

1964

The Legislative Struggle Against Subdivision Frauds

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Recommended Citation

Vincent P. Anderson, *The Legislative Struggle Against Subdivision Frauds*, 13 Cath. U. L. Rev. 160 (1964).

Available at: <http://scholarship.law.edu/lawreview/vol13/iss2/5>

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Comment / The Legislative Struggle Against Subdivision Frauds

“Now! BUILD IN, Live in, Invest in Sunny Arizona. Estate size homesites! A new community is about to come to life—and you can have a part of its future! We have acquired COMPLETE UTILITY SERVICES! This means you can own a king-sized western estate . . . with ROADS, and ELECTRICITY, WATER AND PHONES available . . . two hundred miles of roads have been constructed and are being maintained regularly.”¹ This and many advertisements of its type have regularly filtered into the communications media all over the United States. Most of these advertisements are legitimate attempts to induce purchasers to buy land for retirement living in the Southwest. The problem we will consider arises when the unscrupulous promoter attempts to induce the purchaser into buying worthless tracts of land. Typically, a mail-order promoter will buy a big tract of cheap, undeveloped land and chop it into lots of an acre or so. Then an elaborate advertising campaign is launched in an attempt to sell the lots sight unseen. The advertising material is presented in the form of artist’s conceptions and drawings, with an avoidance of on-site photographs, to present to the buyer in New York a picture substantially at variance with the facts.² Usually, the land is really arid desert, miles from any business district, with no utilities and no roads except bull-dozed scars on the desert. The utilities are available if the unsuspecting buyer is willing to pay for the running of electric lines to his plot, to pay for the installation of sewers and wells, and to pay for a contractor to pave the erosion-pocked strips called roads.

¹ *Hearings before the Special Committee on Aging, United States Senate, 88th Cong., 1st Sess., pt. 2, at 222 (1963)* [hereinafter cited as *1963 Hearings*].

² *1963 Hearings* 142, 223.

The fraudulent sale of subdivided land has grown to heroic proportions. Many government and private agencies have in recent months concerned themselves with the problem.³ The purpose of this comment is first, to analyze the laws of some of those states, enacted to curb abuses in sales of subdivision land, and second, to examine the federal statutes which have been applied to frauds in this area.

STATE SUBDIVISION STATUTES

Before delving into the statutes designed to protect the purchaser of land, it must be noted that the vendee has his normal legal and equitable remedies for damages and rescission if he has bought land relying on false representations of the seller. The reason why these remedies are inadequate in the context of the land frauds area is that a trip to the locus of the land, the retaining of a lawyer, and the prosecution of the suit would probably be a greater expense to the purchaser than the loss of the few hundred dollars remitted to the promoter. Also the type of individual who is induced to buy the land sight unseen is often the type who does not know, or is incapable of asserting his civil remedies.⁴ As a consequence, statutes had to be enacted to protect the purchaser from his folly.

The laws governing subdivision sales among the states are few in number. Only fifteen states as of 1962 had laws governing subdivision sales, and only six of these can be considered as comprehensive—Arizona, California, Florida, Hawaii, New York, and Ohio.⁵

By far the most progressive state in legislating to deter the sale of worthless land is California. California's subdivision law passed in 1943 was the first to recognize the possibilities of subdivision fraud and has subsequently been used as a model for both the Arizona and New Mexico acts regulating subdivision sales.⁶

The basic provision on the subject is the so-called full disclosure provision, demanding that the owner or subdivider of the land must notify the real estate commissioner of his intent to sell or lease the land. The notification must include the name and addresses of the owner and subdivider, the legal description and area of the lands to be sold, a statement of the condition of title, the

³ The Committee on Installment Contracts of the Better Business Bureau met in New Orleans, Jan. 1963; the National Conference on Interstate Land Sales at San Francisco, Oct. 1 & 2, 1962; and the National Association of License Law Officers in Oklahoma, Mar. 10, 1961 and Minneapolis, May 11, 1962. All the above conferences considered the problems raised by interstate land transactions.

⁴ WARREN, REPORT TO COMMISSIONER OF REAL ESTATE—STATE OF CALIFORNIA, OCT. 1, 1962, p. 65, [hereinafter cited as *Warren Report*]. This report was prepared by William D. Warren, Professor of Law at U.C.L.A., as a background paper for the Conference on Interstate Land Sales. This is an excellent comprehensive treatment of the state of the law on this topic as of 1962.

⁵ *Warren Report* 18.

⁶ CAL. BUS. & PROF. CODE §§ 11000-11023.

terms and conditions on which the land is intended to be sold, and the provisions made for utilities.⁷ An amendment to the act in 1963 made provision for the subdivider to describe the uses for which the real estate is offered, and any provisions limiting the occupancy of the parcels and whatever other information is demanded by the commissioner.⁸ The commissioner then investigates the subdivision, at the subdivider's expense, whether within or without the state,⁹ makes his report on it and publishes it.¹⁰ This report must be sent by the subdivider to any prospective purchaser.¹¹ In this manner the law of California insures that a person interested in purchasing land will not do so just upon the representations of the seller in his national advertisements, but rather will be fully informed of all the necessary factors upon which to make a sound decision as to the advisability of the purchase.

In the 1963 session of the California legislature a further provision was passed aimed at regulating sales. This was an amendment to §11018, which provided that the commissioner should issue to the subdivider a report authorizing sale or lease of the land in the state.¹² What this amounts to, in effect, is that before the subdivider can make any sales in California, he must have what amounts to a license to do so. The basic full disclosure provision was designed merely to put the purchaser on full notice of exactly what the condition of the land was and the intentions of the subdivider. After his notification, the rule of *caveat emptor* applied, and he was free to buy whatever he chose. Now, under the amendment, no land may be offered for sale in California if the offer fails to measure up to the standards of the act interpreted by the commissioner. This provision was designed to afford absolute protection to the buyer by not even exposing him to possible fraud or misrepresentation of the qualities of the land, since a further provision absolutely forbids sales without first obtaining the authorization report from the commissioner.¹³

Since the provisions in this act apply not only to lands in California, but also to out-of-state realty offered for sale in California, the question of how to enforce these provisions when the subdivider is out of state becomes paramount.

Any out-of-state subdivider must file an irrevocable consent to service, and if service for a civil action for rescission or damages cannot be had then the Secretary of State is substituted.¹⁴ The problem arises when the out-of-state subdivider, selling, for example, Nevada lands in California, refuses to follow

⁷ CAL. BUS. & PROF. CODE § 11010.

⁸ CAL. BUS. & PROF. CODE § 11010 (Supp. 1963).

⁹ CAL. BUS. & PROF. CODE §§ 11014-11016.

¹⁰ CAL. BUS. & PROF. CODE § 11018.

¹¹ CAL. BUS. & PROF. CODE § 11018.1.

¹² CAL. BUS. & PROF. CODE § 11018 (Supp. 1963).

¹³ CAL. BUS. & PROF. CODE § 11018.2.

¹⁴ CAL. BUS. & PROF. CODE § 11007.

the full disclosure provisions and authorization standards, violates a cease and desist order, or refuses to file his irrevocable consent to service. An attempt to provide for this eventuality is disclosed in an amendment to the act in 1963¹⁵ providing new punitive provisions. Any person who violates the provisions of the act or the orders of the real estate commission is punishable by imprisonment in the state penitentiary, which makes the crime a felony.

The old California punitive provision provided that the violation of the act would constitute a misdemeanor punishable by imprisonment in the county jail.¹⁶ While extradition is available to the demanding state for the commission of misdemeanors,¹⁷ it is only granted for felonies and aggravating misdemeanors.¹⁸ In addition, extradition has traditionally been available only for persons who have committed a felony in the state and have fled therefrom after having been charged with crime.¹⁹ Therefore, in the hypothetical case, with the promotor operating from Nevada, if he did not flee from the justice of California after having committed a crime under its laws, a request for extradition would not be honored by Nevada, even if he had committed a felony.

A recent modification in the law of California, though, does make a criminal extraditable even though never having been in the state. Judge Traynor, in the case of *In re Cooper*,²⁰ held that under § 6 of the Uniform Criminal Extradition Act,²¹ a California resident who commits a crime in Pennsylvania by mailing to that state obscene literature, even though never having been in Pennsylvania, is extraditable to that state.

This change in the extradition law of California, if accepted in other jurisdictions having the Uniform Act,²² would make the felon promoting land transactions from out-of-state extraditable to California under a felony charge, whether he had ever been there or not. The change in the California law becomes understandable now, not only as a minor increase in punishment to the violator of the subdivision law, but also as an attempt to acquire jurisdiction over the out-of-state violator.

A 1963 amendment²³ further attempting to regulate the sales of out-of-state lands to Californians demands that no person can sell land to residents unless

¹⁵ CAL. BUS. & PROF. CODE § 11023.

¹⁶ CAL. STATS. 1943, ch. 127, § 1, at 864.

¹⁷ U.S. CONST. art. IV, sec. 2, cl. 2. "A Person charged in any State with. . . Felony, or other Crime, who shall flee from Justice, and be found in another State, shall on demand of the executive Authority of the State from which he fled, be delivered up, to be removed to the State having Jurisdiction of the Crime."

¹⁸ 35 C.J.S. *Extradition* § 7 (1960).

¹⁹ *Id.* § 8.

²⁰ 53 Cal. App. 2d 772, 349 P. 2d 956 (1960), *cert. denied*, 364 U.S. 294 (1960).

²¹ CAL. PEN. CODE § 1549.1.

²² As of 1963, forty-five of the fifty states have enacted the Uniform Criminal Extradition Act into law. 9 UNIFORM LAWS ANNOTATED (Supp. 1963, at 129).

²³ Chapt. 1819, Ass. Bull. No. 2069 (1960).

he complies with all the provisions of the act. In addition this amendment states that any sales of out-of-state lands is to be considered an investment in securities and, as such, subject to the securities regulations of California.²⁴

One of the principal problems in the sale of undeveloped land is that in most states injunctive relief is not available to the real estate commissioner when, after investigation, he suspects that individuals are violating the law. The injunctive relief measure is severe, but any alternative exposes the purchaser to a continuing flood of false advertising while the investigation is being pursued.²⁵ The California commissioner, though, *does* have the power to issue a stop-order without having to get on a crowded court calendar, on the basis of evidence satisfactory to him that any person has violated or is about to violate any of the provisions of the act on subdivision sales.²⁶

The California act, therefore, covers as completely as possible the problems inherent in the subdivision sales by promoters. One of the difficulties the act presents is that the commissioner is given practically absolute power to give or deny the promoter permission to sell his land. In the writer's opinion this is an overly restrictive approach. Sales should be permitted so long as the buyer knows what he is buying and this is adequately provided for by the full disclosure provisions alone.

The Arizona statute follows the full disclosure provisions of the California statute, which serves as the model for most full disclosure statutes.²⁷ The commissioner, after having investigated the subdivision, if his investigation discloses that the offering would constitute misrepresentation, fraud or deceit, will issue a cease and desist order against the promoter to halt his activities.²⁸ One of the important differences between the two codes is that, while California makes it a felony to break the subdivision law, Arizona merely makes it a misdemeanor,²⁹ thus making it difficult to punish the fraudulent promoter with a base of operations outside Arizona. There is little possibility of extradition unless the crime is a felony.

Another unfortunate aspect of the Arizona legislation is that there are no provisions allowing the commissioner to sue for injunctive relief to halt the suspect activities; therefore, during the investigation of the suspected fraud, through the hearing to show cause why he should not be permitted to sell land in the state, the fraudulent promoter is still free to induce unsuspecting purchasers to lay down their money on the wasteland. A review of the cease

²⁴ See generally CAL. BUS. & PROF. CODE §§ 10237-10239.35.

²⁵ The importance of immediate injunctive measures to halt further transactions can be seen from the celebrated Comstock Ranch case where in three days the promoters sold \$750,000 worth of desert acreage located in Nevada before any measures could be taken to stop them, 1963 *Hearings* 204.

²⁶ CAL. BUS. & PROF. CODE § 10081.

²⁷ ARIZ. REV. STAT. §§ 32-2181 to 32-2185 (1956).

²⁸ ARIZ. REV. STAT. § 32-2183.

²⁹ ARIZ. REV. STAT. § 32-2161.

and desist order by the courts is provided for within thirty days of the commissioner's decision, and the order does not become final until thirty days after the decision on review.³⁰ This gives the swindler at least two months extra in which to practice his craft. What is needed here is a provision similar to California's stop-order statute which would empower the commissioner to prevent the continuance of the fraud by restricting further sales of the land after the commissioner has received sufficient evidence of an illegal promotion without the necessity of waiting on a crowded court calendar.

Although this statute is generally considered one of the more advanced in the area of fraudulent sales, yet certain additions should be made by classifying the crime as a felony, thereby providing a basis for extradition in criminal actions against the out-of-state or fleeing promoter. Also, injunctive power should be given the commissioner in order to halt suspect operations pending determination by the commissioner that the offering is or is not fraudulent.

The New Mexico statute governing frauds in this area, in contrast to the Arizona statute, seems to avoid some of the loopholes available to the scheming promoter.³¹ Again this is a full disclosure statute, making it unlawful not to inform the prospective purchaser of incumbrances, street facilities, and the availability of utilities and water.³² It also lays down a number of standards by which advertisements may be judged in order to determine whether they present a fair picture of the offer made.³³ The statute provides for injunctive relief to be exercised by the commissioner to halt any suspect dealings after an investigation by him of the subdivision.³⁴ The statute provides for a maximum five year imprisonment and one hundred thousand dollar fine for knowingly aiding in the dissemination of false advertising, thus classifying the offense as a felony.³⁵ Other violations of the act, including the advertising of foreign land within the state without complying with the standards set forth in the advertising standards provision, are classified as misdemeanors.³⁶ This section covers the cases which involve residents of New Mexico, but an out-of-state advertiser would have no compunctions about violating this section of the statute, for all that would be rendered is a cease and desist order which would be unenforceable against those not within the jurisdiction of the criminal courts of New Mexico. As an indication of the great importance this jurisdiction attaches to the problem, the legislature declared the problem to be an emergency and provided that the act should take effect immediately.³⁷

³⁰ ARIZ. REV. STAT. § 32-2159 (B) and (D).

³¹ NEW MEX. STATS. ANN. §§ 70-3-1 to 70-3-9 (Supp. 1963).

³² NEW MEX. STATS. ANN. § 70-3-4 (Supp. 1963).

³³ NEW MEX. STATS. ANN. § 70-3-5 (Supp. 1963).

³⁴ NEW MEX. STATS. ANN. § 70-3-8 (Supp. 1963).

³⁵ NEW MEX. STATS. ANN. § 70-3-6 (Supp. 1963).

³⁶ NEW MEX. STATS. ANN. § 70-3-7 (Supp. 1963).

³⁷ NEW MEX. LAWS (1963), ch. 217, § 11.

The statutes of these three jurisdictions are examples of the full disclosure acts which protect the general public by forcing the subdividers to send the Real Estate Commission's report to prospective purchasers and also provide criminal penalties for their violation. The full disclosure law is generally helpful, but unless the buyers know that they can get a report on the actual condition of the realty, the promoter may not send it, and the buyer is still purchasing blindly. Of course, failure to send the report to the purchasers is criminal, but discovering such a violation is difficult except through the complaint of the buyer. California does provide that the subdivider keep a file of the receipts of reports sent to purchasers, and in this way tries to insure that the purchaser gets the report.

A different mode of purchaser protection is provided by the two state laws which regulate sales of realty by the examination of the advertising copy offering land within the jurisdiction to the country at large. Florida and Hawaii are the two states which have laws of this nature.³⁸

Florida makes it unlawful to publish or cause to be published by any advertising media false or misleading information outside the state for the purpose of offering for sale lands located within the state.³⁹ The crime, classified as a felony, carries with it a maximum penalty of five years imprisonment and a fine of one hundred thousand dollars.⁴⁰ The statute also provides for an action for rescission in equity or damages at law for anyone relying on the fraudulent advertising, but if the buyer has actually inspected the land before buying it, this section denies him a cause of action.⁴¹

The Florida statute also regulates the dissemination of advertising before any violation has been committed. Full copies of all the information to be furnished the communications media first must be submitted to the Real Estate Commission. The representations in the advertising copy are investigated by the commission which submits a report after ninety days as to whether the information contained therein is false and misleading.⁴² If false, an immediate injunction may be sued for by the commissioner halting all further advertising until the copy is corrected or until clearly established by hearing whether it is true or misleading. Any violation of an order of the commission or provision of the statute, other than the fraud prohibition section, is considered a misdemeanor, subject to a fine of one thousand dollars or six months in prison.⁴³

There are a number of difficulties with the Florida statute as it now stands.

³⁸ FLA. STAT. ANN. §§ 475.47-475.55 (1951) (Supp. 1962); *Haw. Rev. Laws* § 170-35 (Supp. 1961).

³⁹ FLA. STAT. ANN. § 475.47 (Supp. 1962).

⁴⁰ FLA. STAT. ANN. § 475.48 (Supp. 1962).

⁴¹ FLA. STAT. ANN. § 475.49 (Supp. 1962).

⁴² FLA. STAT. ANN. § 475.51 (Supp. 1962).

⁴³ FLA. STAT. ANN. § 475.55 (Supp. 1962).

First, the purchaser does not get a report on the true condition of the land, as in the full disclosure states. All he is assured of is that the advertising is not misleading in the commission's estimation. The vendee may still, without sufficient facts at his disposal, invest in Florida swampland. Second, the statute, oddly, does not protect the Florida resident because it regulates only out-of-state advertising of Florida land.⁴⁴ As a result, this statute does not protect the Floridian from fraudulent offerings of Florida or out-of-state lands. The above weaknesses should be corrected by the Florida legislature.

The foregoing presents a cross-section of the laws presently controlling the sale of worthless land in the individual states. The principal problem in all these statutes is the difficulty of obtaining jurisdiction over the defrauder when his base of operations is out-of-state. The recent advance in the extradition laws in the state of California does present a possible solution by providing for extradition of out-of-state felons. The problem with this solution is that a small minority of jurisdictions follow California's interpretation of the Uniform Criminal Extradition Act.

Since the problem of interstate land frauds is an immediate one demanding swift resolution, we cannot wait for each jurisdiction to change its extradition law; so, we must look to the federal law to seek possible sanctions for the fraudulent subdivider.

FEDERAL LAW

There are two principal federal statutes which have been applied to the interstate problem of fraudulent land sales. These are the Federal Trade Commission Act⁴⁵ and the two Mail Fraud Acts.⁴⁶

Under the Federal Trade Commission Act, "unfair methods of competition in commerce, and unfair or deceptive acts or practices in commerce, are declared unlawful."⁴⁷ As of 1962, frauds in six states were under investigation for violating this section of the act in the particular area of interstate land transactions.⁴⁸ While this act covers the area, certain aspects of the Federal Trade Commission Act make it less than fully effective.

The Act provides that whenever the commission has reason, after investigation, to believe that anyone has been engaged in an unfair method of competition by fraudulent sales, it may issue a complaint providing for a hearing not less than thirty days after the service of the complaint.⁴⁹ After the hearing, if the commissioner finds that the promoter was engaged in unfair competi-

⁴⁴ FLA. STAT. ANN. § 475.51 (Supp. 1962).

⁴⁵ 38 Stat. 719 (1914), as amended, 15 U.S.C. § 45 (1952).

⁴⁶ 26 Stat. 466 (1890), as amended, 39 U.S.C. 4005 (1960) and 25 Stat. 873 (1889), 18 U.S.C. 1341 (1956).

⁴⁷ 15 U.S.C. § 45 (a) (1).

⁴⁸ 1963 Hearings 150.

⁴⁹ 15 U.S.C. § 45 (b).

tion, he issues a cease and desist order which can be appealed from within sixty days after issuance.⁵⁰ What this means in effect is that the promoter of the subdivision sales has at least a three month period during which he can carry on his unlawful activities, and, therefore, the effect of the cease and desist order is diluted because the damage will have been done. What obviously is demanded is an injunctive measure to assure that the promoter stops his suspect activities and that he not change the thrust of his advertising campaign.

Under the act an injunction is available against only certain types of selling activities, the dissemination of false advertising to induce the purchase in commerce of food, drugs, devices, and cosmetics.⁵¹ This section was passed in 1938 to halt the pernicious effects of false advertising in these commodities, and it would take a simple congressional amendment to add "real estate" to the particular items of trade mentioned.

There are two mail fraud statutes which have been applied to the problem of the scheming promoter of subdivision land, the administrative fraud order statute whereby mail involved in pursuing a suspected fraudulent scheme is marked "fraudulent" and returned to the sender,⁵² and the criminal prosecution statute, which makes it a felony to use the mails for the purpose of executing a fraudulent scheme.⁵³

Problems of enforcement are particularly apparent with the administrative statute. Since we are principally concerned with the protection of the purchaser, it would seem that this statute is particularly suited to stopping any remittances sent by unwary buyers to the suspect promoter. This section is difficult to apply because the standard of proof required before the Postmaster General can order the local postmaster to mark mail fraudulent is the same as for prosecution under the criminal statute.⁵⁴ An unfortunate Supreme Court decision, *Reilly v. Pinkus*,⁵⁵ interpreting the predecessor of the administrative statute, stated that proof of fraudulent purpose is essential in applying this statute. The statute says that, upon evidence satisfactory to the Postmaster General that any person is engaged in conducting a scheme or device for obtaining money or property through the mail by means of false or fraudulent pretenses, representations or promises, the mail could be marked "fraudulent." Now the Supreme Court interpreted false or fraudulent pretenses in the classic definition of fraud by demanding that the evidence necessary must include proof of intent to deceive. This narrow restriction limits the usefulness of the "fraud order" because it demands proof requisite for criminal prosecutions

⁵⁰ 15 U.S.C. § 45 (c). See also, *supra* n. 25 as to the deleterious effect of delay in prosecution.

⁵¹ 15 U.S.C. § 53 (a).

⁵² 39 U.S.C. § 4005 (1960).

⁵³ 18 U.S.C. § 1341 (1956).

⁵⁴ 1963 *Hearings* 240. Remarks of Abraham Levine of the General Counsel's Office, Post Office Department.

⁵⁵ 338 U.S. 269 (1949).

whereas the purpose of the statute is not punishment of the promoter but protection of the remitter.⁵⁶ This requirement of proof of intent is particularly difficult to fulfill because the Post Office has no subpoena powers whereby it could gain access to promoter's office records and documents which would indicate the promoter's intent more clearly than the objective statements made in the advertisements.

Another difficulty with the administrative fraud order statute is that there is no power in the Postmaster General to summarily mark the mail "fraudulent." Instead, a full administrative hearing is necessary to determine the fraudulent nature of the offering before issuing the fraud order.⁵⁷ This, of course, permits the operator to continue his activities in an area where time is of the utmost importance because of the speed at which the fraudulent promoter operates.

The administrative statute should be amended to drop all reference to "fraud" and to insert a prohibition against "false statements" which would change the standard of proof demanded from one requiring proof of the subjective state of mind of the promoter, to one of the objective existence of truth or falsity of the statements made. The Postmaster General should also be given the power to summarily impound the mail without the need of a time consuming hearing, to halt future abusive activities on the part of the promoter.

The criminal statute prohibits the use of the mails in a scheme to defraud by means of false or fraudulent pretenses, representations or promises.⁵⁸ The difficulty in applying this section in the context of land frauds is that the advertisements, rather than being laden with outright lies, contain a conglomeration of half truths, omissions and ambiguities.⁵⁹ The statute really is unsuited to prosecuting violations by omission or ambiguity because the standards against which to measure the clever statements of the promoters are too rigid.

CONCLUSION

The state statutes, in the few jurisdictions where they exist, are comprehensive enough to control the sales of promoters located within the states themselves. But when the transactions take on an interstate character, the laws of the various states are often inadequate to provide for effective regulation of the fraudulent activities of the promoter.

What is clearly demanded is a revamping of the existing federal statutes to do away with time consuming delays and rigid standards of proof. Better still would be federal legislation prohibiting any sales of land in interstate com-

⁵⁶ 1963 Hearings 240.

⁵⁷ Warren Report 59.

⁵⁸ *Supra* note 53.

⁵⁹ Warren Report 60.

merce which would violate existing state laws. In this way, existing state laws would not be pre-empted by the federal legislation, and federal criminal jurisdiction would be available against the out-of-state promoter. This last measure would, of course, have to be based on the existence of state laws; so, as a final recommendation, all the remaining states without some type of subdivision law should adopt either the California full disclosure type or the Florida advertisement-regulation type to provide a basis from which the federal law can operate.

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