionary interest vests in the lessor. There is thus no true ownership but only possession for a limited number of years. Under the Federated Malay States (F.M.S.) Land Code, 1926[3] a lease of a flat cannot exceed thirty years. In Australia, the lessees are in a better position since Australian law allows leases of flats to run for an extended term of 99 or 999 years.

Sometimes options for renewal are put in the leases to cure the defect referred to above and to secure to the leases a "title" in perpetuity rather than a limited interest in real property. In England and in New Zealand there has been much debate as to whether the Rule against Perpetuities applies to an option included in a lease. Options are of two types. They can be either options to purchase or options to renew. Both are complete unilateral contracts. He who has the option has the benefit not of a mere revocable offer of sale or renewal, but of an irrevocable binding contract of sale or renewal. The contract ceases to be conditional and becomes absolute as soon as the purchaser or lessee

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[3]Cap. 138.

finalises the condition by exercising the option in the stipulated manner. Therefore, the consideration given by the option-holder deprives the grantor not merely of the right to revoke the option lawfully but of his power to revoke it effectively.

In the local case of In Re Yap Kwan Seng,[4] the court held that the Rule against Perpetuities did apply to the Federated Malay States (F.M.S.). In Pearson v. Aotea District Maori Land Board,[5] a New Zealand case, it was held that since the Land Transfer Act, 1952[6] was not intended to alter the substantive law of property more than is necessary to effect the purposes of the Act, the Rule against Perpetuities did apply to dealings under the Act. Therefore, it is submitted that the Rule against Perpetuities should similarly apply to dealings effected under the F.M.S. Land Code, 1926,[7] although the Code is silent on this point. Thus, leases registered under the F.M.S. Land Code, 1926[8] may be invalid if they offend against the Rule governing Perpetuities.

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[4]Supplement No. 1 to the S.S.L.R. 1.

[5][1945] N.Z.L.R. 542.

[6] No. 52 of 1952.

[7]Cap.138.

[8]Ibid.

In several English cases, the courts have held that whereas options for purchase create equitable interests in the subject property and are governed by the Rule against Perpetuities, options for renewal which also create equitable interests in the subject property are exempt from the Rule against Perpetuities. Unfortunately, no reasons whatsoever have been given for treating the latter differently from the former although one enterprising judge did try to distinguishthe two in one case.[9]

In Woodall v. Clifton,[10] a lease of land for 99 years was granted in 1867. It contained a proviso that in case the lessee, his heirs or assigns, should at any time during the term be desirous of purchasing the fee simple of the land at the rate of 500l. per acre, the lessor, his heirs or assigns, on receipt of the purchase money, would execute a conveyance of the land in favour of the lessee, his heirs and assigns. In 1904 an action was brought by an assignee of the lessee, who had given notice of his desire to exercise the option, against assigns of the lessor to compel a conveyance of the land accordingly.

The issue before the court was whether the options were valid and subsisting options. This in turn depended on the question whether having regard to the fact that the

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[9] Muller v. Trafford [1901] 1 Ch. 54 at p. 60.

[10] [1905] 2 Ch. 257 - C.A.

option was one which may be exercised at any time during the period of 99 years from June 24, 1866, that is to say, for a period exceeding 21 years, it is void as infringing the Rule against Perpetuities. The Rule against Perpetuities is a rule which fixes the limit of time, now accepted as a life in being or lives in being and 21 years afterwards, within which every executory limitation, not being a limitation subsequent to an estate tail, must necessarily vest, if it vests at all, on pain of being otherwise void.

Warrington J. held that the covenant ran with the land making it an interest in land and an interest in land which was not vested in the lessee at the moment of the lease, but one which came into existence only on the happening of a future event, namely the exercise of the option and the payment of the purchase money and that therefore the two covenants to purchase were not valid and subsisting options. But he felt that covenants to renew were undoubtedly valid although he could find no authority except for the dicta of Farwell J. in Muller v. Trafford[11] which contradicted rather than justified the validity of options to renew. The dicta reads:

"A covenant to renew has been held for at least

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[11] Op. cit. n. 9.

two centuries to be a covenant running with the land. It must bind the land from its inception, because it would otherwise be an executory interest in land arising in futuro, and therefore abnoxious to the rules against perpetuity. Perpetuity has no application to covenants which run with the land as to create something in the nature of an interest in the land. As between lessor and lessee, therefore, the lessee accepts and the lessor grants something which is more or less, according to the point of view from which you look at it, than the actual term or interest granted. It is a term subject to something with the benefit of something. It is reversion subject to something and with the benefit of something, and those two somethings are annexed to and form part of the land from the beginning of the term in such a sense that the doctrine of perpetuity has no application."[12]

To this argument, Warrington J. has this to say:

"[The] dicta of the learned judge ... amounts to this - that the covenant to renew runs with the land, and that being so the doctrine of perpetuities has no application... I confess I do not see why that fact takes it out of the

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[12] Op. cit. n. 9 at p. 60.

> mischief that it infringes the Rule against Perpetuities. I should have thought, on the contrary, it was just that fact which did create an interest in land, that if it was a mere personal and collateral covenant, it might well be argued that it had no such effect ..."[13]

In Rider v. Ford[14] there was an agreement for a lease which provided that the prospective tenant should "take the house for 3, 5 or 7 years, and have the option of purchasing either the freehold or a lease of 97 years". The tenant entered into possession but no lease was ever executed. The court held that the option to purchase the freehold being unlimited as to time was void, under the Rule against Perpetuities. But since the option to purchase the lease was in fact an option to call for a lease, it was outside the Rule against Perpetuities, and was exercisable so long as the relationship of landlord and tenant existed. The court also held that an option to call for a lease was outside the Rule against Perpetuities, although the terms of the new lease were not the same as the terms of the original lease.

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[13] Op. cit. n. 10 at pp. 263 - 264.

[14] (1923) 1 Ch. 541.

In Wag Motors Ltd. v. Hales & Ors.[15] there was an agreement for a lease which contained an option for renewal. When the lessor failed to renew the lease on notice by the lessee, the lessee sued for specific performance. The court held that the obligation under the agreement was within the long-established immunity enjoyed by covenants torenew from the Rule against Perpetuities. The court arrived at its decision after conceding that the basis and the justification for the exception appeared lost somewhat "in the mists of antiquity".

The decisions in the above cases establish that although options to purchase are invalid if they offend against the Rule against Remoteness of vesting, yet options to renew a lease or to call for a lease are valid even if they offend against the Rule against Perpetuities. It is to be noted however that the cases are English cases and since no case has yet gone before the Federal Court it is submitted that it may yet be possible that the Federal Court might reject options for renewal if they do not comply with the limitation period or perpetuity period notwithstanding that they are recognised as exceptions to the general rule in England.

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[15] [1961] 3 W.L.R. 558.

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Another disadvantage of the lease is that banks are reluctant to accept the lease of a flat as security for a loan.

B. THE HOME-UNIT COMPANY SYSTEM

Under the home-unit company system, ownership of specified shares carries with it the right to occupy particular parts of a building. This method of providing home-ownership is not as popular as the other methods because to the writer's knowledge only two companies in Kuala Lumpur operate along this basis. Developers prefer to either lease, or sell an undivided share. The reason is that being businessmen, they are unwilling to go to the expense and trouble of floating a company. Another reason is that as long as the flats are in existence the company has to be kept going.

A home-unit company operates in this way. A group of people get together and form a company which is then incorporated under the Companies Act, 1965.[16] The main object of the company is to acquire certain lands together with the block or blocks of flats erected on the land. The share capital of the company is divided into shares of different classes, each class corresponding to a particular type of flat, e.g.:

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[16] Act 125.

A shares of $9,000/- each (10 ground floor flats).
B shares of $10,000/- each (11 ground floor flats).
C shares of $10,500/- each (12 ground floor flats).
D shares of $9,000/- each (10 first floor flats).
E shares of $9,500/- each (12 first floor flats).
F shares of $10,000/- each (2 first floor flats).
G shares of $8,000/- each (10 second floor flats).
H shares of $8,500/- each (12 second floor flats).
I shares of $9,000/- each (2 second floor flats).
J shares of $7,000/- each (10 third floor flats).
K shares of $7,500/- each (12 third floor flats).
L shares of $8,000/- each (2 third floor flats).

The company's memorandum of association provides that each shareholder shall be permanently entitled to occupy a flat appropriate to his share for a specified term of years. Having disposed off all the shares of the company and having granted leases of flats what is then left of the company's business is the management and maintenance of the land and those parts of the building not covered by the flats or the common property. The control of the complete building is left to the Board of Directors of the company. The duties of the company are, inter alia, to collect the rents (nominal only, sometimes as little as $1.00 a month), to supply the lessees and the occupiers of the flats with electricity and telephone facilities,

hot and cold water, lifts and all services of every description which may seem expedient to the company, to maintain and repair, re-erect, alter and improve the land and the block of flats. On the other hand the lessees and occupiers of the individual flats have to contribute to the rates, any additional charges or rates for supply of water, in respect of sewerage or drainage, quit rent, insurance premiums, cost of repairs and maintenance, wages for labourers employed for cleaning corridors, gardeners, etc; electricity for lighting the common property and fees of directors and secretaries.

The home-unit company system suffers from several disadvantages. There is no free assignability of the lease held by the shareholder of the company. The articles of association restrict the rights of members of the company to transfer their shares. Shares are only to be transferred singly and no transfer of a share by a member can be registered unless and until he has duly executed a transfer of the lease of his flat or right to occupy the flat permanently in favour of the transferree of the share. Therefore, a shareholder cannot sell his share withiut also transferring the lease of his flat at the same time. Another restriction imposed by the articles of association on transfer and transmission is the discretion given to the Board to refuse to register or transfer a share. The Board is

not bound to give reasons for such refusal. In this way the Board retains a considerable degree of control which it exercises for the purpose of excluding undesirable tenants. Thus it is the Board which decides the ultimate composition of the flat-dwellers.

Another defect is that it is harder to raise money on shares in a company than on real property since banks, finance companies and other lending bodies will not lend money on security of shares in home-unit companies. This gives rise to financial difficulties.

Courts will not recognise the shareholder as the owner of his flat. In Tittman v. Traill[17] the Supreme Court, in the course of hearing a claim by such a shareholder for relief under the Landlord and Tenant Act, stated:

> "Although it is true that, under the home-unit scheme adopted by the company, the holding of the specific shares in question conferred rights in relation to a specified flat and garage, nevertheless the ownership of the shares could not, as such, be regarded as equivalent to or as including any estate in the land owned by the company, or in any part of it. Any right which

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[17] (1957) 74 W.N. 284.

> the shareholder had in relation to the premises was a contractual right and not a proprietary right".

It therefore, held that the shareholder could not pursue the normal legal remedies of a landowner, such as trespass, ejectment, etc.

The fourth disadvantage is that this device is an expensive way of achieving ownership of a flat because of the money involved in floating the company.

The most serious disadvantage is that it contravenes the common law principle that a company is prohibited from returning its share capital to its shareholders. This common law principle has been embodied in Section 64 of the Companies Act, 1965.[18] Any return of capital will be declared void unless it is in accordance with Section 64. Any attempt by a company to return capital to its shareholders will be ultra vires even though the memorandum of association expressly provides for such a return unless it is in accordance with Section 64.

Under the home-unit company system, a person who wants a lease of a flat owned by the home-unit company has to subscribe for one share in the company.

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[18] Act 125.

In return for the value of the share fully paid by him, he is given a lease of a flat appropriate to the share. This means that the shareholder is also the lessee of one of the company's flat. He is not allowed to divorce his ownership of the share from his ownership of the lease. The two, namely, the share and the lease, must go together, since it is the holding of the share which entitles him to the ownership of the lease. If he wishes to transfer his share he must also transfer his lease and vice versa. In subscribing for a share of the company the payment of the value of the share goes to the company as part of its share capital. It is with this share capital that the company acquires the land and the block of flats. By giving the shareholder a lease of one of its flats, the company has therefore returned indirectly part of its share capital to its shareholder. It is true that there is no actual return of part of the company's share capital in the form of cash or money. And it is also true that a lease merely gives possession and not ownership since the reversionary interest will vest in the company once the lease determines or expires.

In Trevor v. Whitworth[19] the House of Lords laid down the common law rule that a company is prohibited from

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[19](1887) 12 App. Cas. 409.

entering into a transaction with a shareholder, by means of which the money already paid to the company in respect of his shares is returned to him, unless the court has sanctioned the transaction. Lord Watson held that paid-up capital may be diminished or lost in the course of the company's trading, a result which no legislation can prevent; but persons who deal with, and give credit to a limited company, naturally rely upon the fact that the company is trading with a certain amount of capital already paid, as well as upon the responsibility of its members for the capital remaining at call; and they are entitled to assume that no part of the capital which has been paid into the coffers of the company has been subsequently paid out, except in the legitimate course of its business.

In Australasian Oil Explorations Ltd. v. Lachberg,[20] the High Court of Australia again reiterated that "the fundamental principle"of company law is that "the whole of the subscribed capital of a company with limited liability, unless diminished by expenditure upon the company's objects (or, of course, by means sanctioned by statute) shall remain available for the discharge of its liabilities".

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[20](1958) 101 C.L.R. 119.

In Jenkins v. Harbour View Courts Ltd.[21] a home-unit company had erected a building of flats and contracted to grant to each holder of certain of its shares a lease for 99 years of one of such flats, the rental being only sufficient to meet outgoings but otherwise nominal. The plaintiffs had entered into such a contract under which she had paid the company £3,580 and received an allotment of 3,580 shares. Before a lease had been granted in her favour, the company (the first defendant in the action), which was encountering serious financial difficulties, sold the building to a third party (the second defendant in the action). The plaintiff sought a declaration that she was entitled to an interest in the property as lessee, and specific performance of the contract (between the first defendant and herself) to grant her a lease. The objection was raised that the grant of a lease in these circumstances was ultra vires the company because it amounted to a return of capital to shareholders by the company and hence could not be enforced specifically by the court.

The Supreme Court of Auckland held that the essence of the transaction was a return of part of its capital by the company to its shareholders and as such it was ultra vires the company. Turner J. based his

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[21] [1966] N.Z.L.R. 1.

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[21] [1966] N.Z.L.R. 1.

decision on the following reasons:

> "Here was a company whose nominal capital was one million pounds ... It appears that all the shares in the company were to be held by lessees of its premisies, and by lessees only ... after incorporation shares were alloted to a number of applicants ... a substantial aggregate amount of money had been paid ... to the company by subscribers for shares. This fund, or the assets on the acquisition or improvement of which it had been expended, or what remained of it, or them, after transactions intra vires of the company, was at the date of allotment to the appellant the capital of the company, available to meet the company's obligations to outside persons with whom it might transact business. As a matter of fact, ... the original monetary fund had been entirely, or almost entirely, expended on the acquisition of the piece of land with which this appeal is concerned and the erection upon it of flats; ... But it cannot be contested that at all material times with which we are concerned the capital of this company consisted substantially of a piece of land and some buildings upon it, and of nothing else; and it is a fundamental principle of company law that the whole of a company's capital, unless

> diminished by expenditure on its objects, must remain available for the discharge of its liabilities".[22]

The transaction was one of a series of transactions, the total effect of which was to be that substantially the whole of the land with the buildings erected and to be erected thereon, is to be made the subject of like leases, all for something like 99 years, all to shareholders, and all for no rental in the form of landlord's reward to the company. In other words, the transaction was a part of a process by which the company is to transfer away, for no return, all its beneficial estate in its undertaking for the next 99 years, to its shareholders, retaining for itself only the reversion of its property after the terms had expired. Thus, the learned judge held that he had no hesitation at all in concluding that it was, in factual essence, as much a return of capital fo shareholders as if, from a fund of money, a substantial part were handed out for distribution among them. He cited the following passage from Lord Hershel's judgment in Trevor v. Whitworth:[23]

> "The result ... is the same. The shareholders receive back the moneys subscribed, and there

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[22] Ibid. at p. 22.

[23] Op. cit. n. 19 at p. 416.

passes into their pockets what before existed in the form of cash in the coffers of the company, or of buildings, machinery, or stock available to meet the demands of the creditors".

and continued on to say:

"Here what passed to the shareholders was not money, but a beneficial estate of leasehold; but 'the result is the same' ".[24]

Counsel for the plaintiff had submitted that while the transaction might resemble a return of capital, yet the capital of the company - its estate in the land - remained intact notwithstanding the lease for 99 years, and would return to the company after the expiration of the term of the lease. However Turner J. held that the transaction was in essence one in which the company divested itself of part of its undertaking in favour of a shareholder otherwise than in the course of a bona fide transaction entered into as a matter of contract, and not as a company shareholder transaction. As such the company had given away the enjoyment of its property for the next 99 years which was equivalent to having divested itself of a real part of its asset. What was left was merely the reversion - the reversion of the whole

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[24] Op. cit. n. 21 at p. 23.

it is true, but immediately worth only a small part of the present worth of the whole; and it had done this in favour of a shareholder as one of a series of transactions in which other shareholders were to be similarly benefitted. It was therefore a "return of capital in a plain and obvious form".

The Solicitor-General argued that the transactions were intra vires the company because they were within the provisions of the memorandum and articles of association. Article 4 reads as follows:

> "The original capital of the company is £1,000,000, divided into 1,000,000 shares of £1 each, whereof 400 shares are A class shares, and 999,600 are ordinary shares. Each A class share shall confer on the holder thereof a right or licence to occupy the dwelling unit to be held upon the terms and conditions as appears in the memorandum of lease in the schedule hereto, or such variation or variations thereof as may be approved by the directors, and contemporaneously with the allotment of such share the company shall enter into and execute the said memorandum between the company as lessor and the shareholder as lessee".

Those dealing with the company, he argued, did so with notice of these provisions, and could not complain because they could see that the company's capital was liable to the substantial erosion effected by such transactions. But his argument was rejected on the ground that if such was the law, a company could, by giving itself power to purchase its own shares, validly repurchase from its shareholders shares on which a liability was outstanding, and so at one blow relieve them from further liability and dissipate funds which the law obliges it to hold at the disposal of its creditors.

As a result of the decision of the Supreme Court of Auckland in Jenkins v. Harbour View Courts Ltd. & Ors.,[25] the New Zealand Legislature had to amend the Companies Act, 1955.[26] If this had not been done the very existence of home-unit companies would have been rendered impossible. The amendment provides that in cases of home-unit companies there is no return of capital contrary to Section 75 of the Companies Act, 1955.[27] It abrogates the rule laid down by the Court of Appeal in

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[25] Op. cit. n. 19.

[26] No. 63 of 1955.

[27] The amending Act is the Companies Amendment Act (No. 2 of 1955).

Jenkins's case.[28] The relevant section is the new Section 30A which states:

> "(1) Notwithstanding anything in this Act or in any rule of law, any grant (whether made before or after the commencement of this section) by a company to a shareholder of the right to occupy or use any specified land owned by the company or any specified building owned by the company pursuant to a provision in the aticles of the company entitling him as the registered holder of specified shares in the company to that occupation or use shall be deemed not to be and never to have been a return of capital by the company to the shareholder."

In Malaysia, the Companies Act, 1965[29] has not been amended. Consequently, it would appear that based on the authority of Jenkins's case[30] leases of flats granted by home-unit companies in Malaysia to their shareholders constitute a return of capital and are ultra vires and the leases are invalid. Section 74 of the New Zealand

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[28] Op. cit. n. 19.

[29] Act 125.

[30] Op. cit. n. 19.

Companies Act[31] is similar to Section 64 of the Malaysian Companies Act.[32] The writer submits that Parliament should likewise amend the Companies Act, 1965[33] to enable home-unit companies to function here.

C. THE SALE OF AN UNDIVIDED SHARE

Perhaps the most popular device employed by housing developers and entrepreneurs of flat schemes is the sale of an undivided share. The developer on the completion of the construction of the flats applies for the subdivision of the land on which the block of flats stands, not horizontally but vertically, into separate lots, each to be held by him under a separate title. He then proceeds to sell off the flats on each separate lot individually to separate purchasers. If there are four flats standing on one lot the purchasers of the four flats are registered on the title to the lot as proprietors of a quarter undivided share each. A plan of the building is attached to the title showing the exact interest of each purchaser to prevent any dispute later on.

Although this method comes very near to conferring actual home-ownership since the purchasers are registered as proprietors of a quarter undivided share each, a

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[31] No. 63 of 1955.

[32] Act 125.

[33] Ibid.

number of problems can arise. Since there is only one title it is left to the parties to work out among themselves who should hold the title and how much each should pay towards the quit rent, assessments and the cost of maintaining the staircase, corridors, the roof, the drains and the common property.

Registration is theoretically and physically possible where the building has only a few storeys. But where the building has as many as twenty, thirty or more storeys it is physically impossible though it is theoretically possible for the Registrar of Titles to register the names of all the proprietors on one single title having a very limited surface aeea. The problem becomes more acute when there are dealings affecting the flats, such as leases, transfers, charges, ete. These have to be recorded down in the title. Besides one co-proprietor has to obtain the consent of all the other co-proprietors before he can lease, transfer or otherwise deal with his flat. He is thus seriously hampered and hardly enjoys the benefits which ownership of a house on ground level affords its owner.