

# Speculum Juris

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## A PROPOSAL FOR CURBING EXCESSIVE DIRECTORS' REMUNERATION\*

### 1 Introduction

Although directors' remuneration has been formally recognised as a core aspect of corporate governance since 1994 by the King Report on Corporate Governance (King I),<sup>1</sup> it has still not been satisfactorily addressed by our corporate law. This shortcoming impairs our entire corporate governance system. It is clear that legislative disclosure requirements, compulsory remuneration committees for listed companies and market forces have failed to curb the excessive rise in directors' pay. This note supports the argument that this rise will be curbed by introducing an advisory vote on directors' remuneration similar to that recently introduced in the United Kingdom (UK).<sup>2</sup> There is now evidence that the UK approach is proving successful,<sup>3</sup> and South African shareholders have recently voted against excessive directors' pay.<sup>4</sup> The time is therefore ripe seriously to consider introducing the UK approach in South Africa.

South African directors continue to receive lucrative and (arguably) excessive remuneration. For example in 2004, the average chief executive officer package was R4.3 million excluding share options, the average chief financial officer package was R2.6 million excluding share options, and the average executive director received a total package of R2,4 million.<sup>5</sup> These figures raise vexing questions such as: why should we care about excessive directors' remuneration? and, what practices and policies must be followed in determining appropriate directors' remuneration?

We should care about directors' remuneration for two main reasons.<sup>6</sup> The first reason is because remuneration has an undeniable effect on how directors

\* I am indebted to the Emerging Researcher Programme at the University of Cape Town for supporting the writing of this paper. I am also indebted to Professor Richard Jooste for his incisive comments on earlier drafts of this paper. However, all any errors remain entirely mine.

1 The Institute of Directors in Southern Africa *The King Report on Corporate Governance* November 1994.

2 See Mongalo "Shareholder activism in the United Kingdom highlights the failure of remuneration committees: lessons for South Africa" 2003 *SALJ* 756.

3 Deloitte and Touche (2005) "Report on Directors' Remuneration Report Regulations 2002", written statement to parliament by Patricia Hewitt (25 January 2005). Roach "CEOs, chairmen and fat-cats: the institutions are watching you" 2006 *Comp Law* 297 302-3 gives the following examples: In 2003 GlaxoSmithKline shareholders voted against an £11 million remuneration package and a golden parachute of up to £22 million for CEO Jean-Pierre Garnier. In the same year Aviva shareholders voted against the company's remuneration policy. The threat of shareholders voting against the remuneration policy led Prudential to withdraw excessive packages in May 2003.

4 "The mouse that roared" *Business Day* 31 October 2005.

5 Mabili Search & Selection *Directors' Remuneration Report 2005* 3.

6 These have been discussed at length in academic publications and in the media. For example, see Mongalo 2003 *SALJ* 767-760; "Why we should care about excessive pay" *Business Report* 3 November 2005; "Executive pay: a moral dilemma" 2006 *Management Today* 10; Bussin & Huysamen "Factors driving changes to remuneration policy and outcomes" 2004 *SA Journal of Human Resource Management* 45; Digue "Remuneration – connected to performance targets" 2006 *Management Today* 44.

manage their enterprise. This is evident from a cursory glance at local business news. For example, a recent press report entitled “Fears over FirstRand shares for black directors”<sup>7</sup> expressed the concern that after non-executive directors had been awarded huge monetary benefits by the issuing of shares largely by executive directors, the non-executive directors would be beholden to the executive directors, and as a result would be unable to maintain their independence. In other words, as the executive directors determine the pay packages of non-executive directors, the non-executive directors may be inclined to turn a blind eye to executive excesses or errors in the management of the enterprise. Colloquially, the unspoken agreement would be: “You scratch my back and I scratch yours. I will award you high pay packages, and you let me run the company as I like.”

The second reason is that corporate governance seeks “to align as nearly as possible the interests of individuals, corporations and society”.<sup>8</sup> There needs to be a balance between the rewards an individual director reaps, and employee salaries, the enterprises’ success and the interests of society generally.<sup>9</sup> Excessive directors’ remuneration skews this balance and often receives public criticism, as was shown by another recent press report which criticised Kumba directors for increasing their remuneration whilst simultaneously seeking to retrench workers.<sup>10</sup> This incident showed a clear disregard for the enterprise, employees and society: the enterprise was obviously suffering, hence the need for retrenchments, which would adversely affect society by swelling the numbers of the unemployed.

Our corporate law does not answer the question relating to the determination of appropriate directors’ remuneration in the sense that there are no legislative limits on the amounts paid or how they are to be determined. Similarly, the current law reform process<sup>11</sup> does not focus on this issue. The main reason for this legislative oversight is the strongly held view that such matters are the responsibility of shareholders and the companies concerned.<sup>12</sup> The most prominent proponent of this view is the Chairman of the King Commission, Mervyn King, who stated that “global market forces will sort out those companies that do not have sound corporate governance”.<sup>13</sup> Some academics and practitioners also subscribe to this view.<sup>14</sup>

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7 *Business Report* 20 April 2005 (accessed 5-05-2005).

8 *King Report on Corporate Governance for South Africa* (2002) (hereinafter *King II*) 7.

9 *Mongalo Corporate Law & Corporate Governance: A Global Picture of Business Undertakings in South Africa* (2003) 213 and 219.

10 “Kumba directors setting a bad example” *Sunday Times* 8 April 2005 (accessed 5-05-2005).

11 For a full history of the reform process see Government Gazette, 23 June 2004 No 26493 *South African Company Law for the 21st Century: Guidelines for Corporate Law Reform* 1.1 – 2.3.

12 PriceWaterhouseCoopers (PwC) *Corporate Governance in South Africa: a comparison of the King Report 2002 and the Sarbanes-Oxley Act of 2002* 10 (accessed 17-07-2005).

13 *Ibid.*

14 Maluleke “The link between corporate law and corporate governance” 2005 *Speculum Juris* 63 106 and Cadbury “Corporate Governance”, text of the annual London Lecture of the Association of Certified Accountants in Certified Accountant, June 1993 47. However, it is argued in Belcher “Regulation by the market: the case of the Cadbury Code and Compliance statement” 1995 *Journal of Business Law* 321-342 that market forces are ineffective.

However, whilst accepting that the ultimate responsibility for remuneration policy and practice lies with shareholders, a better view is that government has a crucial role to play through creating an environment which enables shareholders to have a voice in remuneration policy and practice. As succinctly stated by the United Kingdom's Department of Trade and Industry:

"The remuneration policies and practices of quoted companies, and the determination of the remuneration packages of executive directors are a matter for the boards, remuneration committees and shareholders of those companies. It is for shareholders, not Government, to decide whether executive pay is set at appropriate levels and whether it adequately reflects performance. The Government has a role, however, in ensuring that the legislative and corporate governance framework is effective and promotes transparency and accountability to shareholders."<sup>15</sup>

It would have therefore been a good idea to make some provision in the reform documentation for the creation of an enabling environment for shareholders to drive directors' remuneration policy and practice through the advisory vote. Before elaborating this point, I will briefly outline the current state of affairs.

## 2 Current regulation of executive remuneration

In practice, the process for determining directors' remuneration is provided for in the Articles of Association (articles). Companies, upon incorporation, elect whether or not to use the articles provided in Schedule 1 to the Companies Act. If they opt out of these default articles they draft their own articles. I will only discuss the position under the default articles here. The articles provide that "the remuneration of the directors shall from time to time be determined by the company in general meeting".<sup>16</sup> This means that a resolution of the general meeting must be duly passed, but a formal resolution need not be passed if all the shareholders entitled to attend and vote have approved the remuneration.<sup>17</sup> Directors will have indirectly determined their own remuneration in the sense that they make recommendations to the general meeting which usually just approves it without interrogating it; the meeting merely "rubber-stamps" the directors' recommendation. Executive directors' remuneration is set directly by the board of directors.<sup>18</sup> The involvement of directors in determining their pay indisputably contributes to excessive rises. It is after all human nature to serve our own interests above those of others.

Our corporate law places some requirements on the process only at this stage, through binding disclosure requirements in the Companies Act and the Johannesburg Stock Exchange (JSE) Listing Requirements on all companies and on listed companies respectively. Therefore it is fair to say that the law does not concern itself with remuneration policy and practice, it only demands disclosure of what companies have decided.

Section 297 of the Companies Act does not require disclosure in respect of individual directors. It only requires disclosure of the aggregate amount of the emoluments received by the directors as a group including:

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15 Department of Trade and Industry "Rewards for Failure" *Directors' Remuneration: Contracts, Performance and Severance: A Consultative Document* June 2003.

16 See Schedule 1 Table A art 54 and Table B art 55 of the Companies Act.

17 *Re Duomatic Ltd* 1969 2 Ch 365; *Re Halt Garage (1964) Ltd* 1982 3 All ER 1016 1024.

18 See Schedule 1 Table A art 61 and Table B art 62.

1. basic salary;
2. bonuses and performance related payments, sums paid by way of expense allowances;
3. the estimated monetary value of other material benefits received;
4. gains made on the exercise of share options;
5. the amount of the pensions paid or receivable by directors and past directors; and
6. details of directors' service contracts.

The information above is to be categorised into two sections; one for executive directors and the other for non-executive directors.<sup>19</sup>

Listed companies are required by para 8.63(1) of the JSE Listing Requirements to provide a more detailed disclosure than the Companies Act, in the sense that disclosure must be made in relation to individual directors. Companies' annual financial statements must disclose, in relation to the whole board and individual executive and non-executive directors, emoluments paid or receivable by the directors in their capacity as directors or otherwise. These emoluments include service fees, expense allowances, other material benefits received, pension scheme contributions, commission, gain or profit-sharing arrangements and share options. Details pertaining to share options must include their strike price and when and at what price they have been exercised and any other relevant information. Paragraph 3.84(d) requires listed companies to have remuneration committees in compliance with the King Report on Corporate Governance for South Africa (King II).<sup>20</sup> Remuneration committees have however been unsuccessful in curbing excessive pay.<sup>21</sup> In the UK, shareholders have stepped into the gap and are exerting a more meaningful impact on directors' pay through the advisory vote.

### 3 Lessons from the United Kingdom

The UK has focused intensely on executive remuneration since 1999, when it carried out its first consultation through a consultative document entitled "Directors' remuneration".<sup>22</sup> It made a number of recommendations aimed at enhancing transparency and accountability. In 2001 further consultation was conducted, specifically seeking views on draft regulations on directors' remuneration.<sup>23</sup> It resulted in the introduction of the Directors' Remuneration Report Regulations 2002 which apply to listed companies.<sup>24</sup> All other companies are regulated by Schedule 6 of the Companies Act 1985 which requires companies to make certain

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19 Section 297(1A).

20 Clause 2.5.2

21 For a full discussion of remuneration committees see Mongalo 2003 *SALJ* 756 and Chartered Institute of Personnel and Development (CIPD) "Comments from the CIPD on the DTI consultation paper September 2003" [http://www.cipd.co.uk/about/\\_rewfail.htm](http://www.cipd.co.uk/about/_rewfail.htm) (accessed 06-07-2005); Hemraj "Spotlight on executive remuneration" 2005 *Comp Law* 149

22 Department of Trade and Industry (DTI) *Directors' Remuneration: A Consultative Document* July 1999.

23 DTI "Rewards for Failure" *Directors' Remuneration: Contracts, Performance and Severance: A Consultative Document* June 2003.

24 Directors' Remuneration Report Regulations 2002 (S.I. 2002/1986).

disclosures concerning directors' remuneration in notes to the company's accounts. The Directors' Remuneration Report Regulations 2002 require disclosure of information concerning directors' remuneration in the directors' remuneration report.<sup>25</sup>

The Directors' Remuneration Report Regulations 2002 provide for the preparation, approval, signing and auditing of a remuneration report.<sup>26</sup> They "strengthen the crucial role of the remuneration committee and the shareholders . . . [and] introduce *new disclosure requirements on remuneration policy and an advisory vote on the remuneration report for shareholders*".<sup>27</sup> Further, they also introduced a requirement for an enhanced disclosure on directors' contracts policy and an explanation of severance payments. These measures benefit shareholders in two main ways. First, a disclosure of the remuneration policy will enable shareholders over time to monitor and contribute to the development of the remuneration policy. Secondly, shareholders, through the advisory vote, will be able to express their views "if they are not satisfied that a company's policy and practice in this area is sufficiently robust".<sup>28</sup> I shall argue below that this provision could be adopted in South Africa.

In June 2003 another consultative document entitled "Rewards for Failure Directors' Remuneration: Contracts, Performance and Severance" was issued. It focused on "directors' contracts, performance, and severance payments and the linkage between them" and sought views on any measures "required to enable shareholders to ensure that compensation reflects performance when directors' contracts are terminated".<sup>29</sup> This consultative document has not yet resulted in legislation, as respondents strongly opposed further legislation on directors' remuneration. Guidelines are seen as the most appropriate way to proceed.<sup>30</sup> Similarly, I would argue that the way forward for South Africa would be to adopt guidelines rather than legislation.

### 3.1 Impact assessment of UK regime

The Department of Trade and Industry (DTI) commissioned an impact assessment of the Directors' Remuneration Report Regulations 2002 by Deloitte and Touche LLP (Deloitte). The resultant report entitled "Report on Directors' Remuneration Report Regulations 2002" (The Deloitte Report) was completed in November 2004 and published in January 2005.<sup>31</sup> The main objectives of the report were to assess the extent to which companies were complying with the regulations, whether or not company remuneration policies and practices had been changed by the regulations, and whether any aspects of the disclosure requirements should be improved.<sup>32</sup>

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25 Regulation 3.

26 Regulations 3-4, 7-8.

27 DTI "Rewards for Failure" *Directors' Remuneration: Contracts, Performance and Severance: A Consultative Document* 7 (my emphasis).

28 *Ibid.*

29 *Ibid.*

30 The Association of British Insurers, the National Association of Pension Funds and the Confederation of British Industries have issued guidelines on directors' remuneration and severance packages. These are not discussed here.

31 Available at [www.dti.gov.uk/cld](http://www.dti.gov.uk/cld) and [www.deloitte.com/dtt/cda/doc/content/UK\\_Tax\\_DirectorsRemunerationReport.2004.pdf](http://www.deloitte.com/dtt/cda/doc/content/UK_Tax_DirectorsRemunerationReport.2004.pdf) (both accessed 13-07-2005).

32 Deloitte and Touche "Report on Directors' Remuneration Report Regulations 2002" 1.

Deloitte focused on the 350 largest companies by market capitalisation listed on the London Stock Exchange as at August 2004.<sup>33</sup> The report concluded that all of these companies complied with the regulations. For example, in the past few of these companies had put directors' remuneration to a separate shareholder vote. But since the promulgation of the regulations, all of the companies were now placing their remuneration reports for approval by shareholders.

Deloitte then focused on the content of the remuneration reports to evaluate the quality of disclosure. It found that whilst there was substantial compliance, there were several areas where the targeted companies fell short. Some of these areas included disclosure about the reasons for choosing performance conditions for share options and other long term incentive plans. The reasons for this were found to be due to a lack of clarity in the wording of the regulations themselves. Companies were not sure exactly what they were required to disclose.<sup>34</sup> The Deloitte Report makes recommendations to amend the regulations to achieve clarity and encourage compliance.

The Deloitte Report then sought to establish whether or not the remuneration report enabled shareholders to assess the link between company performance and directors' remuneration. It found that whilst the regulations made the picture much clearer for shareholders, there was still room for improvement. However, <sup>legislation</sup> was not the best vehicle for this and guidelines would be more suitable.<sup>35</sup>

Independent assessors have discussed the impact of the above regime. For example, a recent comparison of the differences in executive pay between the UK and the United States notes that UK directors earn approximately half of what their counterparts earn in the US and attributes this directly to the shareholders' advisory vote.<sup>36</sup> The UK Chartered Institute of Personnel and Development (CIPD) has also acknowledged that the Directors' Remuneration Report Regulations 2002 had an immediate impact on directors' pay, and that it supported them.<sup>37</sup> The Directors' Remuneration Report Regulations 2002 are proving to be successful so far.<sup>38</sup>

#### 4 Conclusion: South Africa is ready to follow the UK

South African shareholders have already flexed their muscles and voted against directors pay resolutions. For example, in October 2005 20% of Shoprite shareholders voted against the R59 million remuneration package awarded to Shoprite's

33 Deloitte and Touche "Report on Directors' Remuneration Report Regulations 2002" 4.

34 Deloitte and Touche "Report on Directors' Remuneration Report Regulations 2002" 5.

35 Deloitte and Touche "Report on Directors' Remuneration Report Regulations 2002" 5-6.

36 "Why British CEOs earn less than their US counterparts" Wall Street Journal Online 17 April 2006 <http://www.careerjournal.com/salaryhiring/industries/seniorexecs/20060417-ossinger.html> (accessed 25-08-2006).

37 (CIPD) "Comments from the CIPD on the DTI consultation paper September 2003".

38 There are concerns that the advisory vote may not be enough, as individual shareholders may not be able to use the vote effectively, and that rather it is *institutional shareholders* who are in a better position to use the advisory vote effectively. See Roach 2006 *Comp Law* 297 and Roach "The directors' remuneration report regulations 2002 and the disclosure of executive remuneration" 2004 *Comp Law* 141. It has also been argued that creditors should play a more prominent role in remuneration policy and practice. See Moore "Director's pay as a creditors' concern: the lesson from MG Rover" 2006 *Comp Law* 237.

CEO.<sup>39</sup> It is submitted that South Africa should follow the UK's successful lead and consider issuing regulations on executive remuneration. In particular, provision should be made for the preparation of remuneration reports and a shareholders' advisory vote on directors' remuneration. Cognisance should be taken of the recommendations made by the Deloitte Report, so that any South African regulations promulgated are clear and enable full and proper compliance. It is not contended here that full-scale legislation covering all aspects of executive remuneration be enacted in South Africa, but rather that regulations providing for disclosure should be enacted for larger companies. Such legislation will ensure transparency and hopefully abate some of the fears surrounding executive remuneration. For instance, it will be easier for concerned persons to analyse the link between remuneration and performance.

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<sup>39</sup> "Shareholders raise hell over Basson's package" *Business Day* 28 October 2005.

**THE PLIGHT OF A WIDOW OF AN UNREGISTERED CUSTOMARY  
MARRIAGE ENTERED INTO IN TERMS OF THE TRANSKEI  
MARRIAGE ACT 21 OF 1978: *WORMALD NO v KAMBULE* 2006 3 SA  
562 (SCA)**

## 1 Introduction

The recent decision of the Supreme Court of Appeal in the above-mentioned case is, with respect, a retrograde step and takes us back to the inequitable decision of the Transkei Division of the High Court in *Kwitshane v Magalele* 1999 4 SA 610 (Tk). The latter judgment was overruled by the judgment of the full bench in *Sokhewu v Minister of Police* (case no 293/94, unreported). The *Sokhewu* case was followed in *Feni v Mgudlwa* (case no 24/2002, unreported). The decision of the Court *a quo*, reported as *Wormald NO v Kambule* 2004 3 All SA 392 (E), reviewed the various decisions of the Transkei Division of the High Court, and followed the *Sokhewu* approach. The decision in the *Kwitshane* case has been criticised in a few publications. See, *inter alia*, Mqeke "The Rights of Widows in Unregistered Customary Marriages in the Transkei – A Disappointing Decision: *Kwitshane v Magalele* 1999 4 SA 616 (Tk)" 2000 *Obiter* 231; Malefane "South African Customary Law at the Cross Roads. What is Our Customary Law of Marriages?" 2005 *WSU Law Journal* (formerly the *Transkei Law Journal*) 7 14, and Koyana "Legal Pluralism in SA: The Resilience of Transkei's Private Law" 2005 *Speculum Juris* 131 141, who quotes with approval Pakade J in *Feni v Mgudlwa*. In that case, Pakade J described the approach in *Kwitshane* as "a veiled revival of the old colonial approach that a customary marriage is not a valid marriage because it is not contracted according to western legal norms".

## 2 Facts of the case

The deceased polygamist, Burton Baltimore Zitha Baduza, married a second wife in 1985 in terms of the Transkei Marriage Act, when he was still married to his first wife. The deceased provided the second wife (referred to as the respondent in the case) with accommodation in three different houses from 1987 until his death. According to the report, the first of these properties was registered in her name, and the other two (including the property in respect of which eviction was sought) were purchased under a close corporation. A detailed historical account of the circumstances which culminated in the respondent's occupation of the disputed property appears in the court *a quo*'s judgment (see *Wormald NO v Kambule* 2004 3 All SA 392 (E) 394). The deceased made no provision in his will for the respondent. This is ironic, because the deceased was in the respondent's company immediately prior to his death when he took ill. It appeared that the property which was the subject of the dispute was subject to two mortgage bonds with ABSA Bank which were serviced by the estate on a monthly basis in the sum of R9 451, 86. The respondent occupied the property without paying any rental. After the death of the deceased, his surviving first wife (described as the surviving civil law spouse) attempted to collect rental from the respondent, and the latter refused to oblige.

The deceased's first wife wanted to sell the property, as the mortgage bonds (which exceeded the property's current value) were burdensome on the estate.

She offered the respondent alternative accommodation at a local hotel owned by the estate. The respondent agreed to vacate the property but demanded that the first appellant meet three demands, namely to: "(i) recognise her customary marriage to the deceased; (ii) provide her with suitable and reasonable accommodation, having regard to her station in life and the ability of the estate to pay for such accommodation; and (iii) recognise her contemplated claim for maintenance from the estate". The first wife then instituted eviction proceedings.

The appellants (the administrator of the estate and the civil marriage (first) wife) claimed that the respondent was in unlawful occupation of the property because it was owned by an entity with separate and distinct legal personality from the deceased, and that any right she might have had to occupy it terminated upon the death of the deceased. The respondent's contention was that she occupied the property with the express or tacit consent of the second appellant (the CC) through which it was purchased by the deceased to provide her with accommodation in recognition of his obligation to do so as her husband, flowing from their customary marriage entered into in 1985. The existence of the customary marriage was disputed.

In the court *a quo*, Chetty J accepted that the deceased and the respondent had concluded a customary marriage and that the deceased purchased the property acting in his capacity as the second appellant's sole member to provide the respondent with a home during the subsistence of their customary marriage. The learned judge stated that the customary marriage vested the respondent, as the deceased's widow, with a personal servitude of *usus* or *habitatio* in respect of the residential property with which her deceased spouse had provided her and that the customary marriage was not rendered invalid by the fact of its non-registration in accordance with the Transkei Marriage Act 21 of 1978. He concluded that the respondent was not an unlawful occupier as envisaged in s 1 of the Prevention of Illegal Eviction from and Unlawful Occupation of Land Act 19 of 1998 (PIE). The appellants, represented by the first appellant in his capacity as the executor of the estate, also sought a declaratory order concerning the validity of the customary marriage.

In the Supreme Court of Appeal Maya AJA and Combrinck AJA gave separate judgments. Both judgments, in the present writer's view, are open to question. Maya AJA based her findings on the provisions of PIE and found that the respondent's occupation of the property has no legal basis and as such unlawful. In para 13, the Acting Judge of Appeal pointed out that whilst it is true that in customary law a husband and upon his death, his heir, has a duty to maintain his wife or widow, as the case may be, and provide her with residential and agricultural land "she does not, at any stage, acquire real rights in such land. The *dominium* vests in the husband or his heir". The Acting Judge of Appeal sought reliance on Bennett *Customary Law in South Africa* (2004) 347 and *Xulu v Xulu* 1938 NAC (N & J) 46.

Maya AJA did not find it necessary to refer to cases directly dealing with the legal position of widows in the Transkei such as *Noveliti v Ntwayo* (1911) 2 NAC 170, *Dyasi v Dyasi* 1935 NAC (C & O) 1; *Mavayeni v Mavayeni* 5 NAC 93; *Luke v Luke* 4 NAC 133 and *Sijila v Masumba* 1940 NAC (C & O) 42. These cases dealt, in the main, with the provisions of s 9(1) of Proclamation 142 of 1910, which described the widow's rights variously as the rights of "use and occupation", "usufruct", "servitude of *usus*" and "*habitatio*". (See also Kerr *The Customary Law of Immovable Property and of Succession* 3 ed (1990) 91 where