Fraud, Statute of Limitations, Incorporation/Merger: Lessons from *Marshall*, *Nederlander*, *Grace* & *Foreman*

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A. Introduction: Equitable division of the marital estate depends on full and fair disclosure of all assets, liabilities, and income. It also depends on reasonably accurate valuations of assets. Valuation often depends on whether an asset is being kept (going concern) or sold (fair market value). Misrepresentations or mistakes related to the intent to sell an asset or the price to be received may greatly affect the value assigned to it in divorce settlement negotiations.

The four cases discussed here generally address the response of Michigan's appellate courts to allegations of fraud or mistake in the settlement of divorce cases. That response has evolved over time. A case more recent that any of these calls into question to one of the established ways of thinking about the merger/non-merger issue.

B. The Cases:

1. ***Marshall v Marshall*, 135 Mich App 702, 355 NW2d 661 (1984)**: This was the earliest case addressing fraud and the ***alleged*** distinction between property settlement agreements merged or not merged into the divorce judgment.

The most significant marital asset was the husband's stock in Ogden & Moffett Company, a trucking company. The husband owned 28% of Ogden's stock. It was valued by him at approximately $1,403,000 at the time of the divorce. This valuation was based on an offer to purchase Ogden by a third party, R-W Service Systems.

The parties reached a property settlement agreement in which the husband was awarded the stock. He was to pay the wife a sum of money over time for her share of the value of the stock. The terms of payment were $25,000 up front and $202,000 in semiannual installments of $10,000 or more, plus interest on the unpaid balance at 7%

annually. The property settlement agreement was "incorporated by reference as if fully recited herein, but is specifically declared not to be merged into this judgment, but is declared to be a contractual agreement between the parties hereto." *Id*, at 704.

The husband's obligation owed to the wife was also memorialized in a promissory note in addition to the settlement agreement. The husband's payments to the wife were conditioned upon R-W's performance of its agreement to purchase Ogden at the agreed-upon price.

After the divorce, the stock's value declined. This was due to the federal government deregulated the trucking industry, resulting in a claimed devaluation of the worth of the husband's Ogden stock from $1,403,000 to $1,184,000, a loss of $219,000. This devaluation reduced the amount R-W paid for the Ogden stock, which reduced what was received by the husband in exchange for his stock.

Less than a year after entry of the divorce judgment, the husband filed a motion for modification of the divorce judgment. He alleged as a result of the reduction in the purchase price that R-W paid for the stock, he did not receive from R-W as much as anticipated under the stock purchase agreement. Therefore, he should not have to pay the full amount to the wife agreed to in the property settlement agreement. His motion was filed under GCR 1963 528.3, the predecessor to MCR 2.612.

The trial court denied the husband's first motion to modify the judgment. He then filed a motion for reconsideration, alleging that a modification was necessary for fairness and equity and also based on mutual mistake as to the value of the Ogden stock. The

reconsideration motion was also denied. The husband then made a crucial mistake in failing to appeal either denial.

Approximately nine months later, after expiration of the one-year period from entry of the divorce judgment, the husband filed yet another motion to modify the judgment. He raised the same general grounds, but this time emphasized the "conditional" language in the settlement agreement that made its terms contingent on R-W performing its obligations under the stock purchase agreement with Ogden.

This time the trial court agreed with the husband and reduce the amount owing to the wife from $202,000 to $152,000. The wife moved for reconsideration, but her motion was denied. She then appealed.

The Court of Appeals reversed the trial court. The husband failed to appeal the trial court's denial of his first motion or denial of his reconsideration motion, both of which were timely. His second motion, filed more than a year after entry of the divorce judgment, was not timely. Motions under GCR 1963, 528.3(1) alleging "mistake, inadvertence, surprise, or excusable neglect" must be brought within a year of the judgment or order from which relief is sought. The trial court lacked jurisdiction to grant an untimely motion under GCR 1963, 528.3(1). Presumably, the same would be true under MCR 2.612(C)(2)(a), which contains the same language.

However, lack of timeliness under the "mistake" portion of the rule was not necessarily dispositive. The husband's request for medication (more accurately, a request for relief from the judgmenTodayt0 could also have been considered under the "no longer equitable" or "any other reason justifying relief" language in GCR 1963, 528.3(5) and (6).

Today, those provisions are found in MCR 2.612(C)(1)(e) and (f). Motions under those subsections of the rule need only be filed within a "reasonable time." The trial court could have concluded that the husband's second motion was filed within a reasonable time.

Even if timely, the Court of Appeals held that both parties knew the payment due Ogden from R-W could change. Each assumed the risk of that uncertainty when they entered into their binding property settlement agreement. "[N]either a reduction nor an increase in price was intended to modify the amount of plaintiff's obligation to defendant under the property settlement agreement." Marshall, supra, 135 Mich App at 709.

What of the contingency built into the settlement agreement? This may be the most questionable portion of the appellate decision. The panel held that the contingency related only to the timing of R-W's payment to Ogden, not the amount of the payment. Yet, there is no language in the agreement containing such a limitation. Perhaps the Court of Appeals got it wrong?

Marking the start of a trend that continues to influence family law matters today, the Court of Appeals relied on standard contract law principles in deciding that if "the mistake is with respect to an extrinsic fact, reformation is not allowed even though the fact is one which probably would have caused the parties to make a different contract. The reason for this rule is that the court does not make a new contract for the parties." *Id*, at 710. Because the final purchase price negotiated by Ogden and R-W was extrinsic to the property settlement agreement, the court cannot reform the contract. Stated another way, there was no mistake as to the instrument actually entered into.

Again relying on standard contract law, the *Marshall* panel rejected the view that a court may modify an allegedly inequitable property settlement agreement. The panel stated, "We are satisfied that a contract bargained for by two equally positioned parties is well outside the reach of this provision of the court rule." Id, at 712.

The court then delved into an area technically unnecessary for resolution of the issues on appeal, but which created decades of confusion for family law practitioners and the courts – merger v non-merger of property settlement agreements. The following language reverberated through courthouses for more than 30 years:

> When a property settlement agreement is incorporated and merged in a divorce judgment, it becomes a disposition by the court of the property. But, when not merged in the divorce judgment, the property settlement agreement may only be enforced by resort to the usual contract remedies and not as part of the divorce judgment.

Id, at 712-713.

The panel held that because the parties agreed in the property settlement agreement that it would be incorporated ***but not merged*** in the divorce judgment, it did not fall under the court rule provisions for relief from or enforcement of the judgment. Instead, the parties were left with ordinary contract law remedies. Under contract law, the husband could not show that he was entitled to relief based on fraud, mutual mistake, ambiguity, or unconscionability.

Marshall thus serves as the foundation for the three remaining cases and ushered Michigan family law into an era where contract law principles became critically important.

2. *Nederlander v Nederlander*, 205 Mich App 123; 517 NW2d 768 (1994): This divorce involved a member of the famous Nederlander theater family. It was the husband's interest in Ticketmaster, Inc., that was the focus of this appeal.

Unlike *Marshall*, the *Nederlander* divorce judgment was not the product of an agreed-upon settlement. The judgment was entered after a contested trial. More than one year after entry of the judgment, the wife filed an independent action for monetary damages claiming the husband committed fraud during the divorce proceedings.

The wife alleged that the husband misrepresented the value of his interest in Ticketmaster, as evidenced by Ticketmaster's profitable merger with another company shortly after the divorce greatly increasing its value. She claimed the husband knew of this impending merger at the time of the divorce, but intentionally withheld the information so as to depress the value used by the court when equitably dividing the property.

The husband moved for and obtained summary disposition under MCR 2.116(C)(10). The Court of Appeals affirmed, holding that that public policy concerns precluded a party from maintaining an independent action for fraud more than one year after the divorce judgment was entered.

The *Nederlander* panel concluded that the trial court did not err when it granted the husband summary disposition because the wife's claim was unenforceable as a matter of law. MCR 2.612(C)(1)(c) controls relief from judgment based on fraud. That rule imposes a one-year period to seek relief. The court rule provides the exclusive remedy, precluding an independent action for fraud.

In so holding, the Court of Appeals made a statement not only incredible for its lack of understanding of the divorce process, but also dangerous in the way it exposed divorce lawyers to possible malpractice claims: “The exercise of due diligence during the course of liberal discovery should expose any intrinsic fraud that may be present in the divorce proceeding.” *Nederlander*, *supra*, 205 Mich App at 127. In many cases involving closely-held businesses, there isn’t enough money or time to do the type of discovery that would unearth a carefully crafted effort by the other party to commit fraud. All a defrauding spouse need do is wait one year to find a “safe haven” under the court rule and sell an undervalued asset at great profit.

Also, the panel held that the husband was entitled to judgment on the wife’s claim of breach of fiduciary duty, as no fiduciary relationship existed between the parties at the time of the divorce proceedings. The panel stated, “At the time of the divorce proceedings, there certainly was no reposing of faith, confidence, and trust and the placing of reliance by one party upon the judgment and advice of the other party.” *Id*, at 128. This too is a dangerous approach. The imbalance of power and knowledge in many marriages does not disappear merely because a divorce action is filed. To say that divorcing spouses have no duty to one another makes fraud more likely.

3. *Grace v Grace*, 253 Mich App 357; 655 NW2d 595 (2002): The wife sued her former husband alleging that the husband defrauded her by hiding substantial marital assets and undervaluing disclosed assets before they entered into their property settlement agreement. A jury awarded the wife $ 3.1 million. The husband appealed. The wife cross-

appealed an order that set off her settlement award in a legal malpractice action against her divorce attorney.

The Court of Appeals held that the wife's action was not barred under *Nederlander*, which held that a party claiming fraud in a divorce may not pursue a separate cause of action for fraud. Here, the fraud claim related to the parties' settlement agreement, not the divorce judgment itself.

Unlike *Nederlander*, the divorce property division in Grace was based on the parties' own agreement, not a decision by the court after trial. In addition, the settlement agreement in *Grace*, as in *Marshall*, was incorporated, ***but not merged***, into the divorce judgment.

Evidence of the value of the husband's business after the divorce was relevant to show the reason that the husband would have intentionally misrepresented the value of the profitable business. The *Grace* panel found that there was evidence to sustain the jury's award, as the marital estate was worth about $6 million at the time of the divorce although the wife was induced by the husband during the divorce case to accept only $750,000 as her share of the marital estate. The panel also held that the trial court did not err in setting off the settlement amount in her legal malpractice action from the jury's award in the fraud case, as the wife was seeking damages for the same injury in both cases.

The purported lesson from *Grace* is that a property settlement that is incorporated, but not merged, into the divorce judgment is a separately enforceable contract. It is not subject to the one-year limitation for relief from judgment for fraud found in MCR 2.612(C). *Grace* was therefore responsible for an era of battles over whether a settlement

agreement should or should not be merged with the divorce judgment. The moneyed spouse with potentially something to hide, would push for merger. The non-moneyed spouse who could never be sure she (usually, she, but not always) got the straight scoop from her spouse, would push for non-merger to keep open a possible fraud action if discovered after the one-year period in the court rule. Not only did the substantive terms of the settlement become a potential sticking point, so did the merger/non-merger issue.

4. *Foreman v Foreman*, 266 Mich App 132; 701 NW2d 167 (2005): The wife sued her former husband alleging he committed fraud when representing the value of his car dealership to be $1.7 Million during discussions and mediation leading to the property settlement in their divorce action. The husband also stated that he intended to operate the dealership until he retired. As in *Marshall* and *Grace*, the property settlement agreement was incorporated, but not merged, with the divorce judgment.

The wife discovered the alleged fraud when, less than a year after the divorce, the husband reached an agreement to sell the dealership for $6.6 Million. The jury found in favor of the wife in the total amount of $1,417,000. The trial court denied the husband's motions for summary disposition, directed verdict, judgment notwithstanding the verdict, and for a new trial. The husband appealed.

On appeal, the husband argued that the elements of fraud were not established, and that the trial court erred in submitting the case to the jury. The Court of Appeals disagreed, finding that based on the husband's intimate personal knowledge and representations regarding the intricacies of the nature of his business, he could not assert

that his statements regarding the value of the dealership were mere opinions not subject to recovery in an action for fraud.

The *Foreman* panel held that there was sufficient evidence presented to support the conclusion that the wife was defrauded of $1 million relating to the value of the dealership as a result of the husband's misrepresentations as to his intent to sell the dealership and the impact of those statements on the treatment of the value of the dealership in the property settlement and the adoption of value by the mediator. It was reasonable to infer from the husband's conduct and the circumstances of the sale of the dealership that, while denying outwardly any intention to do so, he intended all along to sell the dealership and that he represented otherwise with an intent to gain financial advantage over the wife in the divorce proceedings.

Foreman reinforced the view from *Marshall* and *Grace* that non-merger of a property settlement agreement with a divorce judgment created a separately enforceable contract to which the rules on relief from, and enforcement of, judgments did not apply. It was pure contract law. Would it last? Sort of. This quartet of cases is really a quintet.

5. *Peabody v DiMeglio (DiMeglio Estate)*, 306 Mich App 397; 856 NW2d 245 (2014): The parties married in 1989 and divorced in Virginia in 1995. As in *Marshall*, *Grace*, and *Foreman*, their divorce property settlement agreement was incorporated, but not merged, with the judgment.

In the settlement agreement, the wife was awarded real property in Colorado. However, the husband was obligated to pay the mortgage payments on that property. Shortly after the divorce, the husband missed several mortgage payments. Concerned

about her liability for the delinquent payments, the parties agreed that the wife would quit claim her interest in the property to the husband. Upon receiving the quit claim deed, the husband refinanced the mortgage on the property.

In 2003, the husband conveyed the property to his new wife. On the same day, she sold the property to a third party for $215,000 and used the money to buy a home in Eaton Rapids, MI. The husband died in 2011.

Upon the husband's death, the first wife filed a claim against his estate alleging breach of contract, breach of a covenant of good faith and fair dealing, conversion, statutory conversion, concert of action, fraud, enforcement of the divorce judgment, and unjust enrichment. The probate court granted summary deposing in favor of the widow and the estate, finding that the six-year contract statute of limitation had run.

On appeal, the first wife argued that claims to enforce a judgment are classified as "noncontractual money obligations" that carry a 10-year statutory period of limitations pursuant to MCL 600.5809, not a six-year limitation period as held by the probate court. The Court of Appeals agreed, holding that because the parties' property settlement agreement, which the first wife seeks to enforce, was expressly incorporated by reference into the divorce judgment, the action is "founded upon a judgment within" MCL 600.5809(3) and the 10-year period of limitations would apply.

The *Peabody* panel distinguished *Marshall*, stating:

> *Marshall* does not specifically address the third possible situation, in which the agreement is incorporated but not merged. It is unclear whether the Court confused the terms 'merged' and 'incorporated' or whether it wished to create a rule that nonmerger precludes enforcement of the agreement as a judgment. Further, this language appeared in the opinion after the Court stated its holding. The Court made it clear that this analysis did not aid the

> plaintiff because it had already determined that the trial court could not interpret the property settlement agreement. Therefore, it is clear that this language was not "germane to the controversy in the case" and was therefore dictum that is not binding on this Court.

Peabody, *supra*, 306 Mich App at 406. This means there are really three options in the merger/non-merger continuum:

(1) a “merged” agreement that is enforceable only as a judgment, not as a contract;

(2) a “nonmerged” agreement (without any language of “incorporation”) that is enforceable only as a contract;

(3) and an “incorporated but not merged” agreement that is enforceable “both as a court order and as an ordinary contract.”

Therefore, adding to our understanding of the merger/non-merger issue in *Marshall*, *Grace*, and *Foreman*, it is now clear from *Peabody* that when parties to a divorce incorporate the terms of a property settlement agreement by reference and specifically agree not to merge the agreement into a judgment, the clear intent of parties entering into such an agreement is to make the agreement enforceable ***both as a court order and as an ordinary contract***.

C. Conclusions: Allegations of fraud or non-disclosure are at the heart of all of these cases, with the exception of *Marshall*, which alleged mutual mistake. The law is clear that a settlement, once entered into consistent with Michigan law or court rule, is binding and may not be modified or vacated absent proving a defect that would invalidate a contract. *Colestock v Colestock*, 135 Mich App 393, 354 NW2d 354 (1984). A settlement agreement cannot be set aside merely because a party has a "change of heart." *Metro Life Ins Co v Goolsby*, 165 Mich App 126, 128, 418 NW2d 700 (1987); *Thomas v Michigan Mut Ins Co*, 138 Mich App 117, 119-120, 358 NW2d 902 (1984).

Absent fraud, duress, or mutual mistake, courts must uphold divorce property settlements reached through negotiation and agreement of the parties. *Calo v Calo*, 143 Mich App 749, 753-754, 373 NW2d 207 (1985). For that reason, knowing the elements of actionable fraud is essential.

To establish a claim of fraudulent misrepresentation, a party must show that:

1. the other party made a material representation;
2. the representation was false;
3. the other party knew, or should have known, that the representation was false when making it;
4. the other party made the representation with the intent that party alleging fraud rely on it;
5. and party alleging fraud acted on the representation, incurring damages as a result.

Hi-Way Motor Corp v Int'l Harvester Co, 398 Mich 330, 336; 247 NW2d 813 (1976).

The party alleging fraud must also show that any reliance on the other party's representations was reasonable. *Novak v Nationwide Mutual Ins Co*, 235 Mich App 675, 690-691; 599 NW2d 546 (1999). In addition, fraud must be pled with specificity. MCR 2.112(B)(1). Mere allegations or conclusions are insufficient. *Emerick v Saginaw*, 104 Mich App 243; 304 NW2d 536 (1981).

In short, successfully proving fraud is not easy. However, in cases where the divorce settlement agreement was incorporated ***but not merged*** with the divorce judgment, filing a separate action in which a jury demand can be made provides certain benefits. A particularly sympathetic former wife alleging fraud against her more affluent former husband may appeal to a jury. Now that *Peabody* suggests that even a non-merged judgment may also be enforced without filing a separate action because the incorporating

judgment is an enforceable court order, there appears to be no downside for the less-moneyed spouse to push for non-merger of the agreement into the judgment.

Even better is to write your nondisclosure/maldisclosure (misstated value) remedy directly into the settlement agreement and divorce judgment. Many agreements and judgments now state that both parties represent they have fully and fairly disclosed all assets and liabilities and, within their ability, assigned reasonable values to all disclosed assets. A sample clause might look something like this:

> The parties affirm by their signatures below that each of them has disclosed all assets that he or she owns or has any interest in, whether held by him or her individually, jointly, or with any other person or entity for his or her benefit. The property division provisions set forth in this judgment are intended to be a distribution and allocation of all of the properties of the parties. If either party has failed, either intentionally or unintentionally, to disclose any of his or her assets or accurately represent the value of those assets, the issue of property division will be reopened on the petition of either party for the purpose of determining and resolving the distribution of the previously undisclosed or improperly valued asset or assets.

Some agreements go a step farther and specify that undisclosed or concealed assets are forfeited to the innocent party – a contractual form of a *Sands* [*v Sands*, 192 Mich App 698; 482 NW2d 203 (1992), *aff'd*, 442 Mich 30, 497 NW2d 493 (1993)] remedy. Here is a sample:

> Each party represents that he or she has made a full and complete disclosure to the other party of all assets and liabilities acquired during the course of the marriage and that this judgment contains a complete itemization of the parties' assets and liabilities and the distribution thereof. Subsequent to the entry of this judgment, if it is determined by the court that either party concealed assets acquired or appreciated during the marriage, failed to disclose assets acquired or appreciated during the marriage, or otherwise attempted to secrete or conceal assets from the other party; the court shall award the non-offending party the entire value of the assets identified as concealed.

The next step along this line is to include in the agreement that the party found to have concealed or failed to disclose assets must pay the actual costs and attorney fees of the other party incurred as a result of the failure to disclose. A sample would like something like this:

> The parties agree to perform their respective obligations in this judgment in good faith. If a party fails to fulfill an obligation and the other party must institute enforcement proceedings, the offending party shall pay the ***actual*** costs and attorney fees incurred by the enforcing party without a showing of need/ability to pay or a hearing to determine the reasonableness of the fees and costs incurred.

The advantage of including a nondisclosure remedy in the judgment (or now the settlement agreement per *Peabody*) is to maximize the time frame to discover and act on a failure to disclose. Not only would a party seeking relief under such a clause not be limited by the one-year period to seek relief from the divorce judgment under MCR 2.612(C) for fraud, that party would also not be limited by the six-year contract statute of limitation. Because the action would technically be to ***enforce*** the terms of the judgment, the ten-year judgment statute of limitation would apply.

In addition, the enforcement proceeding would be brought as a post-judgment motion before the judge who heard the divorce case and who is most familiar with the parties and their circumstances. If it were an action to enforce a contractual right in a settlement agreement (as would have been true pre-*Peabody*), a separate civil action would be filed and likely assigned to a different judge outside of the family division. The attorney fee provision would make the innocent party whole by shifting the cost of enforcement to the offending party.

D. Tips:

- **If you represent the "moneyed" spouse, push for incorporated and merged to limit the period for discovering and acting on alleged fraud to just one year under the court rule.**

- **If you represent the "non-moneyed" spouse, push for incorporation, but non-merger, to expand your actionable fraud period to six years under contract law.**

- **If you represent the "non-moneyed" spouse, try to build your nondisclosure remedy directly into the divorce judgment, including an attorney fee provision, so that you are seeking *enforcement of* rather than *relief from* the judgment, and therefore have a full ten-year statute of limitation per *Peabody*.**

- **If you are the "moneyed" spouse with a closely-held business, avoid the stench of fraud by waiting a decent interval before selling a business you intended to keep at the time of divorce. It is probably not enough to wait just the one year court rule period. A decent interval could be several years post-divorce. Waiting could result in financial hardship or lost opportunity, but I'll bet Mr. Foreman wishes he waited a bit longer after claiming during the divorce that he planned to keep operating the dealership.**

- **If you are the owner of a closely-held business going through a divorce, avoid at all costs giving an opinion as to the value of your business. Instead, gladly pay your spouse whatever he or she needs to hire an expert to assign a value to the business. Most reputable experts are conservative in their approach. The resultant opinion of value is often lower than what you think the business is actually worth (or less than you think you could get for it if sold). If your spouse's expert produces a low value on which your spouse relies in settling the case, you cannot be blamed for misleading your spouse. Call the expert fees "anti-fraud insurance."**

- **If your spouse owns a closely-held business and you are going through a divorce, always ask your spouse his/her opinion of the value of the business. Also ask whether your spouse intends to keep operating the business or plans to sell. If selling, ask the time frame, whether any negotiations have taken place, and whether any offers have been received. If you can afford to wait for your money, negotiate for a share**

of sale proceeds if the business is sold within a reasonable time (perhaps up to 5 years) post-divorce.