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# The Economics of Mutual Wills

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Preliminary draft. Comments are welcomed.

**Abstract** Mutual wills are testamentary instruments created usually by two parties (testators, whom often are spouses), on agreement, to devise and bequeath the first-to-die testator's property to the second testator, and upon the death of the second testator, to devise and bequeath properties from both the first testator and the second testator to a named third party beneficiary or a group of beneficiaries. The doctrine of mutual wills is an English equity doctrine which enforces the agreement between the testators outside of contract law.

Problems usually occur as a result of second testator defecting by not honouring his part of the agreement once his circumstances changes, e.g. when he meets up with a new partner. Therefore, this paper attempts to examine two questions in relation to this problem. The first is which property bundle should be binding in a mutual wills agreement, and secondly, when and whether a testator should be allowed to revoke his will with impunity.

The economic analysis of English equity and trusts law is a lesser researched area in the study of law and economics. This paper hopes to expand and generate interest in this area of research.

**Keywords** Mutual wills · Equity and trusts · Property · Bequest

## 1 Introduction

Wills are testamentary instruments which allow a deceased person—the testator—to convey his property to some named persons—the beneficiaries—according to his predetermined instructions. In English law, some formalities are attached to the execution of a will, such as that the will must be in writing and that the signing of the will must be witnessed by two or more witnesses who are not intending to benefit from the will (Wills Act 1837, ss. 9 and 15). Usually, but not necessarily, one or more persons are named as the executors or trustees in the will. These executors are tasked to carry out the instructions in the will upon the death of the testator.

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Until the death of the testator, a will is ambulatory, that is, without a fixed effect. It may be revoked by a new will or amended through a codicil. Properties acquired after the will was executed are also subject to the terms of the will.

## 2 Mutual Wills

Mutual wills are a special kind of will. Unlike traditional wills, mutual wills are normally made by two persons to correspondingly and reciprocally bequeath property to the surviving party. A mutual wills arrangement is like a contract where execution of the terms occurs upon the death of the first person to die. Dixon J. in the Australian case of *Birmingham v. Renfrew* summarises the governing principles of mutual wills as such:

It has long been established that a contract between persons to make corresponding wills gives rise to equitable obligations when one acts on the faith of such an agreement and dies leaving his will unrevoked so that the other takes property under its dispositions. It operates to impose upon the survivor an obligation regarded as specifically enforceable. It is true that he cannot be compelled to make and leave unrevoked a testamentary document and if he dies leaving a last will containing provisions inconsistent with his agreement it is nevertheless valid as a testamentary act. But the doctrines of equity attach the obligation to the property. The effect is, I think, that the survivor becomes a constructive trustee and the terms of the trust are those of the will he undertook would be his last will.

Mutual wills typically arise in three different scenarios. In the first scenario, two individuals execute mutual wills to bequeath property to the surviving individual absolutely. In the second scenario, two individuals execute mutual wills to bequeath property to the surviving individual, and upon the death of the latter to bequeath the remainder property to an agreed third individual or individuals. In the third scenario, two individuals execute mutual wills to benefit the surviving individual with a life interest, and upon the death of the latter to bequeath the remainder property to an agreed third individual or individuals. A life interest grants the benefiting survivor a right to use the property until his death and thereafter passes the right of disposal to a third part.

Mutual wills are often drawn in relation to properties held under a joint tenancy. Unlike a tenancy in common, where each tenant owns a distinct share in the property, upon the death of one of the joint tenants, the surviving tenant acquires the deceased tenant's share through the right of survivorship. Therefore, property held under a joint tenancy does not pass to other beneficiaries by will. The solution to this limitation is to either to sever the shares in the property by converting a joint tenancy to a tenancy in common, or by entering into a mutual wills arrangement, whereby the last surviving tenant agrees to transmit the property by will to a named third party beneficiary.

Technically speaking, it is not necessary for a mutual will to benefit the surviving party. For example in *In re Dale*, both husband and wife made mutual wills to bequeath all property to their daughter and son in equal share.

Finally, in order for mutual wills to be recognised by the courts, it is insufficient that the terms of the wills are identical. There must be further evidence that the parties intended the wills to be binding and irrevocable. In *In re Oldham*, husband and wife made similar wills giving their property to each other absolutely, and to others

thereafter. After the husband's decease, the wife remarried and made a fresh will giving a life interest in a large portion of her estate to her new husband, and subject thereto left her estate to her own relatives. On the question of whether there was a mutual will capable of binding the wife's action, Astbury J. held that "the fact that the two wills made in identical terms does not necessarily connote any agreement beyond that of so making them, and . . . that there is no evidence on which [he] ought to hold that there was an agreement that the trust in the mutual will should in all circumstances be irrevocable by the survivor who took the benefit (pp. 88–89)."

### 3 The Model

Let  $F$  and  $S$  be two individuals to a mutual wills arrangement.  $T^F$  and  $T^S$  are the life expectancy of  $F$  and  $S$  respectively at the time the mutual wills are executed,  $t = 0$ .  $\rho$  is the probability of  $F$  predeceasing  $S$ , although neither  $F$  nor  $S$  knows for sure who will die first at the time the mutual wills are executed; and that  $\rho$  is a function of  $T^F$ ,  $T^S$  and other random factors such as risk of a fatal accident.

Let  $A_0^F$  and  $A_0^S$  be the initial wealth of  $F$  and  $S$  respectively at time  $t = 0$ ,  $Y_t^F$  and  $Y_t^S$  the incomes at period  $t$ , and  $C_t^F$  and  $C_t^S$  the consumptions at period  $t$ .

The net present value of the bequest from  $F$  is

$$B^F = A_0^F + \sum_{t=1}^{T^F} \frac{Y_t^F}{(1+r)^t} - \sum_{t=1}^{T^F} \frac{C_t^F}{(1+r)^t} \quad (1)$$

where  $r$  is the discount rate. The corresponding net present value of the bequest from  $S$ ,  $B^S$ , is obtained by  $S$  for  $F$  in (1). Since debts cannot be transmitted through a bequest,  $B^F$  and  $B^S$  are constrained by  $B^F \geq 0$  and  $B^S \geq 0$ .

#### 3.1 Cases with No Bequest Motive

**Proposition 1** *Mutual wills are Pareto-improving positive bets for all testators who have no bequest motive, i.e. does not derive utility from leaving a bequest.*

*Proof* The expected benefit of entering into a mutual wills arrangement to  $F$  is  $(1 - \rho)B^S \geq 0$ , and the expected benefit to  $S$  is  $\rho B^F \geq 0$ .

By entering into a mutual wills arrangement, both testators are better off than otherwise, since there is a probability that either one will inherit property from the other. The assumptions underlying this result are that the testators do not derive utility after death, and do not derive a utility from bequeathing a property to others.

**Proposition 2** *Testators with no bequest motive may increase their average consumption in expectation of a bequest.*

*Proof* According to the life-cycle/permanent-income hypothesis (Modigliani and Brumberg 1954; Friedman 1957), households smooth their consumption by dividing their lifetime resources equally among each period. Hence, the average lifetime consumption for  $F$  is

$$\bar{C}^F = \frac{1}{T^F} \left( A_0^F + \sum_{t=1}^{T^F} \frac{Y_t^F}{(1+r)^t} + (1-\rho) \frac{B^S}{(1+r)^{T^S}} \right). \quad (2)$$

Similarly, the average lifetime consumption for  $S$ ,  $\bar{C}^S$ , may be obtained from (2) by substituting  $S$  for  $F$ ,  $F$  for  $S$ , and  $\rho$  for  $(1-\rho)$ .

From (2),  $\bar{C}^F$  will increase if  $(1-\rho)$  is large, that is, when  $S$  predeceasing  $F$  is highly certain; if  $B^S$  is large, that is,  $S$  will leave a large inheritance to  $F$ ; and if  $T^S$  is small, that is,  $S$  will die fairly shortly. Conversely,  $\bar{C}^F$  will not show significant increase if one of these three factors are not present.

**Proposition 3** *Testators with no bequest motive have incentive to leave no or little property.*

*Proof* A testator's utility is a function of his consumption:

$$u = u(C_t), \quad u'(\bullet) > 0. \quad (3)$$

Thus he can increase his utility by raising his consumption. Since the budget constraint for consumption is his wealth,

$$\sum_{t=1}^T C_t \leq A_0 + \sum_{t=1}^T Y_t \quad (4)$$

utility is maximised by consuming all his wealth, leaving little or no property for bequest.

Proposition 3 explains why even though mutual wills are Pareto-improving arrangements, few if not none are made outside of the context of family relations, where bequest motive otherwise plays an important role. When testators have no bequest motive, the tendency is to exhaust one's property before death. Thus, little benefit is gained in entering into a mutual wills arrangement. Furthermore, the risk of defection from a mutual wills arrangement makes it a less attractive venture.

### 3.2 Cases With Bequest Motive

When testators have bequest motive, they derive utility from knowing that an inheritance will be left to their named beneficiaries. Their utility function in relation to the bequest may include variables such as who the individuals are and what property or amount of property is passed. In such a case, proposition 3 does not hold true.

Notwithstanding that testators have bequest motive, they may still defect from a mutual wills arrangement. Defections typically occur in three ways: by dissipating property before it becomes the subject of a probate; by revoking a mutual will prior to the death of the first to die; and by revoking a mutual will after the death of the first to die.

**Proposition 4** *Specifying the bequest property is desirable if the objective is to bequeath an inheritance to a third party.*

If a specific property is not identified to be passed to the third party upon the death of the second testator to die, three property bundles may be relevant for consideration. The first is the property bundle of  $F$  and  $S$  at the time the mutual wills were executed, i.e.  $A_0^F$  and  $A_0^S$ . The second is the property bundle at the time of the first death. The third is the property bundle as remaining at the time of the second death.

The extant case law on this is not absolutely settled. The prevailing view is that as expressed by Dixon J. in *Birmingham v. Renfrew*:

The purpose of an arrangement for corresponding wills must often be, as in this case, to enable the survivor during his life to deal as absolute owner with the property passing under the will of the party first dying. That is to say, the object of the transaction is to put the survivor in a position to enjoy for his own benefit the full ownership so that, for instance, he may convert it and expend the proceeds if he choose. But when he dies he is to bequeath what is left in the manner agreed upon. ... No doubt gifts and settlements, *inter vivos*, if calculated to defeat the intention of the compact, could not be made by the survivor and his right of disposition, *inter vivos*, is, therefore, not unqualified. But, substantially, the purpose of the arrangement will often be to allow full enjoyment for the survivor's own benefit and advantage upon condition that at his death the residue shall pass as arranged.

Unplanned contingencies may occur after the death of the first testator. As alluded in *Birmingham v. Renfrew*, the second testator may need to sell or use up the property, and leaving a smaller inheritance. Alternatively, the second testator may increase his own wealth after the first testator's death, and thus benefiting additionally the third party if the latter is to acquire a share rather than a fixed sum.

Problems usually arise when the second testator remarries. He might want to provide for his new spouse and family. Binding the second testator to an agreement in a different future will foreclose his ability to acquire new wealth for his new family, or worse, create the incentive to dissipate his wealth by way of *inter vivos* disposition. To overcome this problem, it might be desirable to commit only those property in existence at the time of the first death, and allow the second testator to freely acquire new wealth unencumbered by the mutual wills agreement.

An approach to securing the third party's interest in real property is to grant a life interest to the surviving testator and leaving the residual thereafter to the third party. However, this is not practical when the real property is held in a joint tenancy, or that the second testator still hold part-ownership in the said property. Furthermore, survey research shows that today spouses nowadays are not happy with a life interest, and are demanding the conferral of an absolute interest in bequeathed property (Cassidy 2005, p. 130).

**Proposition 5** *Allowing testators to revoke a mutual will before any corresponding mutual takes effect is desirable.*

The mutual wills arrangement crystallizes and become binding upon the death of the first to die testator. In the first English case involving a mutual will, *Dufour v. Pereira*, Lord Camden establishes the rule on revocation that:

It might have been revoked by both jointly; it might have been revoked separately, provided the party intending it, had given notice to the other of such revocation. But I cannot be of opinion, that either of them, during their

joint lives, do it secretly; or that after the death of either, it could be done by the survivor by another will (pp. 420–421).

Ever since *Dufour v. Pereira*, the principle governing mutual wills is thought to be rooted in contract law. When there is a revocation without notice, a testator may bring a claim for damages for breach of contract, although to this day, no case had the opportunity to demonstrate the exercise of this right (Braun 2007, p. 219).

The threat of revocation may act as a sanction against testators who dissipate their wealth too quickly such that it amounts to frustrating the other testator's chance of receiving a seizable bequest. Secondly, revocation allows a testator to deal with changes in circumstances which might affect his preference for conferring a bequest. On the other hand, revocation may sometimes lead to inefficiency when the non-revoking testator has suffered or incurred costs due to reliance on the mutual wills arrangement. However, since the utility from bequest cannot be converted into a monetary equivalent, expectation damages is not a feasible option, and reliance damages might lead to excessive reliance when reliance is compensated.

**Proposition 6** *Allowing testators to revoke a mutual will after a corresponding mutual will has taken effect is not desirable.*

It would appear that since we could not possibly take into account the utility of a dead person, how his property is transmitted after his death should have no impact on social welfare. As a result, allowing a beneficiary to decide on the further transmission of the remaining property would enhance the latter's utility when making a new will. However, if the law allows the latter to depart from a mutual wills agreement, after taking an interest in the former's property, then the former testator would suffer a reduction in his utility due to the uncertainty of the destination of his bequest. Testators would therefore transmit their property in other ways, such as directly to the third party beneficiary instead of relying on mutual wills.

In fact, the whole idea of a mutual wills arrangement is to bind the second testator to his part of the agreement upon the death of the first testator. Since a bequest is like a payment of a stake in a bet and not a trade, technically there is no producer's surplus to speak of. As a result, expectation damages is equivalent to specific performance. The only remedy courts grant is that in equity, i.e. a trust in favour of the third party beneficiary.

Thus in *In re Dale*, a husband and wife made mutual wills and agreed to leave his or her estate to their son and daughter equally. The husband died first and passed his property to his wife, who subsequently made a new will leaving £300 to her daughter and the rest of her estate of £19,000 to her son. Morritt J. held that upon the death of the husband, the obligation on the wife to bequeath in equal share to the son and daughter binds her, and thus when she dies, the son as the executor held the estate on trust for himself and the daughter equally.

#### 4 Conclusion

In this paper, the doctrine of mutual wills is examined. Six propositions are described and their economics analysed. We show that mutual wills arrangements are Pareto-improving bets, but the risk of defections make this kind of arrangement unattractive to most people outside of family relations. We also show that it is desirable

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to allow revocation of the mutual wills arrangement as long as certain conditions are satisfied. However, revocation after the death of one of the testators is undesirable in economic terms.

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### Cases

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