Article

Jim Hawkins†

Law's Remarkable Failure To Protect Mistakenly Overpaid Employees

INTRODUCTION

Mistaken overpayments to employees are everywhere. Whether it is the Department of Defense overpaying soldiers because of antiquated compensation systems and complicated pay structures,[1] a university overpaying employees because of turmoil created by a natural disaster,[2] or a medical center overpaying employees because of poor controls over payments,[3]

† Associate Professor of Law, University of Houston Law Center. I am very thankful for helpful feedback on earlier drafts of this Article from Richard Alderman, Adam Badawi, Peter Linzer, Thomas Kohler, Nathalie Martin, Jeff Sovern, Dru Stevenson, and Ronald Turner. For research assistance, I am grateful to Olivia Peña and Charles Pendergraft.

1. *See* Scot J. Paltrow & Kelly Carr, *How the Pentagon's Payroll Quagmire Traps America's Soldiers*, REUTERS (July 9, 2013, 6:11 PM), http://www.reuters.com/article/2013/07/09/us-usa-pentagon-payerrors-special-report-idUSBRE96818I20130709 ("Pay errors in the military are widespread.").

2. *See* Marsha Shuler, *LSU Agency Audit Finds Pay Errors*, ADVOC. (Baton Rouge), May 22, 2007, at A4 ("[LSU] Health Sciences Center in New Orleans overpaid its employees $600,000 to $700,000 in the turmoil after Hurricane Katrina, the Legislative Auditor stated Monday.").

3. *See State Comptroller DiNapoli's Audit Finds Employee Overpayments at SUNY Downstate Medical Center*, U.S. ST. NEWS, Dec. 24, 2008 ("The State University of New York's (SUNY) Downstate Medical Center allowed 118 current and former employees to collect salary payments totaling $490,257 to which they were not entitled because of poor controls over its payroll system, according to an audit by State Comptroller Thomas P. DiNapoli."). Other reported examples are easy to find. For just a few examples, see Diane Heldt, *State Audit Again Notes UI Overpayments*, GAZETTE (Iowa City) (July 8, 2013, 4:15 PM), http://thegazette.com/2013/07/08/state-audit-again-notes-ui-overpayments ("An annual state audit noted for the third year in a row that the University of Iowa incorrectly made overpayments to employees. . . . It shows the UI incorrectly made 309 payroll overpayments totaling $805,095 during the 2011–2012 year. That's compared to 2010–11, when the university made 338 payroll overpayments to employees totaling $645,741."); Duane

employers seem to be particularly susceptible to making mistakes in paying wages.[4] On the surface, the situation may seem rather unremarkable—an employer pays an employee too much, and then the employee reimburses the overpayment when one of the parties discovers it. In reality, however, these common occurrences can wreak havoc on workers and their families,[5] and quite remarkably, the law does virtually nothing to protect employees.[6]

Consider two different people who owe money: a typical debtor—a woman who buys goods and services on credit and falls on hard financial times—and a commonly overpaid worker—a soldier. The first woman willingly entered into her credit relationships with credit card companies, a mortgage company, a car lender, or a doctor. Perhaps she spent money improvidently and lived beyond her means,[7] or perhaps she was driven to seek credit because of a liquidity crisis.[8] In either case, she made a voluntary choice to obligate herself to repay debts in the future because, presumably, she thought she was better off having the money immediately and repaying it over time. If she

Marstellar, *TN Unemployment Program Problems Cost Business Owners*, TENNESSEAN (Apr. 4, 2013), http://www.tennessean.com/article/20130404/BUSINESS01/106250027/TN-unemplyoment-program-problems-cost-business-owners ("In the report, the state comptroller's office said the labor agency often failed to follow its own procedures in administering the program, which pays up to 26 weeks of benefits to employees who lose their jobs through no fault of their own. That led to the $73 million in overpayments to ineligible employees in a recent six-year period."); *At Miami-Based Jackson Health System, Most Paychecks Are Incorrect*, HEALTH LEADERS MEDIA (Apr. 9, 2010), http://www.healthleadersmedia.com/content/HR-249312/At-Miamibased-Jackson-Health-System-most-paychecks-are-incorrect (citing a Miami Herald article that reported that 7,844 of 11,900 employees at one company were paid incorrectly); Sarah Carr, *Recovery School District's Books Are in Better Shape, but Still Flawed, Audit Finds*, TIMES-PICAYUNE (New Orleans) (Jan. 25, 2010, 8:10 PM), http://www.nola.com/education/index.ssf/2010/01/recovery_school_districts_book.html ("In response to a Times-Picayune request, RSD officials released in November a listing of employee overpayments since 2006, which totaled about $650,000.").

4. For more examples, see *infra* Part I.A.

5. *See infra* Part I.C.

6. *See infra* Part III.

7. For an article encapsulating this vision of the typical debtor, see Edith H. Jones & Todd J. Zywicki, *It's Time for Means-Testing*, 1999 BYU L. REV. 177, 208 ("Bankruptcy is now too frequently a choice fostered by irresponsible spending habits and an unwillingness to live up to commitments.").

8. For an example of this view of typical debtors, see TERESA A. SULLIVAN, ELIZABETH WARREN & JAY LAWRENCE WESTBROOK, THE FRAGILE MIDDLE CLASS: AMERICANS IN DEBT xiv (2000) ("Many in the middle class are economically fragile, barely able to maintain their lifestyle.").

suffers some exogenous shock such as a medical problem or a divorce and cannot repay the debt on time,[9] the law offers her several important protections. First, her creditors cannot garnish more than 25% of her wages,[10] and in some states, they cannot garnish her wages at all.[11] Second, the law limits the conduct of any debt collectors seeking to recover the debt to ensure that the debt collectors behave according to minimal standards of decency.[12] Finally, in the event that she is unlikely to ever repay her debt, the Bankruptcy Code offers her a fresh start by allowing her to escape personal liability for her debts, freeing future income from the hands of her creditors.[13]

The soldier, on the other hand, did not voluntarily establish a debtor/creditor relationship. She was overpaid and never knew about it because military wages are complicated under any standard. Scot Paltrow and Kelly Carr explain: "Congress has made [military wages] even more complicated in recent decades by establishing a multitude of pay levels. There is basic pay, plus 'entitlements' for everything from serving in a combat zone to housing allowances, to re-enlistment bonuses. *An individual's pay can change several times in a day*."[14] It is not hard to imagine a soldier getting paid an extra several hundred dollars a month over several years and not realizing it. Not only is the soldier unaware of the overpayment, but also she is not to blame for it. The government's mistakes cause overpayments to

9. *See* Teresa A. Sullivan, Elizabeth Warren & Jay Lawrence Westbrook, *Less Stigma or More Financial Distress: An Empirical Analysis of the Extraordinary Increase in Bankruptcy Filings*, 59 STAN. L. REV. 213, 251 (Nov. 2006) ("In this contemporary financial environment, families could self-fund themselves through a difficult financial stretch using credit, but if they misjudged how long they would be unemployed or how high their medical bills would eventually go, they would find themselves unable to regain their economic footing because their debts were now sky-high. In other words, the changes in the credit industry in making money available to troubled borrowers may have changed the calculus that leads to bankruptcy. For some people, the lender offered a way for families to stay afloat longer and delay (or perhaps evade) the bankruptcy day of reckoning. But delay has its own costs. The interest payments increased so fast that even a small stumble meant that these borrowers would have to declare bankruptcy or literally never get out of debt.").

10. *See* 15 U.S.C. § 1673(a)(1) (2012).

11. *See, e.g.*, TEX. CONST. art. 16, § 28 ("No current wages for personal service shall ever be subject to garnishment, except for the enforcement of court-ordered: (1) child support payments; or (2) spousal maintenance.").

12. *See* 15 U.S.C. § 1692.

13. *See* 11 U.S.C. § 727 (2012).

14. Paltrow & Carr, *supra* note 1 (emphasis added).

soldiers—it created the payment system, inputted the relevant data, and issued the check.[15]

Even though the soldier spends the money on normal living expenses, when the government finds out about the mistake, it—and a spending-conscious public—obviously wants the money back.[16] Restitution provides the legal basis for correction because the mistake unjustly enriched the soldier.[17] Unlike the first debtor, the soldier does not have the protection of restrictions on wage garnishment because the government is not a third party garnishing wages but instead is just deducting money for the debt from wages it owes to the soldier.[18] The debt collection laws do not apply to an obligation created involuntarily, so debt collectors are free to use a wide variety of abusive collection techniques to recoup the funds.[19] Finally, the ultimate protection for debtors—bankruptcy—is largely unavailable. Even the soldier desperate enough to file for bankruptcy is personally liable for a debt she never agreed to take on.[20]

Soldiers, of course, are just one example, but this same scenario plays out for people from every line of work with every type of employer, and the magnitude of the errors is astounding.[21] Research indicates that errors cause employers to overpay employees by 1.2% per year on average.[22] Considering the fact that the federal government alone spends $200 billion a year in its payroll,[23] government employees are mistakenly

15. *See id.* ("Precise totals on the extent and cost of these mistakes are impossible to come by, and for the very reason the errors plague the military in the first place: the Defense Department's jury-rigged network of mostly incompatible computer systems for payroll and accounting, many of them decades old, long obsolete, and unable to communicate with each other. The DFAS accounting system still uses a half-century-old computer language that is largely unable to communicate with the equally outmoded personnel management systems employed by each of the military services.").

16. *See infra* Part I.B.

17. *See infra* Part II.A.

18. *See infra* Part III.C.

19. *See infra* Part III.A.

20. *See infra* Part III.B.

21. *See infra* Part I.A.

22. *See* Ayushman Baruah, *Efficient Workforce Management Key To Cutting Costs*, FIN. EXPRESS (Mar. 26, 2009, 11:10 PM), http://www.financialexpress.com/news/Efficient-workforce-mgmt-key-to-cutting-costs/439010/ ("A recent study by Nucleus Research indicates that on an average, companies overpay employees by 1.2% due to payroll errors.").

23. CONG. BUDGET OFFICE, COMPARING THE COMPENSATION OF FEDERAL AND PRIVATE-SECTOR EMPLOYEES vii (2012), *available at* http://www.cbo.gov/sites/default/files/cbofiles/attachments/01-30-FedPay.pdf.

overpaid by over $2 billion a year. And, that mistaken overpayment represents just 1.7% of the total American workforce,[24] meaning many employees find themselves in the same situation as my hypothetical debtor/soldier.

Comparing people indebted to credit card companies with mistakenly overpaid employees reveals a disturbing disjunction that has not received any critical attention in the literature on debt collection, restitution, or employment law. Involuntary, unknowing, and often financially fragile employees have been left out in the cold under current debt laws. This Article offers the first explication and critique of the law governing mistaken overpayments to employees. Although the general literature on restitution is very rich[25] and scholars have discussed overpayments in other contexts,[26] scholars have not recognized the absence of laws to protect overpaid employees from abuse and harm. This Article uncovers current law's failure to protect mistakenly overpaid employees and offers judicial and legislative strategies to shelter these employees.

Part I discusses the mechanics of overpayments—why they happen, why employers work so hard to recover them, and how they affect employees. I draw on the military as a case study to provide a detailed example of the importance of this problem in the lives of many low-income Americans.

Part II explains the legal framework that allows employers to recover mistaken overpayments. Overpayments are a classic

24. *Id.*

25. For just a few examples, see HANOCH DAGAN, THE LAW AND ETHICS OF RESTITUTION (2004); Richard R.W. Brooks & Alexander Stremitzer, *Remedies on and off Contract*, 120 YALE L.J. 690 (2011); Douglas Laycock, *Restoring Restitution to the Canon*, 110 MICH. L. REV. 929 (2012); Lionel Smith, *Legal Epistemology in the* Restatement (Third) of Restitution and Unjust Enrichment, 92 B.U. L. REV. 899 (2012).

26. *See generally* David C. Baldus, *Welfare as a Loan: An Empirical Study of the Recovery of Public Assistance Payments in the United States*, 25 STAN. L. REV. 123 (1973) (exploring welfare programs that treat some assistance as loans); Stephanie Ben-Ishai et al., *The Role of Government as a Creditor of the Disadvantaged*, 35 QUEEN'S L.J. 539 (2010) (discussing overpayments by government assistance programs); Andrew Burrows, *Restitution of Mistaken Enrichments*, 92 B.U. L. REV. 767 (2012) (outlining several areas of conflict in the English law of mistaken overpayments); Marie A. Failinger, *Contract, Gift, or Covenant? A Review of the Law of Overpayments*, 36 LOY. L. REV. 89 (1990) (describing the law governing overpayments from welfare programs); Stella L. Smetanka, *The Disabled in Debt to Social Security: Can Fairness Be Guaranteed?*, 35 WM. MITCHELL L. REV. 1084 (2009) (explaining the consequences of overpayments by the Social Security Administration); Adam S. McGonigle, Note, *Applying Equitable Estoppel to ERISA Pension Benefit Claims*, 54 WM. & MARY L. REV. 627 (2012) (discussing pension benefit overpayments).

example of unjust enrichment, so I survey the law of restitution and defenses to restitution actions to show why employers can recover overpayments. More importantly, Part III explains *how* employers recover overpayments—through the self-remedy of setting-off future wages. Self-help allows the employer to act as a judge, a jury, and an agent to execute the judgment without any oversight from courts.

Part IV surveys the laws that protect most debtors—debt collection laws, bankruptcy, and protections for wages. A careful examination of these laws reveals that, contrary to our intuitive response, they do not protect employees who become debtors because of overpayments.

This Article concludes by suggesting ways that courts and legislatures can police employers' collection efforts. I argue that courts should expand defenses to restitution to protect employees who rely on overpayments. The legislative suggestion is even more straightforward. Congress should enact a statute that mandates that overpayments to employees be treated like any other unsecured debt. This relatively uncomplicated change would deny employers the special collection rights supplied by the current self-help remedy, and would ensure that employees have the same protections as other unsecured debtors.

I. THE MECHANICS OF OVERPAYMENTS AND THE HARMS OF AGGRESSIVE COLLECTION

In assessing the legal framework governing mistaken overpayments, it is essential to understand the context in which overpayments occur. This Part uses the military as a case study in why employees are overpaid, why employers are especially motivated to recoup overpayments, and why these efforts are so harmful to employees. Mistaken overpayments to military personnel are a serious problem.[27] The Government Accountability Office conducted a study in 2012 that found that "the nearly $47 billion in reported fiscal year 2011 Army active duty military payroll includes Army service members who re-

27. *See* 155 CONG. REC. E1355 (daily ed. June 9, 2009) (statement of Rep. Carol Shea-Porter) (stating that "[p]ayment errors are common in all military branches" and that military personnel report that overpayment errors were one of their "most significant problems"); John P. Einwechter, *New Developments in Substantive Criminal Law Under the* Uniform Code of Military Justice (1997), ARMY LAW. 20, 30 (1998) (noting that a case involving overpayments is "now a familiar one to military courts").

ceived pay to which they were not entitled and others who did not receive the full pay they were due."[28] More specifically, in 2011, the military "was pursuing" over $50 million of pay-related debts just for soldiers who had already left active service.[29] "[M]ilitary pay-related debts accounted for over 90 percent of the Army's out-of-service debts in fiscal year 2011."[30] While overpayments occur in many settings,[31] the military provides a rich context in which to study overpayments, and it is particularly important as a policy matter because it implicates national security concerns and public spending in addition to concerns about the welfare of low-income Americans. After outlining the reasons that overpayments are so common in the military (and other contexts), I describe the powerful motivation officials have for recouping overpayments from soldiers. This Part concludes by detailing the harmful effects that aggressive collection of overpayments has on the individuals affected.

A. THE REASONS FOR OVERPAYMENTS

Numerous entities are involved in administering pay to military personnel. Military pay levels and policies are set by the Department of Defense's Comptroller's Office.[32] A soldier's unit commander and a handful of other parts of the military organization generate personnel records that dictate how much the military should pay an employee.[33] The Defense Finance and Accounting Service ("DFAS") is the entity that processes the military's payroll.[34]

On the one hand, the military mistakenly overpays its employees for some rather mundane reasons. Overpayments may

28. U.S. GOV'T ACCOUNTABILITY OFFICE, DOD FINANCIAL MANAGEMENT: ACTIONS NEEDED TO ADDRESS DEFICIENCIES IN CONTROLS OVER ARMY ACTIVE DUTY MILITARY PAYROLL ii (Dec. 2012), *available at* http://www.gao.gov/assets/660/650826.pdf.

29. *Id.* at 10.

30. *Id.*

31. The following footnotes point out evidence that many of the issues encountered in the context of the military also exist in other situations as well.

32. *See* U.S. GOV'T ACCOUNTABILITY OFFICE, *supra* note 28, at 3.

33. *Id.* at 4 ("DFAS-IN and its Military Pay Operations (Mil Pay Ops) staff rely on numerous Army military personnel records generated by the Army Reception Battalion installation personnel offices, Defense Military Pay Offices (DMPO), Army Finance Offices, Army Human Resources Command, and unit commanders to establish and update active duty military pay accounts in DJMS-AC.").

34. *See id.*

result from data entry errors[35] and failures to submit the correct paperwork to change an employee's status from, for instance, service in a combat zone to service outside a combat zone.[36]

Other causes, however, are less pedestrian. The sheer complexity of the military's pay arrangement causes errors because people assigning wages have so many moving parts to deal with. Different positions obviously have different pay rates, but other factors also set an employee's pay, including the length of time in service, the employee's location, the employee's marital status, and the employee's dependents.[37]

The military also changes its personnel's compensation based on things such as "pay of medical and dental officers, pay for hostile fire or imminent danger, and pay for foreign language proficiency; bonuses; allowances; allotments; tax withholding; and leave."[38] The system is so dynamic that pay levels can change throughout a single day.[39]

35. *See id.* at 19. Such errors cause overpayments in civilian industries as well. *See* Jon Ortiz, *Audit: Departments Wrongly Doled Out Hourly Jobs to Managers*, SACRAMENTO BEE (May 17, 2013), http://blogs.sacbee.com/the_state_worker/2013/05/audit-departments-wrongly-doled-out-hourly-jobs-to-managers.html ("Some of California's most prominent departments improperly gave salaried managers additional jobs that pay an hourly wage, violating civil service rules, according to a[n] audit released late this afternoon. . . . Investigators concluded the mistakes were clerical errors.").

36. *See* U.S. GOV'T ACCOUNTABILITY OFFICE, *supra* note 28, at 21 ("Overpayments may occur when a servicemember returns from a combat zone deployment to a duty station in the United States and the Army personnel system fails to notify the pay system."). Again, these sorts of errors occur outside the military as well. Heldt, *supra* note 3 ("'Overpayments generally occur when electronic forms reflecting changes in employment status are not submitted by the employing department on a timely basis, according to the report. When payroll cutoff dates are a week in advance of the month's end, overpayments and underpayments are unavoidable given the many factors affecting the UI's full-time and part-time employees,' Moore said."); *see also* Lawrence v. United States, 69 Fed. Cl. 550, 552 (2006) ("Plaintiff and his colleagues in Germany were informed that because of mismanagement and negligence by individuals overseeing the LQA program in Washington, D.C., they had received these payments in excess of those authorized by statute and were responsible for repaying the overpayments.").

37. *See* U.S. GOV'T ACCOUNTABILITY OFFICE, *supra* note 28, at 4.

38. *Id.* at 3.

39. Paltrow & Carr, *supra* note 1. Outside the military, employers have also faced obstacles to correctly calculating pay because of an inability to "accurately track time off," Zachary Reid, *City Schools' Payroll Unit Criticized*, RICHMOND TIMES-DISPATCH, June 23, 2009, at B1, and because of other complicated payroll considerations. *See* Karen Florin, *Retired DOC Worker Told He Was Overpaid*, THEDAY.COM (Feb. 17, 2012, 3:53 PM), http://www.theday.com/article/20120217/NWS01/120219639 (quoting a spokesman for the Con-

The computer software that DFAS uses to process this complex scheme is very old.[40] One report describes the dire straits:

> [T]he Defense Department [uses a] jury-rigged network of mostly incompatible computer systems for payroll and accounting, many of them decades old, long obsolete, and unable to communicate with each other. The DFAS accounting system still uses a half-century-old computer language that is largely unable to communicate with the equally outmoded personnel management systems employed by each of the military services.[41]

Indeed, the software is so old that the military has a hard time finding people who are proficient in the language it uses.[42] Additionally, accounting is complicated by the fact that the military has literally thousands of different accounting and business systems in place.[43] Fixing problems within or even using

necticut Department of Corrections explaining that overpayments are not unusual because "[t]he formulation of payroll is so complicated because of accruals of vacation time, longevity, etc."). Complexity also causes overpayments in oil and gas leases. Douglas R. Hafer & Daniel B. Mathis, *Mineral Royalty Mispayments: The Payor's Rights, Obligations, and Risks in Royalty Mispayment Scenarios, Including the Pitfalls and Prerogative of Self-Help Recoupment*, 18 TEX. WESLEYAN L. REV. 85, 86 (2011) ("Given an operator's large volume of oil and gas production, the numerous and disparate leases under which production is carried out, the varying royalty fractions, the minute decimal interests, and the cumbersome calculation models that often dictate royalty payments, as well as the thousands of diverse payees receiving the royalty payments, it is inevitable that either human or electronic error will occasionally cause incorrect royalty distributions. For these same reasons, such mistakes may go unnoticed for many months or even years.").

40. *See* Paltrow & Carr, *supra* note 1.

41. *Id*. Similarly, software problems have caused other mistaken overpayments. *See At Miami-Based Jackson Health System, Most Paychecks Are Incorrect*, *supra* note 3 (reporting that a software conversion led to mistakes in the paychecks of 7,844 of a company's 11,900 active employees).

42. Paltrow & Carr, *supra* note 1 ("As time passes, the pool of Cobol expertise dwindles." (internal quotation marks omitted) (quoting an Army assistant deputy chief of staff)).

43. Scot J. Paltrow, *The Pentagon's Doctored Ledgers Conceal Epic Waste*, REUTERS (Nov. 18, 2013, 9:56 AM), http://www.reuters.com/article/2013/11/18/us-usa-pentagon-waste-specialreport-idUSBRE9AH0LQ20131118 ("No one can even agree on how many of these accounting and business systems are in use. The Pentagon itself puts the number at 2,200 spread throughout the military services and other defense agencies. A January 2012 report by a task force of the Defense Business Board, an advisory group of business leaders appointed by the [S]ecretary of [D]efense, put the number at around 5,000. 'There are thousands and thousands of systems,' former Deputy Secretary of Defense Gordon England said in an interview. 'I'm not sure anybody knows how many systems there are.'").

this complex, outdated system is extremely difficult, providing fertile ground for mistakes to arise.[44]

To compound the problems generated by the complex pay structure and outdated software, the military cannot effectively discover errors. The military lacks an efficient system for detecting errors,[45] and it has no mechanism for comprehensively assessing the accuracy of its payroll system.[46] This lack of financial controls allows mistakes to persist over time.[47] The end result of these factors is that many military personnel encounter the problem of the military seeking to recover mistaken overpayments.[48]

B. THE MOTIVATION FOR RECOVERING OVERPAYMENTS

All employers are obviously motivated to recover overpayments for economic reasons. People have created numerous guides to aid employers seeking to recover overpayments.[49] But in the setting of the military and other public spending, another powerful motivation is the public's disdain for government waste.[50] When people discover the government has mistakenly

44. *See id.*

45. U.S. GOV'T ACCOUNTABILITY OFFICE, *supra* note 28, at 9.

46. *Id.* at 18.

47. *Id.* Poor controls over payroll systems cause overpayments in other contexts as well. *Audit of Yonkers Schools Find Weak Internal Controls over Payroll, Contracts and Payments*, OFFICE OF THE N.Y. STATE COMPTROLLER (Nov. 16, 2006), http://www.osc.state.ny.us/press/releases/nov06/111606.htm ("Weak internal financial controls in the Yonkers City School District led to excess overtime payments, salaries that were higher than authorized, and impermissible sick leave payments to some school district employees as well as other accounting problems, according to an audit issued today by State Comptroller Alan G. Hevesi."); *State Comptroller DiNapoli's Audit Finds Employee Overpayments at SUNY Downstate Medical Center*, *supra* note 3 ("The State University of New York's (SUNY) Downstate Medical Center allowed 118 current and former employees to collect salary payments totaling $490,257 to which they were not entitled because of poor controls over its payroll system, according to an audit by State Comptroller Thomas P. DiNapoli.").

48. *See* Paltrow, *supra* note 43.

49. For one example, see M. Christine Carty & Alizah Z. Diamond, *FAQ: Making Wage Deductions To Recover Inadvertent Overpayment of Wages*, SCHNADER (Sept. 3, 2013), http://www.schnader.com/files/Uploads/Documents/SH549-L&E_ALERTFAQ.09.13-prf3.pdf.

50. *See, e.g.*, Failinger, *supra* note 26, at 105 (describing the political pressure to recover overpayments by the Social Security Administration); *City's Budget Missteps Draw Flak from Citizens*, ARIZ. REPUBLIC, Oct. 9, 2009, at 4 ("Speakers at the meeting [about mistaken severance overpayments] said they were 'appalled' and 'flabbergasted' that city staff could commit such gross financial errors."); B.J. Reyes, *Senators Upbraid Officials for Overpaying Employees*, STARADVERTISER.COM (Mar. 14, 2012, 1:30 AM), http://www

overpaid employees, they demand that the government recover the money.[51] Governments are criticized if they are ineffective in recovering mistaken payments[52] and are instructed to increase aggressive debt collection.[53] People are enraged when debt collection activities against public employees cease.[54] Because the military and other public entities have a strong interest in preserving goodwill and funding, they experience significant pressure to recover overpayments.

.staradvertiser.com/s?action=login&f=y&id=142595426 ("State senators scolded Cabinet members and other department officials Tuesday for messy bookkeeping and a perceived disregard for taxpayer money after discovering that public employees had been paid more than $2 million they weren't due.").

51. *See, e.g.*, James Dao, *Duplicate Payments Bedevil Veterans' Pension System, Employees Say*, N.Y. TIMES, Sept. 23, 2012, at A19 ("'No one has a real handle on this,' Representative Michael G. Fitzpatrick, a Republican from Bucks County, said in an interview. 'The V.A. management appears to believe it is not their responsibility to get our tax dollars back from people who should not have received the money in the first place.'").

52. *See, e.g.*, Josh Sweigart, *State Fails To Recover $60M in Missing Taxpayer Funds*, DAYTON DAILY NEWS (Mar. 8, 2012, 11:21 AM), http://www .daytondailynews.com/news/news/local/state-fails-to-recover-60m -in-missing-taxpayer-fun/nMzG7 ("State watchdogs tout their ability to track down misspent public money. But when it comes to retrieving that money, state officials have been largely ineffective . . . . 'Once we came into office, we saw this as something that needed to be addressed and improved,' said Carrie Bartunek, spokeswoman for Auditor of State David Yost. 'One of the primary purposes of our office is to protect taxpayer dollars.'").

53. Ben-Ishai et al., *supra* note 26, at 550 ("In the 2004 report, the [Office of the Auditor General of Ontario] criticized the [Ontario Disability Support Program] for being lax in its efforts to collect the overpayments, in both active and inactive cases. In particular, the program was criticized for not applying the directive which provides that benefits on active accounts can be reduced by up to ten percent."); *Camden Council Calls for Inquiry*, COURIER-POST (Cherry Hill, N.J.), May 24, 2006, at B1 ("The [S]tate Department of Community Affairs continues to maintain that the city must recover $2.6 million from its employees for an overpayment in 2004, said spokesman Sean Darcy."); Josh Richman, *Audit: State Prisons Had Lousy Bookkeeping*, MERCURY NEWS (San Jose) (July 20, 2011, 4:15 PM), http://www.mercurynews.com/breaking-news/ci_18516583 ("The review of California Department of Corrections and Rehabilitation records found that inadequate collection efforts led to delays in collecting millions in overpayments for employee salary and travel advances. . . . The corrections department has now 'prioritized the vigorous collection of outstanding debts' . . . ." (quoting a corrections department administrator)).

54. *See* Teresa Walsh, Letter to the Editor, *Extra Cash Belongs to Schools*, N.Z. HERALD, Mar. 15, 2013, at A040 ("As an administrator of a school, I am incensed at the calling off of debt collector Baycorp's action against teachers and teacher aides who are not paying back their overpayments. My school has had more than $58,000 overpaid since August. All those who received part of this money have had three letters . . . . My school is still owed $29,000, which is money that could be being spent on educating pupils.").

C. THE HARMS OF AGGRESSIVELY RECOVERING OVERPAYMENTS

Recovering overpayments would be unobjectionable if it merely resulted in reallocating the money to the party that, absent an error, should have had it. But employers' attempts to recover funds often place employees in financial distress, and this distress has the potential to harm both the employee and parties completely unrelated to the transaction.[55] Obviously, not all mistaken overpayments have negative effects—small overpayments that can be easily repaid are trivial. But, larger overpayments paid out over time can cause the employee to become significantly indebted,[56] leading to the harms associated with financial distress. And, even small increases in employees' debt loads can cause problems.[57] People experience distress when their paychecks are decreased because even small decreases in income for low-income Americans create problems in paying bills.[58] Moreover, Americans in general are already highly leveraged.[59] Americans carry more than ten times the amount of debt we did fifty years ago (adjusting for inflation), one in seven are contacted by debt collectors in a given year, and "the annual number of freshly minted bankruptcy debtors [exceeds] the number of new college graduates."[60] Adding small amounts of debt can push vulnerable individuals into bankruptcy.[61]

On the most basic level, employees are harmed when they suddenly have less money coming into their accounts than before. In one highly publicized case, a soldier earning $3,300 a

55. Oren Bar-Gill & Elizabeth Warren, *Making Credit Safer*, 157 U. PA. L. REV. 1, 59–62 (2008).

56. *See, e.g.*, McCarron v. United States, 84 Fed. Cl. 616, 617 (2008) (finding that a military law enforcement officer was mistakenly paid $10,800.00 in wages); Lawrence v. United States, 69 Fed. Cl. 550, 552 (2006) (discussing how a transportation operation specialist in the General Services Administration was overpaid by $53,233.60 over a three year period); *see also* Stevedoring Servs. of Am., Inc. v. Eggert, 914 P.2d 737, 739, 740 (Wash. 1996) (en banc) (describing the Social Security Administration's claim that it mistakenly provided $106,464.73 to an injured longshoreman).

57. Michael S. Barr et al., *Behaviorally Informed Regulation*, *in* THE BEHAVIORAL FOUNDATIONS OF PUBLIC POLICY 440, 455 (Eldar Shafir ed., 2013).

58. *Id*.

59. Katherine Porter, *The Damage of Debt*, 69 WASH. & LEE L. REV. 979, 979–80 (2012).

60. *Id.* at 980.

61. *See generally* Paige Marta Skiba & Jeremy Tobacman, *Do Payday Loans Cause Bankruptcy?* (Vanderbilt U. L. & Econ. Res. Paper Series, Working Paper No. 11-13, 2011) (arguing that just the fees associated with payday loans push vulnerable borrowers into bankruptcy).

month was instead only paid $2,337.56 for a month and then just $117.99 so that the government could recover an overpayment.[62] Because many soldiers make lower wages, even small mistakes in payments "can be devastating," causing affected employees to turn to food pantries, emergency loans, and pawnshops.[63] The effects of overpayments are more pronounced on low-income Americans,[64] and many military personnel are vulnerable to financial harm.[65] Even a representative of the Defense Department has recognized that recouping overpayments is "catastrophic."[66] The Federal Trade Commission currently prohibits assigning wages as a source of collateral for a loan because of the risks inherent in giving creditors the ability to disrupt wages.[67]

62. Paltrow & Carr, *supra* note 1.

63. *Id.*; *see also* Thomas E. Geidt & Judith M. Kline, *Selected Wage & Hour Issues*, *in* CAL. BUS. LAW DESKBOOK § 16:18 ("[T]he Legislature has recognized the employee's dependence on wages for the necessities of life and has, consequently, disapproved of unanticipated or unpredictable deductions because they impose a special hardship on employees." (internal quotation marks omitted) (quoting Hudgins v. Neiman Marcus Grp., Inc., 41 Cal. Rptr. 2d 46, 51–52 (Ct. App. 1995))); Samantha Valerius, Note, *Safeguarding a Portion of the Retirement Nest Egg: ERISA and the Need for Regulations in Restricting Companies' Ability To Recoup Overpayment of Pension Funds Made to Struggling Retirees*, 33 HAMLINE J. PUB. L. & POL'Y 423, 428 (2012) ("Even if a benefit [to a retiree] is merely reduced, a beneficiary's monthly payments may decrease by 25 percent or more, devastating retirees with a fixed income.").

64. *Cf.* Ben-Ishai et al., *supra* note 26, at 542 ("[W]e show that debts owed to the government are especially important in the lives of low-income people."); Valerius, *supra* note 63, at 424–25 ("Recoupment actions are legal, and commonly pursued by companies in all sectors of the economy. The current legal and regulatory environment places the burden of administrative mismanagement of employee retirement plans on one of the most economically vulnerable populations: elderly retirees.").

65. *See* Christopher L. Peterson, *Removing the Target: Protecting Military Service Members and Veterans from Financial Predators*, HUM. RTS., Spring 2008, at 8 ("The great majority of service members are young, junior enlisted personnel who are frequently from economically challenged backgrounds. Moreover, most enlisted personnel have limited education experiences—indeed, the opportunity to save for an education is one of the primary benefits of military service. . . . And military culture and codes of conduct demand prompt repayment of even onerous and unfair debts.").

66. *DOD and VA Collaboration To Assist Service Members Returning to Civilian Life*: *J. Hearing with H. Armed Servs. Comm. Before the H. Comm. on Veterans' Affairs*, 113th Cong. 19 (2013) (statement of Jessica L. Wright, Acting Under Secretary of Defense for Personnel and Readiness, Department of Defense).

67. *See* 16 C.F.R. § 444.2(a)(3) (1988).

Beyond the problems associated with a period of having a lower income, there are also problems associated with being in debt. There is a substantial body of evidence that indicates a heavy debt load can harm individuals experiencing financial distress, their families, and even their employers.[68] In terms of the individuals themselves, debt can: cause people to diminish their wealth;[69] prevent people from getting future jobs because employers check potential employees' credit scores;[70] lead to medical problems;[71] affect access to credit and the terms of the credit;[72] and lower self-esteem.[73]

In addition to the costs to the employee, debt can hurt third parties.[74] Oren Bar-Gill and Elizabeth Warren summarize the research on these costs:

> The costs of financial distress are borne by immediate family members. . . .
>
> The impact of financial distress does not stop with the immediate family. An individual in financial distress will often require support from more distant family, friends, or the state. Such transfers from one individual to another, including transfers mediated by the state, involve transaction costs. . . .
>
> Financial distress also affects the productivity of borrowers-workers. Recent evidence collected by the [Department of Defense] shows that employees or, in the [Department of Defense's] case, military personnel, become less productive when in financial distress. This finding should not come as a surprise. An employee concerned about debt repayment and about protecting her family from abusive debt-collection practices is clearly less able to focus on work.[75]

68. *See generally* Porter, *supra* note 59.

69. *Id.* at 1005.

70. Jonathan Berr, *Should Employers Be Barred from Using Credit Reports in Hiring?*, CBS NEWS (Dec. 17, 2013, 5:12 PM), http://www.cbsnews.com/news/should-employers-be-prohibited-from-using-credit-reports-in-hiring.

71. Matthias Keese & Hendrik Schmitz, *Broke, Ill, and Obese: The Effect of Household Debt on Health* (Ruhr Econ. Paper No. 234, 2010), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1735420 (drawing a causal link between debt and physical/mental health).

72. *See generally* Katherine Porter, *Bankrupt Profits: The Credit Industry's Business Model for Postbankruptcy Lending*, 93 IOWA L. REV. 1369 (2008).

73. Porter, *supra* note 59, at 1011–12.

74. Bar-Gill & Warren, *supra* note 55.

75. *Id.*; *cf.* Amanda Harmon Cooley, *Promissory Education: Reforming the Federal Student Loan Counseling Process To Promote Informed Access and To Reduce Student Debt Burdens*, 46 CONN. L. REV. 119, 140 (2013) (arguing in the context of student loans that "excessive debts and inabilities to repay those debts have resulted in acute harms to individual students, their families, and society at large").

In the military specifically, mistaken overpayments can have even further reaching effects because financial distress can inhibit efficacious service.[76] If soldiers are focusing on ways to generate money to repay mistaken overpayments while dealing with wage deductions, lawsuits, or debt collection calls, the financial distress can "detract from their focus on mission."[77] If soldiers feel desperate for cash to repay an employer, they are more susceptible to extortion and more likely to lose their security clearance.[78]

In short, mistaken overpayments are commonplace, employers are very motivated to recover overpayments, and this aggressive recovery has the potential to harm vulnerable employees and their families. Recovery is only a lifeless threat, however, if employers lack a legal basis on which to recoup overpayments. The next Part describes the legal foundation for recovery actions and how employers actually recoup mistaken overpayments.

II. ESTABLISHING AN EMPLOYEE'S LIABILITY FOR OVERPAYMENTS—IN LAW AND IN FACT

Employers have a firm legal foundation for recovering overpayments because of the law of restitution. While employees theoretically have several defenses to restitution available to them under the law, these defenses only apply in narrow instances and will not generally help an overpaid employee avoid repayment. Moreover, employers rarely go through the courts to collect overpayments. Instead, they use a self-help remedy—offsetting any debt they believe the employee owes against the employee's future wages.

A. THE LAW: WHY EMPLOYERS CAN LEGALLY RECOVER OVERPAYMENTS

Restitution is a claim lawyers are increasingly turning to in litigation,[79] and absent a contractual provision that allows an

76U.S. GOV'T ACCOUNTABILITY OFFICE, *supra* note 28, at 20.

77. *Id*. *See also* Scott Carrell & Jonathan Zinman, *In Harm's Way: Payday Loan Access and Military Personnel Performance*, (Fed. Reserve Bank of Phila. Research Dep't, Working Paper No. 08-18, 2008), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1269414 (finding "some evidence that payday loan access has adverse effects on job performance and readiness").

78. Bar-Gill & Warren, *supra* note 55.

79. George P. Roach, *Unjust Enrichment in Texas: Is It a Floor Wax or a Dessert Topping?*, 65 BAYLOR L. REV. 153, 156 (2013) ("The rapid growth in the number of cases relating to unjust enrichment in both state and federal courts

employer to recover overpayments,[80] restitution is the primary legal theory for employers attempting to recover overpayments made to employees.[81] As summarized by the recently completed *Third Restatement of Restitution and Unjust Enrichment*, restitution's general principle is that a "person who is unjustly enriched at the expense of another is subject to liability in restitution."[82]

Overpaying on a contractual obligation is a paradigmatic example of unjust enrichment[83]: "Payment by mistake gives the payor a claim in restitution against the recipient to the extent payment was not due."[84] Overpaying an employee is an example of over performance of contractual obligations.[85] The doctrine of restitution's goal in these situations is to "bring the transfers between the parties into conformity with the true state of their contractual obligations"[86] by compelling the employee to return the overpayment.[87]

over the last twenty years confirms an increasing presence in litigation.").

80. *See* Northcutt v. Gen. Motors Hourly-Rate Emps. Pension Plan, 467 F.3d 1031, 1032–33 (7th Cir. 2006) (quoting a provision in an employment contract obligating the employee to repay any mistaken overpayments); Ravetto v. Triton Thalassic Techs., Inc., 941 A.2d 309, 325 (Conn. 2008) (noting in the context of advances on commissions, "many courts have reasoned that because the employer usually drafts the employment agreement, it easily may include language in the agreement obligating the employee to repay any advances that exceed commissions").

81. *See, e.g.*, W. E. Neely, *Liability for Overpayment of Allotments*, JAG J., Nov. 1953, at 13 (discussing restitution as the legal theory used to recover mistaken overpayments to military personnel); Cindy Carcamo, *Surf City Officials Sue Ex-Employee They Mistakenly Overpaid*, ORANGE COUNTY REG. (Jan. 2, 2009), http://www.ocregister.com/articles/city-128478-brooks-officials.html ("City officials are suing a former employee, hoping to collect thousands after they mistakenly overpaid the Lake Forest woman more than $85,000 in retirement benefits. . . . 'Brooks was unjustly enriched by the overpayment of supplemental retirement benefits,' the lawsuit states.").

82. RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 1 (2010).

83. *See* Douglas Laycock, *The Scope and Significance of Restitution*, 67 TEX. L. REV. 1277, 1284 (1989). In his seminal essay on restitution, Douglas Laycock explains that one place where restitution matters most is situations where restitution is the only basis for civil liability. *See id*. The first example of such a situation he offers is where a defendant is "enriched by mistake, as in cases of mistaken payments . . . ." *Id*.

84. RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 6 (2010).

85. *See id*. § 6 cmt. c.

86. *Id.*

87. *See id.* One recent case summarizes some courts' approach succinctly: "In fact, courts grant recovery in this situation—whether the mistake is exclusively the employer's or a mutual one—'almost as a matter of course and with-

This result is unsurprising if the employee who receives an overpayment knows of the overpayment and accepts it anyway, and the employer's mistake in overpaying is an innocent one.[88] But what is the result if the employer's negligence caused the overpayment? On the one hand, the Restatement explains that a claimant cannot "profit by his own wrong,"[89] so if an employer knowingly overpays an employee, the employer will not be able to recover.[90] But restitution generally requires that claimants be *conscious* of their wrongdoing for courts to prevent them from using restitution to recover overpayments,[91] so negligent overpayment does not preclude restitution.[92] Thus, even if an employer is negligent in overpaying an employee, restitution gives that employer a right to recover the mistaken payment.

Depending on the circumstances, employees may be able to raise several defenses to employers' claims for restitution, but none of them are likely to work in most cases. First, if the employer's compensation system is extremely unreliable, employ-

out extended discussion.'" Baylor v. Gen. Anesthesia Servs., Inc., Civil Action No. 2:04–CV–01265, 2006 WL 2290707, at *3 (S.D. W. Va. Aug. 8, 2006) (quoting G.B. Crook, Annotation, *Recovery Back by Employer of Compensation Paid to Employee as Result of Mistake or the Employee's Fraud*, 88 A.L.R.2d 1437, 1451 (1963)); *see also* Duncan v. Office Depot, 973 F. Supp. 1171 (D. Or. 1997); Green Local Teachers Ass'n v. Blevins, 539 N.E.2d 653 (Ohio Ct. App. 1987) (holding a board of education could recover overpayments made to teachers because of the education board's treasurer's miscalculation); Salvati v. Streator Twp. High School Dist. No. 40, 200 N.E.2d 122 (Ill. App. Ct. 1964); Aebli v. Bd. of Educ., 145 P.2d 601 (Cal. Dist. Ct. App. 1944) (holding that employer could get overpayments back without considering the fact that employees relied on the wages and did not seek other jobs).

88. *See* RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 6 cmt. a (2010) ("On the other hand, the recipient of a mistaken payment who is aware at the time of the payor's mistake is almost certain to be liable in restitution, because notice to the recipient will foreclose the most significant of the affirmative defenses.").

89. *Id.* § 3.

90. Cassells v. Hill, No. 1:07-CV-2755-TCB, 2010, WL 4616573, at *11 (N.D. Ga. Nov. 8, 2010) (denying an employer's motion for summary judgment to recover wages mistakenly paid because "Cassells [the employee] does resist the county's claim and argues against the unfairness of refunding his salary and benefits when, according to Cassells, the county knew that he was no longer working in the Sheriff's Office but continued paying him anyway").

91. RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 3 cmt. a (2010).

92. *Id.* § 65 cmt. a ("[A] recipient's primary liability in unjust enrichment is usually independent of questions of fault. The claimant in a mistaken-payment case has often been negligent; the recipient is typically blameless. Liability is initially imposed without reference to this comparison, because (but only so long as) the recipient is not being asked to bear any loss.").

ees could invoke the voluntary payment rule as a defense to a restitutionary claim. As we might guess from the name, the voluntary payment rule prevents payors from recovering payments that are made voluntarily.[93] Typically, the rule involves payments made as a result of mistakes about legal rules where the payor makes a payment and later discovers the payment was not legally compelled.[94] Mistakes of fact, on the other hand, do not usually give rise to this defense.[95] The rule exists primarily to support lawsuit settlements by making payments binding even in light of uncertain legal rules.[96]

Mistaken overpayment in the employment context is almost by definition involuntary or a mistake of fact, making the defense generally inapplicable. Yet, the voluntary payment rule includes payments made "in the face of a recognized uncertainty as to the existence or extent of the payor's obligation,"[97] and some courts consider a payor's failure to investigate the facts sufficient to prevent the payor from seeking restitution for a mistaken payment. In *Bank of Saipan v. CNG Financial Corp.*, a bank and a company were both defrauded by a third party who got a loan from the bank and paid the money to the company.[98] The bank sued the company for unjust enrichment, but the company defended by arguing that the bank had "unclean hands" because it failed to investigate the third party's credit and collateral before giving him the loan.[99] The Fifth Circuit Court of Appeals sent the case back to a jury to determine whether the bank's negligence contributed to its losses and thus should reduce its claim against the company.[100] In the same way, a court might hold that an employer who routinely

93. *Id.* § 6 cmt. e.

94. Hafer & Mathis, *supra* note 39, at 91–92.

95. *Id.* ("The [voluntary payment rule] is an effective defense even if the payor is mistaken as to his legal obligation to pay—an error commonly referred to as a 'mistake of law.' . . . That being said, overpayments may be recovered if they are made due to a 'mistake of fact.' In this regard, recovery of payments based on a mistake of fact does not violate the policies underlying the [voluntary payment rule] because such mistakes do not contribute to the party's determination of its liability to pay, and such factual mistakes generally vitiate the 'voluntariness' of the payment.").

96. *Id.* at 90.

97. RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 6 cmt. e (2010).

98. Bank of Saipan v. CNG Fin. Corp., 380 F.3d 836, 838–39 (5th Cir. 2004).

99. *Id.* at 841–42.

100. *Id.* at 842.

overpays employees has unclean hands and should not recover completely. While a negligent mistake of a fact might not qualify for the voluntary payment defense as a complete bar to recovery, it could reduce any recovery for an employer.[101]

Still, courts might be unwilling to extend the voluntary payment defense beyond its traditional boundaries, making it problematic for employees to use.[102] Also, for many overpayment cases, the employee will be unable to establish that the employer was negligent in designing its compensation system, further limiting the usefulness of this defense.

Second, some employees could raise an affirmative defense that the overpayment caused a detrimental change of position. Section 65 of the *Third Restatement of Restitution* outlines the defense: "If receipt of a benefit has led a recipient without notice to change position in such manner that an obligation to make restitution of the original benefit would be inequitable to the recipient, the recipient's liability in restitution is to that extent reduced."[103] Employees who spend the money their employers overpay them can establish a defense to restitution if they can establish that they *only* spent the money because of the overpayment. The comments to the *Restatement* explain:

> When a claimant makes a payment that is otherwise subject to restitution, the fact that the recipient has spent the money is not of itself a defense to liability in restitution, because an expenditure of funds—without more—does not constitute a change of position. To be entitled to a defense on this ground, the recipient must demonstrate a causal

101. *See* Hafer & Mathis, *supra* note 39, at 97 ("If the payor was negligent, or was carelessly ignorant of the facts as to which he was mistaken, while not necessarily barring recovery, those factors could be considered in determining the equities between the parties and may reduce the amount of recovery."). Another possible variation of this defense is that if a party is negligent in discovering an overpayment, a court might deny recovery for the overpayment because the party overpaying did not notify the other party within a reasonable time. Johnson Controls, Inc. v. Jay Indus., Inc., 459 F.3d 717, 724–25 (6th Cir. 2006) (holding plaintiff can only recover amount of overpayment after notice was given since notice was not given in a reasonable time).

102. *See* Helen Scott & Danie Visser, *Excess Baggage? Rethinking Risk Allocation in the* Restatement (Third) of Restitution and Unjust Enrichment, 92 B.U. L. REV. 859, 880 (2012) (discussing mistaken overpayments of legitimate obligations and concluding that it could not "conceivably nullify a contract in accordance with the provisions of sections 151 through 154 of the *Restatement (Second) of Contracts*").

103. RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 65 (2010). The defense has a long history in English law. *See, e.g.*, Buller v. Harrison, [1777] 98 Eng. Rep. 1243 (K.B.). For a discussion of English law's conceptualization of the defense, see Yung F. Chiang, *Payment by Mistake in English Law*, 11 FLA. J. INT'L L. 91, 158–62 (1996).

> relationship between receipt and expenditure: in other words, that the expenditure is one that would not have been made but for the payment or transfer for which the claimant seeks restitution.
>
> Because this causal relationship is usually conceded, the more important test relates to the nature of the expenditure. Spending money is normally not a change of position unless the consequence of rejecting the defense (and imposing a liability in restitution) would be a net decrease in the recipient's assets. Expenditures devoted to extraordinary consumption or to gifts have this effect; ordinary living expenses, debt repayment, and the acquisition of capital assets generally do not.[104]

Many employees that receive overpayments likely spend the money on ordinary living expenses, rendering this defense unhelpful. One of the *Restatement*'s illustrations describes an employer overpaying an employee because of a clerical error relating to the employee's W2. If the IRS forces the employer to pay the money to the Treasury, the employer "has a prima facie entitlement to restitution from [the e]mployee."[105] Such an employee, the *Restatement* explains, could not use a change of position to defend against the restitution claim if the employee "defends on the ground that the refund has been consumed in everyday living expenses."[106]

PaineWebber, Inc. v. Levy[107] provides one of many examples of this rule in action.[108] In *PaineWebber*, the claimant mistakenly overpaid the defendant because of confusion concerning a reverse stock split.[109] The defendant argued he should not have to repay the mistaken payment because he spent the money on "a

104. RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 65 cmt. c.

105. *Id.* § 65 cmt. c, illus. 12.

106. *Id.*; *cf.* CSX Transp., Inc. v. Appalachian Railcar Serv., Inc., 509 F.3d 384, 388 (7th Cir. 2007) (applying Indiana law and holding that the mere fact someone has spent money given to them by mistake does not preclude a claim for restitution).

107. PaineWebber, Inc. v. Levy, 680 A.2d 798 (N.J. Super. Ct. Law Div. 1995).

108. *See, e.g.*, United States v. Reagan, 651 F. Supp. 387, 388 (D. Mass. 1987) (spending money from a mistaken tax refund did not establish a detrimental change of position); Monroe Fin. Corp. v. DiSilvestro, 529 N.E.2d 379, 384 (Ind. Ct. App. 1988) (spending money on home improvement did not meet the elements for a detrimental change of position); Westamerica Sec., Inc. v. Cornelius, 520 P.2d 1262, 1270 (Kan. 1974) ("If the payee uses the erroneous payment to pay debts existing when he received the money, or to pay living expenses, there is no change of position as will be a defense to an action to recover the payment."); Messersmith v. G.T. Murray & Co., 667 P.2d 655, 658 (Wyo. 1983) (concluding payment of bills and the purchase of a house did not meet the test of change of position).

109. *PaineWebber, Inc.*, 680 A.2d at 798.

past debt to his veterinarian," "his daughter's college tuition and expenses, including $2500 for a new computer," and his "own living expenses."[110] The court refused to grant summary judgment on the detrimental change of position defense on all the expenses except the computer purchase because it found that the defendant incontestably "would not have purchased the computer, but for the overpayment"[111] but that there were genuine issues of material fact concerning the other expenses.[112]

Some older cases use a more generalized approach and hold that spending money is never a change of position because the person spending the money receives something of value from the exchange, so the person is not worse off.[113] *Kunkel v. Kunkel*, a case from 1920, exemplifies this view:

110. *Id.* at 799.

111. *Id.* at 800.

112. *Id.* The court's analysis is worth considering:

> Genuine issues of material fact exist which make summary judgment inappropriate in the case at bar. It is unclear whether Levy would have paid for his daughter's college tuition and expenses absent the overpayment. He had paid for her tuition during prior semesters, but in September 1993, both Levy and his wife were discharged from Chapter 7 bankruptcy. If Levy would have paid for his daughter's college expenses (approximately $12,000) without the benefit of the overpayment, then restitution of that amount is appropriate.
>
> In addition, it is unclear which of Levy's living expenses were ordinary, and which were induced by his good faith reliance upon his right to the $25,000 overpayment. For example, Levy testifies that he "was watching the money even though I was a little easier . . . giving out money at that time because I had this amount of money and I thought that it was going to increase three times." While one may infer from this statement that Levy did not use the proceeds for anything but ordinary living expenses, he goes on to state that he would not have purchased a $2500 computer for his daughter without the overpayment. Plaintiff's motion and defendant's cross motion for summary judgment are denied, because genuine issues of material fact remain as to what portion of the overpayment was detrimentally relied upon by Levy in his expenditures for living expenses and his daughter's college expenses.

Id. Like in other cases, the change of position defense could be a partial defense here. *See, e.g.*, Firestone Tire & Rubber Co. v. Cent. Nat. Bank, 112 N.E.2d 636, 645 (Ohio 1953).

113. *See, e.g.*, Union Trust Co. v. Gilpin, 84 A. 448, 450 (Pa. 1912) ("It has been sometimes said that plaintiff's laches will preclude recovery unless defendant can be put in status quo. And it is upon this principle that it was sought to be proven here that defendant had spent the money. There is neither reason nor authority, however, to support the theory that the mere fact of the money having been spent amounts to an alteration of defendant's legal position. It is enough to say that, if it were so, the instances in which the right to recover has been affirmed would have been much less frequent.").

> If defendant spent the money, presumably he has either the things which it purchased or the benefit therefrom; or, if, as intimated in a refused offer of proof, he set the fund aside for the benefit of, or gave it to, his mother (for whose support he had a contingent legal liability), this cannot fairly be said to represent a loss to him, which bars plaintiffs."[114]

Some recent cases seem to follow this reasoning, holding, for instance, that a defendant who paid off her mortgage with a mistaken payment had not detrimentally relied on the overpayment because she retained the value of that payment.[115]

But, there are other cases like *PaineWebber* where courts have found that a change of position barred a claim for restitution. The elements of the defense that many courts require the defendant to establish are that the "change must be detrimental to the payee, material and irrevocable."[116] A Texas court of appeals case, *Lincoln National Life Insurance Company v. Rittman*, illustrates the sort of facts that meet the elements.[117] In *Rittman*, an insurance company erroneously overpaid a hospital for treatments it was giving to an insured's daughter.[118] The insurance company sued the hospital and the insured to recover the payments, and the insured defended by testifying "that he could not have kept his daughter in treatment without the extended payments, and that he would have withdrawn her if he had had to pay the medical costs personally."[119] The court did not think that recovery would be equitable under the circumstances, likely because of the insured's extraordinary ex-

114. Kunkel v. Kunkel, 110 A. 73, 75 (Pa. 1920).

115. Ohio Co. v. Rosemeir, 288 N.E.2d 326, 329 (Ohio Ct. App. 1972). *See also* Shearson/Am. Express, Inc. v. Mann, 814 F.2d 301, 306 (6th Cir. 1987) (holding that converting a mistaken payment into a real estate investment was not a detrimental change of position); Monroe Fin. Corp. v. DiSilvestro, 529 N.E.2d 379, 384 (Ind. Ct. App. 1988) (holding purchasing furniture and appliances was not a detrimental change of position); *Firestone Tire & Rubber Co.*, 112 N.E.2d at 645 (holding that bank's use of overpayment as security for a loan was not a detrimental change of position).

116. Capin v. S & H Packing Co., 636 P.2d 1223, 1224 (Ariz. Ct. App. 1981) (quoting Jonklaas v. Silverman, 370 A.2d 1277, 1281 (R.I. 1977)). On the irrevocable element, see *Shearson/Am. Express, Inc.*, 814 F.2d at 306 (holding that a defendant had not detrimentally changed his position by using funds to acquire real estate investments because the value of the mistaken payment had not been lost but merely had been converted into an investment).

117. Lincoln Nat'l Life Ins. Co. v. Rittman, 790 S.W.2d 791 (Tex. Ct. App. 1990).

118. *Id.* at 792.

119. *Id.*

penses, and therefore denied the insurance company from recovering its overpayments.[120]

So, an employee could theoretically use the detrimental change of position defense, but only if the employee made extraordinary purchases with the overpayment. In addition to being limited to this small group of defendants, however, this defense may be hard to establish because the employee has the burden of proof.[121] More importantly, for members of the military, the fact that payments to military personnel involve public funds makes the defense even harder to establish. When public money is involved, courts are less likely to allow individual litigants to keep money because it thwarts the will of the public.[122] In *Office of Personnel Management v. Richmond*, the Supreme Court rejected a claim from a Navy employee for disability annuity payments despite the fact he relied on a federal government employee's advice.[123] The erroneous advice, even if it caused the employee to become ineligible for disability annuity payments, did not give rise to an estoppel case against the Government requiring payments because "the payment of money from the Treasury must be authorized by a statute."[124] While the Court did not hold that estoppel could never lie against the Government, it noted that "[f]rom our earliest cases, we have recognized that equitable estoppel will not lie against the Government as it lies against private litigants."[125] For overpayments to military personnel, a court would likely hold that an equitable defense like change of position cannot prevent the Government from recovering overpayments from the Treasury.

Thus, for many employees, overpayment results in liability to employers under restitution for the overpaid amount, and the employee will have no viable defense. The employer can go to court and seek relief. The problem with all of the preceding analysis, of course, is that employees and employers are rarely ever before courts to determine what the employer should recover. Instead of using the State as the agent to adjudicate and

120. *See id.* at 794.

121. Hafer & Mathis, *supra* note 39, at 94.

122. *See* Romano v. Ret. Bd. of Emps. Ret. Sys. 767 A.2d 35, 45 (R.I. 2001) (finding the defense inapplicable in part because "we are dealing with excessive pension payments involving public funds").

123. Office of Pers. Mgmt. v. Richmond, 496 U.S. 414, 416 (1990).

124. *Id.* at 424.

125. *Id.* at 419.

recover an overpayment, employers take matters into their own hands through self-help remedies.

B. THE REALITY: HOW EMPLOYERS ACTUALLY RECOVER OVERPAYMENTS

Instead of going to court to have a judge decide the relevant rules of law that govern a particular overpayment situation, a jury resolve the important factual questions, and the State enforce any judgment, many employers act as a judge, a jury, and an enforcer by exercising a self-help remedy. Simply, the employer withholds payment from an employee's paycheck pursuant to set-off law.[126] Subject to a few restrictions described in Part IV, if the employer has overpaid an employee, the employer just pays the employee less money than the employee actually earned until the employer recovers the full amount.[127] As the Government Accountability Office explains, "For active duty soldiers, . . . overpayments result in a deduction to the soldier's pay."[128] This administrative offset, as it is called, occurs frequently when employees owe the government money. For instance, in 2010, the Veteran's Administration referred ninety-nine percent of its eligible debt to the agency that administers set-offs to employees' payments.[129] If the employer cannot re-

126. Self-help usually means "a privilege to do something that would otherwise be legally actionable in order to prevent or cure a legal wrong." Catherine M. Sharkey, *Trespass Torts and Self-Help for an Electronic Age*, 44 TULSA L. REV. 677, 683 (2009). Set-offs are not always a self-help remedy, but in the context of an employer recouping overpayments, they are a unilateral act without judicial involvement. *See* John C. McCoid, II, *Setoff: Why Bankruptcy Priority?*, 75 VA. L. REV. 15, 32 (1989) ("In a narrow sense [set-off], too, is a procedure followed in the course of civil litigation to balance the mutual obligations of the plaintiff and the defendant. But setoff sometimes operates outside of judicial proceedings and may involve no more than a unilateral act by the creditor.").

127. For one example of a state law explicitly authorizing set-off for mistaken overpayment, see N.Y. LAB. LAW § 193 (2009). The federal government relies on set-offs to obtain refunds for overpayment of vacation pay due to the unearned leaves of separated administrative personnel. 5 C.F.R. § 630.209(a)(2). Parties making mistaken payments also resort to self-help when they overpay royalties in oil and gas leases. "[P]ayors routinely recoup royalty overpayments through unilateral 'adjustments,' 'off-sets,' 'revenue rebooking,' or otherwise withholding or debiting a payee's future royalties until the overpaid amounts are collected." Hafer & Mathis, *supra* note 39, at 98. Similarly, set-offs are common when the Social Security Administration wants to recover overpayments. Deborah I. Ginsberg, *Preventing Social Security Overpayments to Older Claimants*, 3 ELDER L.J. 275, 290 (1995).

128. U.S. GOV'T ACCOUNTABILITY OFFICE, *supra* note 28, at 5.

129. Stacy L.Z. Edwards, Note, *The Department of Veterans Affairs' Enti-*

cover the overpayment directly through withholding payments, it can still hire private debt collectors to seek repayment outside the judicial process.[130]

Set-off law allows a creditor to set off money it owes to a debtor by the amount of debt the debtor owes to it.[131] For instance, if a debtor owes a creditor $1,000, but the creditor owes the debtor $200, the creditor can just reduce the amount the debtor owes to $800 without any judicial involvement.[132] Without the right to an set-off, the creditor would have to pay the debtor the $200 it owes, and then seek the $1,000 the debtor owes the creditor through a separate legal action. If the debtor can pay the full $1,000, then the set-off right is inconsequential and has no distributional effects. It merely increases efficiency by compressing the transactions.[133] On the other hand, if the debtor is insolvent, the creditor without a set-off right pays the $200 and gets in line with all other unsecured creditors for a portion of the debtor's estate. Thus, the set-off is an efficient and powerful tool for creditors to obtain full payment from a debtor.[134]

Employers recovering overpayments by deducting from employees' wages is analogous to the classic self-help remedy: the rights a secured creditor has under Article 9 of the Uniform Commercial Code.[135] Under Article 9, if a debtor defaults on a loan and the creditor has a security interest in some collateral from the debtor, the creditor does not have to go to court and

tlement Complex: Attorney Fees and Administrative Offset After Astrue v. Ratliff, 63 ADMIN. L. REV. 561, 587 (2011).

130. *See* U.S. GOV'T ACCOUNTABILITY OFFICE, *supra* note 28, at 6 ("Thus, if debts are not paid before the soldier separates from military service, [the Defense Finance and Accounting Service] can refer these debts to private collection contractors."); Paltrow & Carr, *supra* note 1 (describing how military personnel who have been overpaid have been "pursued by private collection agencies").

131. Mark J. Roe, *Clearinghouse Overconfidence*, 101 CAL. L. REV. 1641, 1665 (2013).

132. *Id.*

133. *Id.* at 1664.

134. 5 COLLIER ON BANKRUPTCY ¶ 553.02 (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2011).

135. There are many other analogies, such as the Uniform Computer Information Transactions Act. It enables a licensor of a computer program to electronically erase a copy of a program without judicial process upon cancellation of a license. Uniform Computer Information Transactions Act § 815 (2009). Another non-commercial example is the right of theft victims to use reasonable force to recapture their possessions. Adam B. Badawi, *Self-Help and the Rules of Engagement*, 29 YALE J. ON REG. 1, 2 (2012).

get a judgment and drag the sheriff out to levy on the debtor's property.[136] Instead, as a general matter, Article 9 empowers the secured creditor to just go get the collateral[137] and sell it to repay the debt[138] or keep the collateral itself as payment for the debt.[139]

This self-help power is "very valuable" to secured creditors[140] and "one advantage of having a security interest."[141] For one thing, it saves the time and costs associated with litigation.[142] Also, it helps the lender control how the collateral is maintained.[143] Finally, it supplies significant bargaining leverage that allows secured creditors who have possession of the debtor's property to hold the property hostage until the debtor agrees to more favorable terms.[144]

While self-help remedies are extremely valuable to secured creditors, they also create "serious social dangers."[145] Because creditors decide for themselves whether the debtor has defaulted on the loan agreement, self-help repossessions provide debtors no due process rights before the creditor seizes the property.[146] Margaret Jane Radin has argued that excessive self-help undermines the rule of law:

> [W]orst, self-help can degenerate into vigilante "justice," which might better be described as a partial retreat from the liberal ideals of civil society. Too much self-help "invite[s] disorderly scrambles"; that is, a return to the war of all against all in which it is every man for him-

136. The secured creditor can pursue a judicial foreclosure, UNIF. COMMERCIAL CODE § 9-609(b)(1), 3 U.L.A. 671 (2010), but almost none do.

137. *Id.* § 9-609(a)(1).

138. *Id.* § 9-610(a).

139. *Id.* § 9-620(a).

140. Jay Lawrence Westbrook, *The Control of Wealth in Bankruptcy*, 82 TEX. L. REV. 795, 844 n.207 (2004).

141. Jean Braucher, *The Repo Code: A Study of Adjustment to Uncertainty in Commercial Law*, 75 WASH. U.L.Q. 549, 568 (1997).

142. LYNN M. LOPUCKI & ELIZABETH WARREN, SECURED CREDIT: A SYSTEMS APPROACH 40 (7th ed. 2012).

143. *See* Ronald J. Mann, *Explaining the Pattern of Secured Credit*, 110 HARV. L. REV. 625, 683 (1997) (observing that secured credit limits "the borrower's ability to engage in conduct that lessens the likelihood of repayment").

144. LOPUCKI & WARREN, *supra* note 142, at 40.

145. Westbrook, *supra* note 140, at 844 n.207.

146. Samuel J.M. Donnelly & Mary Ann Donnelly, *Commercial Law*, 50 SYRACUSE L. REV. 405, 466 (2000) ("Given the widespread abuse of self-help repossession, our legislature, when it considers adopting Rev. Art. 9, should consider whether we can do without UCC Rev. section 9-609(b)(2). At least given the total absence of due process of law in self-help repossession . . . .").

> self, the condition that the state is supposed to supplant with its peaceful juridical order of mutual reciprocal rights and obligations.[147]

Self-help remedies also invite the risk of mistakes as the lender alone weighs its rights and liabilities.[148] The risk of mistake is especially problematic if it has serious consequences, such as a landlord exercising self-help through an eviction on a residential property, leaving a family without a place to live.[149]

The situation of the employer and the secured creditor are deeply similar. In the context of a collateralized loan, the lender has valuable property to repay the debt, and in the context of employment, the employer has the value of the employee's future wages. In fact, the weak economic condition of many employees makes them essentially judgment-proof because they lack the resources to repay an overpayment if it was reduced to a judgment,[150] so the promise of future wages is the most valuable thing the employee has.[151] While both Article 9 repossession and wage withholding can be challenged in court after the fact, they both proceed without any due process on the front end. And, just like a secured creditor can maximize the value of the collateral by quickly repossessing and selling it, the most efficient and effective way to collect debts from employees is by

147. MARGARET JANE RADIN, BOILERPLATE: THE FINE PRINT, VANISHING RIGHTS, AND THE RULE OF LAW 49–50 (2013) (quoting Tapscott v. Cobbs, 52 Va. (11 Gratt.) 172, 177 (1854)).

148. *See generally* Badawi, *supra* note 135 (critiquing the self-help literature's focus on the risk of violence and offering the risk of mistakes as an alternative justification for restrictions on self-help).

149. *See* Daphna Lewinsohn-Zamir, *In Defense of Redistribution Through Private Law*, 91 MINN. L. REV. 326, 382 (2006) ("The goal of restrictions on eviction is to prevent the grave, negative effects on people's welfare caused by *immediate* eviction. Individuals' self-respect, self-esteem, and ability to act autonomously are severely diminished if they can be dispossessed overnight, and the landlord can throw their belongings into the street. Such extreme insecurity in one's own shelter adversely affects the possibility of realizing additional objective values, such as understanding and accomplishment."); Joseph William Singer, *Something Important in Humanity*, 37 HARV. C.R.-C.L. L. REV. 103, 107 (2002) ("Respect for human dignity, for example, may justify a rule protecting tenants from eviction without a court proceeding ensuring that the landlord is legally entitled to the eviction. Requiring the landlord to use court-supervised evictions also ensures that the tenant has sufficient time to move.").

150. Daniel Stanton, Comment, *Between a Rock and a Hard Place: Maintenance and Cure in the Wake of* Atlantic Sounding, 10 LOY. MAR. L.J. 471, 491 (2012) ("In many cases an employee may in fact be judgment proof.").

151. *Cf.* Ben-Ishai et al., *supra* note 26, at 544 ("[T]he government, which is often [assistance recipients'] most important creditor, controls their income and has more collection options than private creditors.").

offsetting current wages.[152] Self-help offsetting is even more useful for employers because employers can use overpayments as a defense to an employee's breach of contract or conversion suit even if the employer could not recover in restitution for some reason.[153] Also, the fact that employees are so often judgment-proof creates an incentive for employers to sweat out small payments from employees' wages over time.[154]

For the same reasons, the self-help remedy of withholding wage payments is even more dangerous than self-help repossession under Article 9. Like in the context of Article 9, the employer might make mistakes about whether an overpayment has been made and the extent of the overpayment,[155] and like a mistake about an eviction in residential real estate, mistaken wage withholding can have serious negative consequences for employees who are left with less funds than they expected. Such mistakes generate externalities when they are corrected because the party making the mistake does not bear all the costs associated with its correction.[156] Worse than the externalities associated with correcting mistakes, however, is the risk that the mistakes will not be discovered by employees and, even if they are discovered, will not be corrected because of the costs of doing so.[157] An employee's inability to discover or correct

152. Claudio Ginocchi, *Debt Collections on Behalf of Nonappropriated Fund Instrumentalities*, ARMY LAW., Apr. 1991, at 2, 4 ("Alternate methods are not as quick and sure as an offset action, and they do not apply to every category of debtors."); Mary N. Milne, *Staking a Claim: A Guide for Establishing a Government Property Affirmative Claims Program*, ARMY LAW., Aug. 2012, at 17, 25 ("Administrative offset, also referred to as an involuntary collection, is a powerful method of enforcing collections. Under the Debt Collection Act of 1982, the Army can withhold money payable by the United States to an individual to satisfy a debt owed by that individual.").

153. Waechter v. Amoco Prod. Co., 537 P.2d 228, 255 (Kan. 1975).

154. *Cf.* Ronald J. Mann, *Bankruptcy Reform and the "Sweat Box" of Credit Card Debt*, 2007 U. ILL. L. REV. 375, 379 (arguing that "the most important effect" of the 2005 bankruptcy reforms would be "to slow the time of inevitable filings by the deeply distressed, allowing [credit card] issuers to earn more revenues from these individuals before they file").

155. Badawi, *supra* note 135, at 14.

156. *Id.* ("A second reason that the incentives of the creditor may diverge from those of broader society is that the creditor does not have to pay some or all of the costs of mistakes. This is a problem that has, thus far, received little attention in the literature on self-help law. Nevertheless, it is a concern because a creditor may mistakenly use self-help, and there is a cost to correcting those mistakes.").

157. For a rare example of a case in which employees prevailed in a wrongful recovery of an overpayment, see Leirer v. Caputo, 616 N.E.2d 147, 150 (N.Y. 1993) (concluding "that statutory and common-law recoupment powers

mistakes makes the employee situation look more like self-help in the context of real property than personal property. Self-help is prohibited for debts secured by real property because, among other reasons, it is difficult to unwind a mistaken repossession.[158] This similarity in the difficulty of correcting mistakes in real property repossession and recovering overpayments should caution against self-help in the context of employee overpayments.

Another risk with self-help remedies is that they prevent people from raising affirmative defenses that they could raise in court. This fact creates an incredibly large imbalance of power between the parties, even more so than already exist. For instance, the statute of limitations for an employer's cause of action for unjust enrichment is only two years in some states.[159] Employers can fail to detect overpayments for longer than two years.[160] Yet, if the employer simply withholds money from the employee's paycheck, the employee will never have the opportunity to raise a statute of limitations defense. Employees probably do not know about the statute of limitations, making them less likely to challenge the withholding and more likely to agree to it.[161]

---

of the County Comptroller do not extend to the unilateral design and execution of a wage withholding regime to recoup purported salary overpayments under circumstances such as these when the basis for and amounts of the overpayments were never reduced to an established debt and when County Charter procedural rubrics have been ignored or bypassed").

158. Badawi, *supra* note 135, at 4; *see also id.* at 18–19 ("There is also good reason to believe that landlords will not fully internalize the cost of the harm from the mistaken use of self-help because capturing the damages associated with a wrongful eviction can be quite difficult. To make this concept more concrete, imagine that a landlord uses self-help to evict a retailer and, after several months of litigation, the retailer establishes that the eviction was improper. To internalize properly the cost of the harm the landlord would, at a minimum, need to compensate the retailer for lost profits, lost goodwill, the costs of rehiring employees, and the costs of repairing supplier relationships. These types of costs can be quite difficult to measure and, insofar as landlords do not have to pay them, one can expect them to be more aggressive than society would prefer when it comes to self-help.").

159. HECI Exploration Co. v. Neel, 982 S.W.2d 881, 885 (Tex. 1998) (stating the statute of limitations for unjust enrichment claims is two years in Texas).

160. *See* U.S. GOV'T ACCOUNTABILITY OFFICE, *supra* note 28 ("GAO's analysis of DFAS data on military pay debts and Army investigations of potential fraud completed over the past 2 years identified numerous instances of the effect of errors or irregularities in Army active duty payroll disbursements that went undetected for lengthy periods of time, including some that were not detected for up to 2 years or until the soldier left the Army.").

161. Timothy E. Goldsmith & Nathalie Martin, *Testing Materiality Under*

The one place where the analogy between repossessions under Article 9 and setting off wages breaks down is the level of protection afforded to the party subject to the self-help remedy. Under Article 9, a debtor can sue a secured creditor for damages if the creditor fails to follow Article 9's guidelines on repossession,[162] and if the property securing the loan was a consumer good, the debtor "may recover for that failure in any event an amount not less than the credit service charge plus 10 percent of the principal amount of the obligation or the time-price differential plus 10 percent of the cash price."[163] The debtor in this final instance is entitled to recover even if the debtor did not suffer an injury from the secured creditor's illicit conduct.[164] Moreover, a well-informed debtor can almost always prevent self-help repossession by threatening violence because a creditor continuing to repossess under these circumstances is likely breaching the peace, so the repossession is illegal.[165] On the other hand, even informed employees are powerless to prevent self-help set-offs, and the best case scenario for the employee subject to wrongful wage withholding is that the employee will recover for the employer breaching its employment contract or for the tort of conversion. But, to recover, the employee needs an attorney, and it is unlikely that people who do not have enough money to live because their employer has withheld wages will have the money to pay a lawyer.[166]

This lack of protection for the overpaid employee is remarkable, given the level of protection for even a business debtor under Article 9. The next Part explores other potential laws that might protect employees and demonstrates how each fails to offer substantial safeguards for employees.

---

the Unfair Practices Acts: What Information Matters When Collecting Time-Barred Debts?, 64 CONSUMER FIN. L.Q. REP., Spring 2010, at 372, 380. For some situations, offsetting wages also allows the employer to avoid the statute of limitations altogether. *See* 31 U.S.C. § 3716(e)(1) (2012) ("Notwithstanding any other provision of law, regulation, or administrative limitation, no limitation on the period within which an offset may be initiated or taken pursuant to this section shall be effective.").

162. UNIF. COMMERCIAL CODE § 9-625, 3 U.L.A. 736 (2010).

163. *Id.* § 9-625(c)(2).

164. *See id.* § 9-625(c) cmt. 4 (stating that § 9-625(c)(2) was "designed to ensure that every noncompliance with the requirements of Part 6 in a consumer-goods transaction results in liability, regardless of any injury that may have resulted").

165. *Id.* § 9-609(b).

166. *Cf.* Smetanka, *supra* note 26, at 1085 ("Hiring a lawyer, however, is virtually impossible in most cases since an overpaid benefits recipient is already in the minus column and can rarely afford representation.").

III. LAW'S FAILURE TO PROTECT OVERPAID EMPLOYEES

Most unsecured creditors face a series of obstacles to collecting debt. These obstacles ensure debtors are treated humanely. They make collection more difficult and costly, but they reflect social concerns about fairness and decency in consumer affairs. This Part describes the most common laws aimed at protecting debtors—the Fair Debt Collection Practices Act in Section A, bankruptcy law in Section B, the Fair Labor Standards Act in Section C, and for the military, military wage deduction laws in Section D. As each of the following sections indicate, however, these common debtor protection laws have little effect on the collection activities of employers seeking to recoup overpayments.

A. THE FAIR DEBT COLLECTION PRACTICES ACT

For most debtors, the Fair Debt Collection Practices Act (FDCPA) offers important protections against abusive debt collection by debt collection agencies.[167] For instance, it forbids debt collectors from calling the debtor "at any unusual time or place or a time or place known or which should be known to be inconvenient to the consumer,"[168] from contacting the debtor directly if the debtor is represented by an attorney,[169] and from contacting the debtor at the debtor's work if the collector knows the employer does not permit such calls.[170] It also forbids the debt collector from harassing or abusing the debtor by, for instance, using "obscene or profane language"[171] or by calling the debtor repeatedly.[172] Finally, it requires that debt collectors inform debtors of certain important rights.[173]

Congress passed this statute because it concluded that "[t]here is abundant evidence of the use of abusive, deceptive, and unfair debt collection practices by many debt collectors"[174] and that "[e]xisting laws and procedures for redressing these injuries are inadequate to protect consumers."[175] Before Con-

167. 15 U.S.C. § 1692 (2012).
168. *Id.* § 1692c(a)(1).
169. *Id.* § 1692c(a)(2).
170. *Id.* § 1692c(a)(3).
171. *Id.* § 1692d(2).
172. *Id.* § 1692d(5).
173. *Id.* § 1692g.
174. *Id.* § 1692(a).
175. *Id.* § 1692(b).

gress enacted the FDCPA, "[i]t was not unusual for [debt collectors] to make telephone calls at all hours of the night, issue threats to the consumer, or divulge a consumer's confidential information to friends and neighbors, all in the quest to collect outstanding debts."[176] Abusive debt collection can have devastating effects on the employee, even causing medical problems.[177] Even more significantly from a public policy standpoint, it can create negative externalities by adversely affecting third parties completely unrelated to the employer/employee relationship, such as family members[178] and the state.[179]

There is substantial evidence that employers turn to debt collectors to recover overpayments from employees,[180] especially if setting-off the employee's wages is impossible for some reason. Since numerous situations exist in which employers cannot recover simply by deducting overpayments from an employee's future wages, employers turn to debt collectors as a logical resource. The Department of Defense, for instance, uses debt collectors to recover overpayments from soldiers.[181] In other

176. Elwin Griffith, *Identifying Some Trouble Spots in the Fair Debt Collection Practices Act: A Framework for Improvement*, 83 NEB. L. REV. 762, 763 (2005).

177. Melissa B. Jacoby, *Does Indebtedness Influence Health? A Preliminary Inquiry*, 30 J.L. MED. & ETHICS 560, 561 (2002).

178. RONALD J. MANN, CHARGING AHEAD: THE GROWTH AND REGULATION OF PAYMENT CARD MARKETS 49–50 (2006).

179. Oren Bar-Gill, *The Behavioral Economics of Consumer Contracts*, 92 MINN. L. REV. 749, 788 (2008).

180. *See, e.g.*, Daniel J. Chacon, *Payroll Errors Near $200,000 a Year: City Taking Steps To Stop Overpaying Departing Workers*, ROCKY MOUNTAIN NEWS, June 11, 2008, at 8 (describing how Denver collected some overpayments from employees directly but noting that "about $400,000 of overpayments during the past five years were sent to collections . . ."); Ronnie Blair, *Schools Stiffed for $108,829*, TAMPA TRIBUNE (May 7, 2009), http://tbo.com/news/education-news/2009/may/07/pa-schools-stiffed-for-108829-ar-91514/ (describing efforts to collect employee salary overpayments, including "telephone calls, letters and assistance from a collection agency"); John Woolfolk, *Reservists' Pay Debated*, SAN JOSE MERCURY NEWS, July 31, 2011, at 5 ("Changes since 2007 that give city officials quicker access to reservists' military pay stubs have reduced errors. But Christian said one fellow officer and reservist earlier this year had a city-hired collection agency come after him to recoup overpayments despite the employee's repeated attempts to reconcile the matter."); Florin, *supra* note 39 ("Walter L. Edwards III of Niantic, who retired from the state Department of Correction on Jan. 1 after 20 years of service, was shocked to receive a letter saying he had been overpaid by the department and owed $1,255 . . . . Edwards said he was told his account would be sent to a collection agency if he did not repay the department within a month.").

181. Paltrow & Carr, *supra* note 1 ("Former soldiers have had their civilian wages and their Veterans Administration benefits garnished. They have been

overpayment contexts, like Social Security, the government similarly turns to debt collectors to spur repayment.[182]

We might expect the FDCPA to protect employees from the harms of abusive debt collection, but it does not. The Act only applies to the collection of "debt," and debt "means any obligation or alleged obligation of a consumer to pay money *arising out of a transaction* in which the money, property, insurance, or services which are the subject of the transaction are primarily for personal, family, or household purposes . . . ."[183] One essential component of debt under the Act is that it must arise out of a transaction.[184] Several federal appellate courts have held that a transaction means a consensual interaction.[185] Under this

pursued by private collection agencies and forced to pay tax penalties."); *Pay My Debt*, DEFENSE FINANCE AND ACCOUNTING SERVICE, http://www.dfas.mil/debtandclaims/paymydebt/paymydebt.html (last visited Oct. 16, 2014) (informing military personnel that they will be charged a $15 administrative fee for "[i]nitial referral to a private collection agency"); Ginocchi, *supra* note 152, at 4 (footnotes omitted) ("31 U.S.C. section 3718 authorizes agencies to contract for debt collection services. Accordingly, DOD has informed all of its components that they could use commercial collection agencies for collection services to supplement their collection programs.").

182. 31 U.S.C. § 3711(g)(4) (2006); Ben-Ishai et al., *supra* note 26, at 545 (discussing "the range of collection options open to the Ontario government as it tries to collect debts owed to [provincial programs], options that include the reduction of benefit levels, referral to private collection agencies, court action and the set-off of tax refunds . . .").

183. 15 U.S.C. § 1692a(5) (2012) (emphasis added).

184. *Id.*

185. *See* Romea v. Heiberger & Assocs., 163 F.3d 111, 115 (2d Cir. 1998) ("Back rent by its nature is an obligation that arises only from the tenant's failure to pay the amounts due under the contractual lease transaction. In this respect, back rent is much like the obligation arising out of a dishonored check where a service has been rendered or goods sold on the premise of immediate payment. The obligation to pay the bounced check, like the duty to pay back rent, does not derive from an extension of credit but rather because the payor breached its payment obligations in the contract between the parties."); Beggs v. Rossi, 145 F.3d 511, 512 (2d Cir. 1998) (per curiam) (holding that unpaid taxes do not constitute a debt); Ladick v. Van Gemert, 146 F.3d 1205, 1206–07 (10th Cir. 1998) (holding that a condominium assessment is debt because it arises out of a consensual transaction—the purchase of the condominium); Duffy v. Landberg, 133 F.3d 1120, 1123–24 (8th Cir. 1998) (holding that dishonored checks are debts within the FDCPA because they arose out of the purchase of goods, which is a consensual transaction); Hawthorne v. Mac Adjustments, Inc., 140 F.3d 1367, 1371 (11th Cir. 1998) (holding that payment obligations arising from negligent acts are not debts subject to the FDCPA because they do not arise out of a consumer transaction); Bass v. Stolper, Koritzinsky, Brewster & Neider, S.C., 111 F.3d 1322, 1327 (7th Cir. 1997) (determining that the FDCPA's legislative history clearly shows that Congress intended for consumer obligations paid by check to fall within the definition of "debt"); Zimmerman v. HBO Affiliate Grp., 834 F.2d 1163, 1168 (3d Cir. 1987)

gloss on the word transaction, mistaken overpayments do not qualify because no one voluntarily agrees to the interaction when both parties are making a mistake.

A recent case from the Eastern District of New York illustrates this conclusion. In *Orenbuch v. Leopold, Gross & Sommers, P.C.*, the court directly addressed a situation in which an accounting error caused an employer to overpay an employee.[186] After noting that mistaken overpayments were not part of the FDCPA's legislative history,[187] the court dismissed the employee's claim: "[T]his is not the type of debt contemplated by the FDCPA because the overpayment of salary was not a 'transaction' within the meaning of the statute."[188] Because many state consumer debt protection laws use the exact same definition of debt,[189] these state laws also do not likely offer overpaid employees any protection.

If the employee signed an agreement to repay mistaken overpayments, then courts would likely consider the overpayment to be a debt.[190] Because restitution sets the default rule as one of repayment, however, many employers do not have this provision in their agreements.[191] The result is that for many employees, debt collectors have few restraints on their conduct.[192]

(holding that allegedly obtaining HBO illegally was not a debt because it did not arise out of a consensual transaction); Mabe v. G.C. Servs. Ltd. P'ship, 32 F.3d 86, 88 (4th Cir. 1994) (holding that child support payments are not debts because they arise from a parental duty and are imposed by the state); Staub v. Harris, 626 F.2d 275, 279 (3d Cir. 1980) (holding that the FDCPA does not apply to tax collections). For a detailed look at the case law, see Griffith, *supra* note 176, at 765–75.

186. Orenbuch v. Leopold, Gross & Sommers, P.C., 586 F. Supp. 2d 105, 106 (E.D.N.Y. 2008).

187. *Id.* at 107.

188. *Id.* at 108. For a similar analysis in which a court found that a bank overpaying a customer was not considered a debt, see Arnold v. Truemper, 833 F. Supp. 678, 685–86 (N.D. Ill. 1993).

189. *See, e.g.*, 32 ME. REV. STAT. § 11002 (2013) (using the FDCPA's definition); R.I. GEN. LAWS § 19-14.9-3(4) (2013) (same).

190. *See* Oppenheim v. I.C. Sys., Inc., 627 F.3d 833, 838 (11th Cir. 2010) (holding that a mistaken overpayment by PayPal to a user was a debt because the PayPal user agreement made the user fully liable for invalidated payments); Hoffman v. GC Servs. Ltd. P'ship, 3:08-CV-255, 2010 WL 9113645 (E.D. Tenn. Mar. 3, 2010) (same).

191. *See* Smith v. Bear, Inc., 419 S.W.3d 49, 58 (Ky. Ct. App. 2013), *review denied* (Feb. 12, 2014).

192. Common law torts, such as intentional infliction of emotional distress or invasion of privacy, still apply, but Congress enacted the FDCPA precisely because these protections were inadequate to restrain debt collectors.

B. BANKRUPTCY

The ultimate protection in American law for people who owe money is bankruptcy.[193] Bankruptcy is valuable for individuals because the automatic stay stops all attempts to collect debts from the moment the individual files for bankruptcy.[194] Moreover, bankruptcy allows people to start fresh by discharging their debts.[195] This fresh start can rehabilitate debtors because "1) . . . discharge should (whether or not it does) serve a consumer education function; 2) . . . discharge constitutes an emotional and psychological purgative for the debtor; and 3) . . . discharge allows the debtor to resume active participation in the open credit economy."[196] Debtors who are freed from overwhelming debt are able to provide for those who depend on them because their income is not taken to service debt.[197]

Yet, for many employees, bankruptcy is not a safeguard for liability stemming from their employers' mistaken overpayments. While it is true that some courts deem overpayments to be debts that are dischargeable in bankruptcy,[198] many others do not, leaving employees liable to repay their employers even if they seek bankruptcy protection.[199] The difference between

193. *See* Ronald J. Mann & Katherine Porter, *Saving Up for Bankruptcy*, 98 GEO. L.J. 289, 291 (2010) ("Bankruptcy is not the cause of financial distress; it is our institutional remedy for it.").

194. 11 U.S.C. § 362 (2012).

195. *See* Grogan v. Garner, 498 U.S. 279, 286 (1991) (citations omitted) (internal quotations omitted) ("This Court has certainly acknowledged that a central purpose of the Code is to provide a procedure by which certain insolvent debtors can reorder their affairs, make peace with their creditors, and enjoy a new opportunity in life . . . ."); Williams v. U.S. Fid. & Guar. Co., 236 U.S. 549, 554–55 (1915) (citations omitted) (recognizing that the purpose of bankruptcy is "to relieve the honest debtor from the weight of oppressive indebtedness and permit him to start afresh free from the obligations and responsibilities consequent upon business misfortunes"); Margaret Howard, *A Theory of Discharge in Consumer Bankruptcy*, 48 OHIO ST. L.J. 1047, 1047 (1987) ("The purpose of the consumer bankruptcy system, effectuated by discharge, is to give a fresh start . . . ."); Thomas H. Jackson, *The Fresh-Start Policy in Bankruptcy Law*, 98 HARV. L. REV. 1393, 1393 (1985) ("Discharge, the doctrine that frees the debtor's future income from the chains of previous debts, lies at the heart of bankruptcy policy.").

196. Howard, *supra* note 195, at 1059–60.

197. Jackson, *supra* note 195, at 1418–19.

198. *See, e.g.*, *In re* Sterling, 479 B.R. 444, 447 (Bankr. E.D. Mich. 2012) (finding that "debt owed to [the former employer] as a result of compensation overpayments" was dischargeable).

199. *See* Celi v. Trs. of Pipefitters Local 537 Pension Plan, No. 10-11152-DJC, 2011 WL 5926669, at *7 (D. Mass. Nov. 28, 2011) ("Accordingly, the bankruptcy discharge order did not extinguish the Defendants' right to recoup

these two outcomes lies in whether the court views the employer's action to recover overpayments from an employee's wages as a set-off or a recoupment.[200] If it is the former, the overpayment is covered by the automatic stay and discharged through the bankruptcy, but if it is the latter, neither the automatic stay nor a discharge offer employees any protection.[201]

Under the Bankruptcy Code, a set-off occurs when a creditor has a claim against the debtor and, as part of a separate transaction, the debtor has a claim against the creditor.[202] Under state law, a creditor in that situation can set-off the amount the debtor owes the creditor before the creditor pays anything to the debtor.[203] In bankruptcy, however, a creditor can only recover prepetition overpayments by a set-off from prepetition wages.[204] In other words, all of the wages the employee earns after filing for bankruptcy are the debtor's to keep free from the set-off from the debt the employee owed from before filing. If an employee files for bankruptcy and the court considers the set-off rules to cover the over-payments, then the debt is discharged in bankruptcy.

---

the disability pension overpayments made to Celi under the Plan."); Eissa v. Aetna Life Ins. Co., No. 09-1268-EFM, 2010 WL 4942131, at *4 (D. Kan. Nov. 30, 2010) (holding that an insurer could recoup overpayments despite the insured's bankruptcy); *cf.* Kosadnar v. Metro. Life Ins. Co. (*In re* Kosadnar), 157 F.3d 1011, 1016 (5th Cir. 1998) (per curiam) (holding that voluntary overpayments of commissions were outside the purview of bankruptcy and thus an employer did not violate the automatic stay when it recouped the overpayments from the employee's paychecks after the employee declared bankruptcy).

200. *See Kosadnar*, 157 F.3d at 1013 ("The disposition of this case depends on whether MetLife's withholdings from Kosadnar's pay are characterized as recoupment or setoff.").

201. Slater Health Ctr., Inc. v. United States (*In re* Slater Health Ctr.), 398 F.3d 98, 105 (1st Cir. 2005). *See generally* Marvin E. Sprouse III, *Governmental Recoupment: An Equitable Remedy with an Equitable Result?*, 26 AM. BANKR. INST. J. 12 (2007) (explaining the differences between set-off and recoupment through a series of cases involving overpayments by government entities).

202. Holford v. Powers (*In re* Holford), 896 F.2d 176, 178 (5th Cir.1990).

203. Lawndale Steel Co. v. Magic Steel Co. (*In re* Lawndale Steel Co.), 155 B.R. 990, 996 (Bankr. N.D. Ill. 1993).

204. 11 U.S.C. § 553(a) (2012) ("Except as otherwise provided in this section and in sections 362 and 363 of this title, this title does not affect any right of a creditor to offset a mutual debt owing by such creditor to the debtor that arose before the commencement of the case under this title *against a claim of such creditor against the debtor that arose before the commencement of the case*, except to the extent that . . . ." (emphasis added)).

Many courts, however, treat recovering mistaken overpayments as recoupments.[205] Recoupment is an action to recover a debt by reducing a payment due under and arising out of the same transaction.[206] Such an action "allows a defendant to reduce the amount of a plaintiff's claim by asserting a claim against the plaintiff which arose out of the same transaction to arrive at a just and proper liability on the plaintiff's claim."[207] The test for whether the creditor's and the debtor's claims against each other arise from the same contract or transaction is an equitable one.[208] If the court characterizes the overpayment as a recoupment, then the overpayment is not a debt under the Bankruptcy Code at all. As one bankruptcy court explained:

> The term 'debt' is defined under the Bankruptcy Code as 'liability on a claim.' 'Claim' in turn is defined as a 'right to payment . . . .' The basis for [a creditor's] argument that the overpayment does not constitute a debt is the premise that its deductions are a recoupment of the overpayment . . . . Because recoupment only reduces a debt as opposed to constituting an independent basis for a debt, it is not a claim in bankruptcy, and is therefore unaffected by the debtor's discharge.[209]

Because recoupment is not a debt under the Bankruptcy Code, the automatic stay and discharge provisions of the Code do not apply.[210]

The connection between recoupment and restitution is plain. One formative case notes this link:

> Further, bankruptcy courts apply recoupment as an equitable doctrine. Here we face a question of unjust enrichment. The situation before us is not one in which the creditor seeking relief consciously

205. *See, e.g.*, Ashland Petroleum Co. v. Appel (*In re* B & L Oil Co.), 782 F.2d 155, 159 (10th Cir. 1986); Sheppard v. Fla. Unemployment Appeals Comm'n, 492 So. 2d 827, 828 (Fla. Dist. Ct. App. 1986); Gen. Accident Ins. Co. v. Yaglowski, 188 A.D.2d 1032, 1032 (N.Y. App. Div. 1992).

206. *See In re* Pub. Serv. Co. of N.H., 107 B.R. 441, 444 (Bankr. D.N.H. 1989).

207. U.S. Abatement Corp. v. Mobil Exploration & Producing U.S., Inc. (*In re* U.S. Abatement Corp.), 79 F.3d 393, 398 (5th Cir. 1996) (internal quotation marks omitted).

208. *See* Malinowski v. N.Y. State Dep't of Labor (*In re* Malinowski), 156 F.3d 131, 133 (2d Cir.1998) (internal quotation marks omitted) (stating the test is whether "both debts . . . arise out of a *single integrated transaction* so that it would be *inequitable* for the debtor to enjoy the benefits of that transaction without also meeting its obligations"); Cont'l Cas. Co. v. Gullett, 253 B.R. 796, 804 (S.D. Tex. 1999) (noting that the Fifth Circuit has not stated a test so that courts can consider "the facts and equities of each case").

209. *In re* Delicruz, 300 B.R. 669, 679–80 (Bnkr. E.D. Mich. 2003) (internal quotations marks omitted) (citations omitted).

210. *Id.* at 683–84.

> made a loan, extended credit, or made payments required by a contract, as did the bankrupt's ordinary creditors. Ashland paid the sums to B & L by mistake. Although common sharing may be required in some mistake cases by the bankruptcy laws' cleavage rules, allowing B & L's other creditors to share in this money would give them a windfall, a classic case of unjust enrichment.[211]

Thus, the very doctrine of restitution that enables employers to recover overpayments will cause many bankruptcy courts to consider withholding wages from the employee to be recoupment, not subject to bankruptcy protection.[212]

Even if the court does categorize an overpayment as a set-off and not a recoupment, the debt still may be excepted from the employee's discharge if the employee kept the overpayment intentionally. If the employee knew about the overpayment but purposefully retained it, an employer could argue that § 523(a)(6) makes the debt nondischargeable because the debt was "for willful and malicious injury by the debtor to another entity or to the property of another entity."[213] Thus, even employees who fit the overpayment into the set-off category could find the debt is nondischargeable.[214] Whether it is because withholding wages is recoupment or because the debt is nondischargeable, the end result is the same—an employee is

211. *Ashland Petroleum Co.*, 782 F.2d at 159. For an excellent extended consideration of the connection between restitution and recoupment, see Centergas, Inc. v. Conoco Inc. (*In re* Centergas, Inc.), 172 B.R. 844, 848–52 (Bankr. N.D. Tex. 1994) ("A review of the cases dealing with the doctrine of recoupment shows a common theme running through them: There were advance payments or overpayments made to the debtor which, if kept by the debtor, constituted unjust enrichment.").

212. *Cf.* Mullen v. United States, 696 F.2d 470, 472 (6th Cir. 1983) (holding that, despite the fact the debtor had filed for bankruptcy, the Air Force could withhold money from a service member's retirement benefits because he had received a $15,000 payment that had to be repaid for him to be eligible for retirement benefits and the Air Force's withholding was merely a recoupment); *In re* Ruiz, 146 B.R. 877, 877 (Bankr. S.D. Fla. 1992) (permitting an employer to withhold postpetition commissions to recoup advance commissions paid prepetition); *Cont'l Cas. Co.*, 253 B.R. at 804 ("The circumstances in the case at bar reveal that Continental's efforts to obtain the $8,619.54 it had overpaid Gullett were acts of recoupment. Continental overpaid Gullett TIB totaling $8,619.54 under a workers' compensation insurance policy. At the time Continental took the actions in issue concerning the $8,619.54, Gullett was asserting a claim against Continental for impairment income benefits under the same workers' compensation policy. Both obligations arose out of Continental's insurance contract.").

213. 11 U.S.C. § 523(a)(6) (2012).

214. *Cf. In re* Hayes, Nos. BK10–43784–TJM, A11–4015–TJM, 2011 WL 4352315, at *5 (Bankr. D. Neb. Sep 16, 2011) (finding a debt to workers compensation was nondischargeable because the debtor caused the overpayment by putting in the wrong employment numbers on a form).

left without the basic protection bankruptcy affords to debtors in extreme financial distress.

C. THE FAIR LABOR STANDARDS ACT

Employers do not have to worry about wage garnishment laws because they are not setting-off wages pursuant to a legal or equitable proceeding,[215] nor are they creditors collecting debts from assets in the possession of a third party.[216] But, the federal Fair Labor Standards Act (FLSA)[217] does apply to many employees and potentially offers them minimal protections against employers withholding money from their wages.[218]

The FLSA forbids employers covered by the Act from paying employees covered by the Act less than the minimum wage,[219] even if the employee agrees to the lower payment.[220] Thus, just based on the face of the FLSA, such an employer cannot withhold wages that would render the payment below $7.25 an hour.[221] The FLSA might also protect overtime pay due to an employee from withholding,[222] but the rule's application in this context is less clear. In some Circuits, courts have held that the FLSA prohibits employers from offsetting mistaken overpayments from overtime wages due under the statute,[223] but other Circuits permit set-offs. The Fifth Circuit has held, for instance, that if an employer has paid wages in advance of when they are due, the employer does not have to pay the over-

215. *See* 15 U.S.C. § 1672(c) (2012) ("The term 'garnishment' means any legal or equitable procedure through which the earnings of any individual are required to be withheld for payment of any debt.").

216. *See* Fidel Rodriguez, Jr. & Manuel C. Maltos, *Attorney's Fees and Judgments*, 54 ADVOC. (TEX.) 5, 8 (2011) ("A garnishment action is against a third party who is in possession of money or property of the debtor or is owed money by the debtor.").

217. 29 U.S.C. § 201 (2012).

218. Additionally, several states have laws that protect employees from withholding. *See, e.g*., N.Y. LAB. LAW § 193 (2009); THOMAS E. GEIDT & JUDITH M. KLINE, CAL. BUS. LAW DESKBOOK § 16:18.

219. 29 U.S.C. § 206(a).

220. *See* Brennan v. Veterans Cleaning Serv., Inc., 482 F.2d 1362, 1370 (5th Cir. 1973) ("It has long been recognized that the protection afforded by the Fair Labor Standards Act may not be waived by agreement between employer and employee.").

221. *See* Wage and Hour Division, *Minimum Wage*, U.S. DEP'T OF LAB., http://www.dol.gov/whd/minimumwage.htm (last visited Oct. 16, 2014).

222. *See* 29 U.S.C. § 207.

223. *See* Herman v. Fabri-Centers of Am., Inc., 308 F.3d 580, 591 (6th Cir. 2002) (limiting overpayments to offset only overtime wages due during the same period, not different pay periods).

time wages as required by the FLSA but instead can set-off the amount already paid.[224] Even more limiting, the U.S. Department of Labor issued on opinion letter along these same lines, but it stated that an employer could deduct wages to recover an overpayment even if it caused the employee to go below the minimum wage.[225] Although the opinion only covers the facts presented in the question to the Department of Labor, it might signal that the Department does not believe employers recouping overpayments have to pay the minimum wage at all.

Even in the jurisdictions with the most expansive view, the FLSA's protections are very limited and not applicable to all employees. First, the only guarantees are payment of the minimum wage and potentially overtime, which most likely is not enough to support an employee's financial obligations.[226] It does not assure the employee will get any money above minimum wage.[227] Second, the Act does not apply to some types of employees, including employees in "executive, administrative, or

224. *See* Singer v. City of Waco, 324 F.3d 813, 824 (5th Cir. 2003) (holding that overpayments made in error to firefighters could offset underpayments from subsequent pay periods); Goulas v. LaGreca, No. 12-898, 2013 WL 2477030, at *10 n.3 (E.D. La. June 7, 2013) ("In the instant case, Services seeks to offset the overtime wages it owes to Goulas with other wages it actually paid to Goulas. This is clearly permissible under *Singer* and is not foreclosed by *Martin*.").

225. Wage and Hour Division, *Opinion Letter*, U.S. DEP'T OF LAB., FLSA2004-19NA (Oct. 8, 2004), http://www.dol.gov/whd/opinion/FLSANA/2004/2004_10_08_19FLSA_NA_recoup.pdf ("It has been our longstanding position that where an employer makes a loan or an advance of wages to an employee, the principal may be deducted from the employee's earnings even if such deduction cuts into the minimum wage or overtime pay due the employee under the FLSA. . . . Thus the amount the department chooses to recoup in the next pay period is at the department's discretion. It does not matter whether the deduction was made in the next pay period or several pay periods later.").

226. *See* Sarah Leberstein & Anastasia Christman, *Occupy Our Occupations: Why "We Are the 99%" Resonates with Working People and What We Can Do To Fix the American Workplace*, 39 FORDHAM URB. L.J. 1073, 1095 (2012) ("A full-time worker earning $7.25 an hour brings home about $15,000 a year, barely above the federal poverty line for a family of two people. Unfortunately, the federal minimum wage has fallen far below its historic value; currently it is $7.25 per hour and would have to be set at over $10 per hour to achieve the value it held in 1968." (footnote omitted)). *See generally* BARBARA EHRENREICH, NICKEL AND DIMED: ON (NOT) GETTING BY IN AMERICA (2001) (documenting the experience of a woman attempting to survive on minimum wage).

227. *See* Lopez v. Tri-State Drywall, Inc., 861 F. Supp. 2d 533, 536 (E.D. Pa. 2012). The employee is entitled to the full amount the contract promises the employee if the employee must be paid for overtime. Hayes v. Bill Haley & His Comets, Inc., 274 F. Supp. 34, 37 (E.D. Pa. 1967). But, for jurisdictions allowing set-offs, the outcome is unclear.

professional capacity."[228] Because employers initially determine who counts as an exempt employee and may not comply with the law in making this determination, the Act is underenforced.[229] Third, in the context of the case study I presented in Part I, some military personnel are not covered by the FLSA at all. Military personnel serving outside of the United States are not under the FLSA because the FLSA only governs "among the several States or between any State and any place outside thereof"[230] and not foreign military bases, for instance.[231] Furthermore, the military activity (done by soldiers or civilians) of prosecuting war is not covered by the FLSA because it is not "commerce" as required by the Act.[232]

Finally, and most importantly, the FLSA does not prevent the employer from collecting the debt in ways other than withholding wages. The employer can still contact the employee and demand immediate and full repayment, and it can still hire debt collectors, engendering the problems discussed in subpart III.A. The only possible limit is on the self-help remedy of withholding wages.

D. MILITARY WAGE PERIODIC DEDUCTIONS

For military personnel, 5 U.S.C. § 5514 specifically authorizes withholding wages periodically, but it limits the amount

228. 29 U.S.C. § 213(a)(1) (2012). For a discussion of how the exemptions have increased over time, see Leberstein & Christman, *supra* note 226, at 1095 ("[F]ast-growing low-wage jobs like home care continue to be excluded from the Fair Labor Standards Act by overbroad U.S. DOL regulations, rendering 2.5 million workers ineligible for basic protections like the minimum wage and overtime pay. Furthermore, in recognition of changes in our economy and the increasing prevalence of low-wage jobs, lawmakers need to repeal or narrow exclusions in minimum wage and overtime standards that have driven down standards in key sectors such as agriculture, domestic and home care work, and food service." (footnote omitted)).

229. Deborah C. Malamud, *Engineering the Middle Classes: Class Line-Drawing in New Deal Hours Legislation*, 96 MICH. L. REV. 2212, 2317 (1998) ("[E]nforcement of the upper-level exemptions requires individual employees to come forward and demand that they no longer be categorized as exempt—a change that is still experienced as a status loss.").

230. 29 U.S.C. § 203(b).

231. *See* Filardo v. Foley Bros., 45 N.Y.S.2d 262, 263 (N.Y. App. Div. 1943) (interpreting the Fair Labor Standards Act as inapplicable to employees at a defense base in Iran).

232. *See* Barksdale v. Ford, Bacon & Davis, Inc., 70 F. Supp. 690, 695 (E.D. Ark. 1947) ("Nor do we think that the term 'commerce' as used in said phrase [in the FLSA] can logically be construed to include a shipment across state lines by the Government to its military facilities of Government-owned munitions of war to be used in the prosecution of the war.").

that can be withheld unless the employee agrees to a higher level.[233] It states: "The amount deducted for any period may not exceed 15 percent of disposable pay, except that a greater percentage may be deducted upon the written consent of the individual involved."[234] Additionally, the statute requires the government to give notice to the employee, provide records related to the debt, and have a hearing.[235] Also, if offsetting fifteen percent of an employee's wages will cause "extreme financial hardship,"[236] the government cannot withhold the funds.[237] Finally, the government can waive the collection of the debt if "the collection of [a debt created by overpayment] would be against equity and good conscience and not in the best interests of the United States,"[238] so employees have the potential for their overpayment debt to be waived.

The problem with these protections is that, as the statute states, members of the military can waive the protections, and reports suggest these sorts of waivers occur routinely.[239] The

233. 5 U.S.C. § 5514(a)(1) (2012) ("When the head of an agency or his designee determines that an employee, member of the Armed Forces or Reserve of the Armed Forces, is indebted to the United States for debts to which the United States is entitled to be repaid at the time of the determination by the head of an agency or his designee, or is notified of such a debt by the head of another agency or his designee the amount of indebtedness may be collected in monthly installments, or at officially established pay intervals, by deduction from the current pay account of the individual."). The implementing regulation is 31 C.F.R. § 285.7(a)(1) (2012). In some cases, the government must use 37 U.S.C. § 1007 (2012) to deduct wages.

234. 5 U.S.C. § 5514(a)(1).

235. *Id.* § 5514(a)(2).

236. 34 C.F.R. § 31.8(b).

237. For an explanation of the rules implementing 5 U.S.C. § 5514 regarding extreme financial hardship, see Sibley v. U.S. Dep't of Educ., 913 F. Supp. 1181, 1186 (N.D. Ill. 1995) ("We first address the merits of the ALJ's rejection of the plaintiff's claim that a 15% offset would cause 'extreme financial hardship.' 34 C.F.R. § 31.8(b). Section 31.8(b)(1), promulgated pursuant to 5 U.S.C. § 5514(b)(1), explains that an employee would suffer 'extreme financial hardship' if the offset 'would prevent the employee from meeting the costs necessarily incurred for essential subsistence expenses.' Section 31.8(b)(2) in turn defines 'essential subsistence expenses' as the costs of 'food, housing, clothing, essential transportation and medical care.' In addition, a relevant factor in determining the existence of extreme financial hardship is whether the expenses 'have been minimized to the greatest extent possible.' § 31.8(b)(3)(iii).").

238. 5 U.S.C. § 5584(a).

239. U.S. Army Claims Serv., *Collection of Debts and Overpayments from Claimants Using IRS Tax Offset Procedures*, ARMY LAW., Sept. 1991, at 41 ("Moreover, all claimants who receive funds from the government, regardless of employment status, are further vulnerable to involuntary collection. Specifically, by signing the DD Form 1842, each claimant has expressly authorized

protection afforded by the notice is even more ephemeral because if the mistaken payment really did belong to the government, then failing to give notice is a harmless error.[240] Similarly, the right to inspect the records relating to the debt does not give the employee a private cause of action, undermining its utility.[241] Finally, the provision permitting the government to waive the right to the debt is of little comfort because even if its conditions are completely met, the decision-maker still has discretion not to grant a waiver. Because the statute uses the word "may," nothing can compel a waiver of the debt.[242] The fact that numerous stories report high levels of withholding demonstrates the facile nature of this protection.[243]

In each of these cases, traditional debtor laws and employment laws that we would expect to apply to mistakenly overpaid employees turn out to offer little or no protection. While years of consumer advocacy have resulted in laws that protect borrowers with unsecured debts, the law has failed to offer minimal safeguards to employees suffering from financial

---

the government to withhold his or her pay for any overcompensation which the claimant may receive because of subrogated payments by insurers, carriers or any other persons, or because of any information that the claimant has provided to the government that the government later discovers to be untrue."). Outside the context of government employees, payroll professionals suggest that employers have employees sign waivers to enable them to withhold wages to obviate state wage laws. *See* Howard Perlman, *Recovering Wage Overpayments: Navigating the Maze of Compliance*, BLOOMBERG BNA, http://info.bna.com/apa/document.aspx?ID=195525 (last visited Oct. 16, 2014) ("In general, acquiring employees' written authorization can help employers defend the legality of the deductions, [Barbara Youngman, CPP, payroll manager with Southwest Airlines] said.").

240. *See* McCarron v. United States, 84 Fed. Cl. 616, 621 (2008) ("Because plaintiff does not allege that she is entitled to the $10,800.00 in overpaid wages, the Government's failure to follow procedures in 5 U.S.C. § 5514 would constitute a harmless error, and any damages incurred as a consequence of this error would be de minimis.").

241. *See* Roby-Wilson v. Potter, No. 01-3871, 2002 WL 32348831, at *2 (E.D. Pa. Feb. 14, 2002) ("The next count of plaintiff's amended complaint alleges that the Postal Service violated 5 U.S.C. § 5514(a)(2) by failing to supply for inspection and copying its records relating to the purported debt, and that she incurred legal fees and other out-of-pocket losses as a result. The statute does not create a separate, private right of action for violation of this provision . . . .").

242. Lawrence v. United States, 69 Fed. Cl. 550, 555–56 (2006).

243. *See* 155 CONG. REC. E1355-01 (daily ed. June 9, 2009) (statement of Rep. Carol Shea-Porter) (describing two-thirds of a National Guard Sergeant's pay being deducted to pay back a mistaken overpayment); Paltrow & Carr, *supra* note 1 (reporting a soldier's pay was cut from $3,300 a month to $117.99 to recover an overpayment).

distress. This absence of meaningful protection requires judicial or legislative action.

IV. FULFILLING LAW'S PROMISE TO PROTECT EMPLOYEES FROM ABUSIVE COLLECTION

This Part outlines two paths that the law should take to protect employees from abusive collection methods by employers for mistaken wage overpayments. The first suggests ways for common law courts to reshape restitution doctrine to protect employees. The second offers a simple legislative fix to the problem that would eliminate the incongruity in current law that puts employees in such a vulnerable position relative to other debtors. Specifically, legislation should define wage overpayments as unsecured loans for collection purposes and should forbid employers from setting-off overpayments from an employee's wages without judicial involvement.

A. JUDICIAL REFORMS OF RESTITUTION LAW

One modest change courts could make to restitution law is to expand the change of position defense to include expenditures for ordinary living expenses. While the predominate view currently is that the recipient of funds must make an extraordinary purchase to qualify for the change of position defense,[244] courts should recognize that many, if not most, people spend whatever money they make. Thus, mistakenly overpaying someone and causing them to spend more money is a detrimental change of position for individuals.

Most people do not have a personal budget that limits their purchasing decisions in any specific way.[245] Instead, they live paycheck-to-paycheck, spending virtually all of the money in their bank accounts each pay period.[246] As one financial planner

244. *See* RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 65 cmt. c (2010).

245. *See* Anthony Keane, *Income Is the Vital Asset To Generate Wealth*, COURIER MAIL (Austl.), June 16, 2008 ("95 per cent of people do not budget."); Crystal Wylie, *Workshops Offered To 'Help Stuff Your Wallet,'* RICH. REG. (Ky.) (Jan. 26, 2012), http://www.richmondregister.com/news/local_news/article_3400c240-c727-52f6-8630-0baffd6cadb2.html (""The majority of people do not budget, although more than 70 percent of consumers live paycheck to paycheck,' [Harvey R. Little Jr., a certified financial planner] said. It is estimated that only 39 percent of adults have enough money in cash or savings to cover three months of living expenses, he said.").

246. *See* Sara Sternberg Greene, *The Broken Safety Net: A Study of Earned Income Tax Credit Recipients and a Proposal for Repair*, 88 N.Y.U. L. REV.

observed, "'Most people do not budget in a theoretical way, where they sit down and sort of write everything down. Instead, they budget intuitively against the cash in the bank. They sort of intuitively know when it's low and restrain their spending . . . .'"[247] When such individuals are overpaid, they adjust the amount they spend to reflect their income.[248] In that way, they detrimentally change their position because of the overpayment.

Some courts have already held that spending money for regular expenses counts as a changed position. In one example where a welfare receipt was mistakenly overpaid benefits, the court found "from the record it is undisputed that the monies received have been spent for rent, groceries, food, gas, electric, phone and other essentials by Garber; therefore, Garber has changed his position and has disbursed the money . . . ."[249] Even

515, 545 (2013) ("Most of these [low-income] families live paycheck to paycheck, making just enough (or in many cases not enough) to pay their bills, keep their apartments, and provide basic necessities for their children."); Creola Johnson, *Congress Protected the Troops: Can the New CFPB Protect Civilians from Payday Lending?*, 69 WASH. & LEE L. REV. 649, 698 (2012) ("[T]he majority of Americans live paycheck to paycheck . . . ."); Annamaria Lusardi, Daniel J. Schneider & Peter Tufano, *Financially Fragile Households: Evidence and Implications* 2 (Nat'l Bureau of Econ. Research, Working Paper No. 17072, 2011), http://www.fdic.gov/news/conferences/lusardi.pdf ("Using this $2,000/30 day metric of financial fragility, we find widespread financial weakness in America: one quarter of Americans report that they certainly could not come up with the funds needed to cope with such a shock within thirty days, and an additional 19% would cope at least in part by selling or pawning possessions or taking payday loans. Adopting a broader definition of financial fragility, we find that almost half of all households report that they certainly not or could probably not come up with funds to deal with an ordinary financial shock of this size. We examine the cross-sectional distribution of financial fragility and we show that it is not just a poor person's problem: a material fraction of the solidly middle class is pessimistic about their ability to come up with $2,000 in a month.").

247. Chris O'Malley, *Budgeting for Household Expenses Remains Important To Increase Savings*, THE INDIANAPOLIS STAR (Mar. 12, 2001) (quoting John Guy, president of Wealth Planning & Management in Indianapolis).

248. *Cf.* Valerius, *supra* note 63, at 439 ("These recoupment practices have devastating financial consequences because by the time that the retirees are notified that their pension payments will be reduced, the retiree has already reasonably planned his expenses around the set amount he has been receiving.").

249. State *ex rel.* Steger v. Garber, No. L-79-031, 1979 WL 207282, at *4 (Ohio Ct. App. 1979) (per curium); *see also* Firestone Tire & Rubber Co. v. Cent. Nat. Bank of Cleveland, 112 N.E.2d 636, 638 (Ohio 1953) ("Where, after a payment under mistake of fact, the payee in good faith changes his position so that he no longer has possession of the money or will be in a worse condition if he is required to refund it than if the payer had refused to pay, to such

a case from centuries ago accounted for actual budgeting and spending practices of overpaid workers. In the old English case, *Skyring v. Greenwood*, the paymaster of a military corps mistakenly increased a soldier's pay for several years and even continued to overpay the soldier after being notified of the problem.[250] The court held that "it was not competent to the paymaster to retain any of such sums of money on account of the sums which they had credited him for by way of increased pay, and which they had allowed him to consider his own for so long a period of time."[251] Part of the rationale for the decision was the reality that people spend the money they earn, and after spending the money, the soldier had changed his position:

> He who receives it has a right to consider it as his without dispute: he spends it in confidence that it is his . . . . He who receives it is not in the same condition: he has spent it in the confidence it was his, and perhaps has no means of repayment. . . .
>
> It is of great importance to any man, and certainly not less to military men than others, that they should not be led to suppose that their annual income is greater than it really is. Every prudent man accommodates his mode of living to what he supposes to be his income; it therefore works a great prejudice to any man [that] he may be called upon to pay them back.[252]

The idea that individuals who are overpaid do not change their position by essentially unknowingly taking on a debt to their employers is completely divorced from reality for the vast majority of individuals affected by mistaken overpayments. It is time that courts protect workers through adapting the change of position defense in the case of overpaid employees.

The idea that the law of restitution should adapt to assure justice is not particularly revolutionary. Indeed, restitution itself developed to address the injustice caused by legal rules in specific situations.[253] While the *Third Restatement of Restitution* presents restitution as primarily a set of legal rules and not "a free-floating moral inquiry,"[254] a formalistic approach to restitution is inappropriate in unconventional situations such

extent the payee is exonerated from repayment.").

250. Skyring v. Greenwood, [1825] 107 Eng. Rep. 1064 (K.B.) 1064.

251. *Id.*

252. *Id.* at 1066–67 (internal quotation marks omitted).

253. Laycock, *supra* note 83, at 1278 ("Restitution arose to avoid unjust results in specific cases—as a series of innovations to fill gaps in the rest of the law. Consequently, any definition of restitution risks the self-conscious circularity of Maitland's definition of equity: restitution consists of those rules that originated in writs and equitable remedies that lawyers think of as restitutionary.").

254. Laycock, *supra* note 25, at 932.

as this one, where low-income workers are being overpaid because of sophisticated businesses' negligence. As Peter Linzer has argued, for cases outside of conventional categories, "there is no way to avoid the question of justice—including fault—in deciding whether an enrichment (or impoverishment) is or is not unjust. In deciding on the basis of rough justice, it is necessary to look closely at the facts."[255]

Some courts are already sympathetic to Linzer's point.[256] For instance, in *Lincoln National Life Insurance Company v. Rittman*, in which the court held that the insurance company could not recover in restitution, the court discussed the change of position defense, but it also concluded that restitution was inappropriate for a more general reason: it would be inequitable. The court argued:

> There is yet a deeper reason for denying the restitutionary claim. We simply do not think recovery would be equitable under the circumstances. That, after all, remains the test. Perhaps this approach lacks analytical rigor, but it was precisely a scrupulous adherence to rigor that resulted in the growth of the courts of equity in the first place. While we do not deprecate the logic of appellant's legal position, there sometimes arise cases where law goes only so far and the chancellor must step in.[257]

Because in many instances recovery of a mistaken overpayment would cause employees substantial hardship, courts should assure rough justice and adapt the change of position defense for employees.[258] Courts will already consider the

255. Peter Linzer, *Rough Justice: A Theory of Restitution and Reliance, Contracts and Torts*, 2001 WIS. L. REV. 695, 774.

256. Even in the context of recoupments in bankruptcy, courts have recognized the hardship that recovering overpayments can cause and suggest that equity should prevent recoupment. *See In re* Ross, 104 B.R. 171, 174 (E.D. Mo. 1989) (recognizing "the hardship that could occur when an unemployed bankrupt would have to forego this sole subsistence as a penalty for receiving excess payments for earlier claims" and suggesting that "[e]quity demands some compromise").

257. Lincoln Nat'l Life Ins. Co. v. Rittman, 790 S.W.2d 791, 794 (Tex. App. 1990).

258. Even the Restatement itself appears open to the possibility courts might adapt the change of position defense for specific circumstances:

> Particularly after substantial time has elapsed, a court may conclude that the imposition of a present obligation to repay money long since spent would be inequitable to the recipient, if circumstances make it impossible to restore the parties to the positions they would have occupied but for the claimant's mistake.

RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 65 cmt. c. (2010).

payor's negligence as one factor in their equitable inquiry,[259] further justifying this shift in the approach to the change of position defense.

One argument against my move to expand the defense, however, has been advanced by some commentary that suggests that a broad changed circumstances defense incentivizes recipients to quickly spend overpayments.[260] As one article argues, "From a policy perspective, allowing a payee's dissipation of proceeds as a defense to repayment creates an incentive for the recipient of mistakenly paid funds to spend the money—and that is not an incentive most courts want to create."[261] The problem with this argument, however, is that it assumes people who receive funds will know they do not have a right to the funds. If that were the case, they would be ineligible for the change of position defense in the first place.[262] And, the law cannot influence people who are unaware of the overpayment, because such people will not be thinking about the law at all. Thus, for courts concerned with employers' collection efforts, the change of position defense offers a way to alter the legal landscape in favor of employees.

But, merely denying an employer the right to recover in restitution will not ultimately solve the problem. If employers cannot recover for overpayments through restitution, they will contract in advance for the right to recover. As Saul Levmore notes, "[t]he decision to deny restitution can thus be seen as a means of encouraging the party most in control, the provider, to enter bargains in which the price of his provision is explicitly determined."[263] Indeed, when courts are reluctant to grant restitution for overpayments, pro-employer commentary suggests that employers include rights to repayment in contracts.[264] Thus, to police employers' aggressive, unhindered collection techniques, legislative action is required.

259. Gulf Oil Corp. v. Lone Star Producing Co., 322 F.2d 28, 31 (5th Cir. 1963) ("The fact that the payor was negligent, or was carelessly ignorant of the facts as to which he was mistaken does not necessarily bar recovery, but may be considered in determining the equities between the parties and may reduce the amount of recovery.").

260. Hafer & Mathis, *supra* note 39, at 95.

261. *Id.*

262. *See supra* text accompanying notes 84–105.

263. Saul Levmore, *Explaining Restitution*, 71 VA. L. REV. 65, 72 (1985).

264. Stanton, *supra* note 150, at 490–91.

B. SIMPLE LEGISLATIVE FIX

Commentators on overpayments in other contexts have offered elaborate statutory solutions to balance the rights of the party overpaying and those being overpaid, suggesting limits on set-offs from future payments[265] or new standards for equitable estoppel.[266] Some states and other jurisdictions already offer more comprehensive protections to employees who are mistakenly overpaid.[267] And, in state benefit programs, "a significant portion of states look at the twin concerns of fault and recipient need or situation in determining whether unemployment payments will be recouped from future benefits."[268]

Instead of a new framework for overpayments to employees, I propose a simple shift. Congress should require that employer overpayments are treated like any other unsecured loan for all federal and state collection purposes, and it should prohibit employers from setting-off overpayments from an employee's wages. Treating overpayments like an unsecured debt would mean that the Fair Debt Collection Practices Act and similar state laws applied to overpayments, it would put employers in the same pool as other unsecured creditors in bankruptcy and would extinguish overpayment debt through a discharge, and it would ensure employers did not withhold wages with or without the consent of the employee by removing the

265. Valerius, *supra* note 63, at 446–47.

266. McGonigle, *supra* note 26, at 630–31.

267. In California, the general rule is that an employer cannot withhold wages to offset debts the employee owes the employer. *See, e.g.*, Morse v. ServiceMaster Global Holdings Inc., No. C 10-00628 SI, 2011 WL 2470252, at *4 (N.D. Cal. 2011) ("To allow an employer to offset against wages for debts an employee may owe the employer would allow the employer to do by self-help what he cannot accomplish by attachment, and thus it would defeat the public policy of the attachment exemption for wages. It does not matter whether the employee owes the employer money to pay back a promissory note, to pay for a training where he failed to stay on the job for the requisite amount of time, or simply because the employer made a mistake and overpaid the employee one month." (internal citations omitted)). But, this protection is easily avoided by employers, because the employee can consent to withholding. *See* THOMAS E. GEIDT & JUDITH M. KLINE, CAL. BUS. LAW DESKBOOK § 16:18 ("Even though the recoupment of overpayments or debts arguably benefits the employer, the DLSE has taken the enforcement position that employers *may* make a deduction to recover an overpayment, debt, vacation advance, or other amount owed to the employer if the employee has first voluntarily signed a written authorization to permit the deduction—whether as a one-time deduction or a series of installments—provided that the amount deducted does not exceed the amount authorized and the deduction does not have the effect of reducing the employee's pay below the minimum wage.").

268. Failinger, *supra* note 26, at 109.

self-help remedy of offsetting wages. Because the legal framework is already set up in great detail, designating overpayments as unsecured debts is relatively inexpensive from both a legislative and a legal/business strategy standpoint.

Changing the status of mistaken overpayments to purely unsecured debt by eliminating special collection rights makes sense, because the traditional justifications for secured creditors having superior collection rights do not hold true in the context of mistakenly overpaid employees. As Part III points out, unsecured creditors face obstacles to collecting debts, such as (i) debt collection laws, (ii) the potential of bankruptcy, and (iii) the need to file a lawsuit, obtain a judgment, and execute that judgment before getting paid.[269] Employers recouping overpaid wages do not face any of these barriers. Under Article 9, secured creditors similarly have superior collection rights compared to unsecured creditors, because they can repossess specific collateral,[270] but these rights are defensible because the debtor acquires corresponding benefits. The debtor benefits from the security interest by obtaining lower interest rates and access to credit because the secured creditor passes on some of the benefits of its ability to obtain repayment.[271] On the other hand, because mistaken overpayments occur involuntarily for all parties, employees do not obtain a corresponding benefit. The employee who is overpaid by mistake does not, for instance, get more money from the employer because the employer can collect more easily. Even if we wanted to allow wage assignments to incentivize lenders to extend credit to consumers and to decrease the cost of credit,[272] the rationale does not apply in the involuntary overpayment context.

Another important policy within commercial law also justifies eliminating employers' special collection rights. Within the context of an insolvent debtor, set-offs redistribute the employee's assets to the employer at the expense of the employee's other creditors, undermining bankruptcy's fundamental goal of creditor equality.[273] If employees cannot pay all of their creditors, the right to a set-off means that the employer will get paid

269. *Supra* Part III.

270. UNIF. COMMERCIAL CODE § 9-609(a)(1), 3 U.L.A. 671 (2010).

271. Mann, *supra* note 143, at 667.

272. Jonathan Riley Key, Note, *Misguided Paternalism: The U.C.C. and FTC's Attempt To Limit Wage Assignments*, 62 ALA. L. REV. 823, 832 (2011).

273. Begier v. IRS, 496 U.S. 53, 58 (1990) ("Equality of distribution among creditors is a central policy of the Bankruptcy Code.").

100% of its claim, leaving the other creditors with no rights to the wages.[274] The employer's superior position is, as Judge Posner argues, "fortuitous . . . and therefore arbitrary."[275] Loans secured by collateral also ensure the secured creditor is paid before unsecured creditors, disrupting creditor equality, but this disruption only occurs when the creditor has perfected its interest and thereby warned the world of its superior interest.[276] The employer, on the other hand, has done nothing to justify its superior position over other creditors. Thus, reducing overpayment debts to normal unsecured debts and disallowing set-offs reflect the principles underlying secured credit and bankruptcy law and theory.

In my proposal, employers could still seek to recover overpayments. In jurisdictions that do not allow set-offs now, employers pursue overpayments through lawsuits: "Where no such agreement or statutory authorization exists [to offset wages], the employer has the option of recovering overpayments in other ways such as pursuing a grievance, or bringing a claim against the employee."[277] But, the costs of recovery would be substantially higher.

The basic economic theory underlying much of tort law, the least-cost avoider principle, justifies allocating the cost of the mistake to the employer instead of the employee.[278] The least-cost avoider principle states that the party best able to foresee and avoid costs should be liable.[279] In the absence of a negotiated agreement, law often tries to approximate what agreement the parties would come to if they had negotiated about a term.[280] In most employment contracts, the employee does not negotiate what will happen in the event of a mistaken overpayment,[281] so this tort principle is applicable.

274. Roe, *supra* note 131, at 1667–68.

275. *In re* Elcona Homes Corp., 863 F.2d 483, 485 (7th Cir. 1988).

276. David Gray Carlson, *Debt Collection as Rent Seeking*, 79 MINN. L. REV. 817, 832 (1995).

277. Health Emp'rs Ass'n of B.C. v. B.C. Nurses' Union, 2005 BCCA 343 ¶ 67 (Can.).

278. GUIDO CALABRESI, THE COSTS OF ACCIDENTS: A LEGAL AND ECONOMIC ANALYSIS 135 (1970).

279. Holtz v. J.J.B. Hilliard W.L. Lyons, Inc., 185 F.3d 732, 743 (7th Cir. 1999); Guido Calabresi & Jon T. Hirschoff, *Towards a Test for Strict Liability in Torts*, 81 YALE L.J. 1055, 1060 (1972).

280. Scott Hershovitz, *Two Models of Tort (and Takings)*, 92 VA. L. REV. 1147, 1150 (2006).

281. *Cf.* Failinger, *supra* note 26, at 131 ("Further, the recipient has no bargaining power about who will bear the risk if an error occurs, how that er-

In the context of overpayment, employers are the least-cost avoider. The mere fact that the employer is the one making the overpayment demonstrates it is the party able to avoid overpayments, because it has both the ability and opportunity to stop them.[282] Considering overpayments to be general unsecured debts would encourage employers to make payments more carefully, because the cost of errors would increase as more overpayments would become unrecoverable.[283] Under the current laws, employers have such powerful collection tools that they likely underinvest in ensuring they are paying correct wages. Increasing the costs of collection would encourage investment.

Of course the counterargument to this point is that the law should incentivize employees, not employers, to vigilantly review their paychecks for overpayments. The difficulty with this position is that overpayments are often difficult to discover because of the complexity of compensation schemes. Even businesses with far superior resources, experience, and incentives argue that overpayments from the government are difficult to discover.[284] Additionally, in many cases, the business has made an error because the correct amount of the wage is very complicated to determine. It is difficult to think the employee could make the determination more accurately than the business.[285]

ror will be repaid, or the amount and timing of repayment.").

282. *See* Levmore, *supra* note 263, at 74 (explaining the least-cost avoider thesis in the context of a creditor/debtor overpayment situation).

283. *Cf.* McGonigle, *supra* note 26, at 644–45 ("A more compelling argument can be made that permitting equitable estoppel claims based on gross negligence will actually better protect the actuarial soundness of the pension fund. Permitting claims based upon gross negligence will incentivize the employer or pension administrator to take special care in dealing with pensions. This, in turn, will ensure that employers and pension administrators are not overpaying pensions, thereby protecting the pension fund's assets.").

284. *See* Steven J. Chananie et al., *Disclosing and Refunding Overpayments in Healthcare Cases*, 24 HEALTH LAW. 16, 17 (2012) ("[M]any overpayments can be difficult to quantify and it can take—in some cases—far longer than 60 days to do so. Such difficulties may arise, for instance, when a possible overpayment is discovered that involves numerous services and bills, each of which must be examined to determine whether there was, in fact, an overpayment or the extent of the overpayment. Such cases may require the review of substantial numbers of medical charts and billing records, the hiring of an outside consultant, or conducting a review of a statistically valid random sample and then performing an extrapolation. In such cases, it may be physically impossible to complete, or unreasonable to expect completion of, the review and quantification of the overpayment within the mandated 60 day time period.").

285. *Cf.* Valerius, *supra* note 63, at 433 ("If accountants specializing in

The business usually has superior resources to invest in accuracy.

A second counterargument to this desire to increase the incentive for employers investing in accuracy is that it could be inefficient for employers to *over*invest in accuracy.[286] Eric Kades gives the example of someone mistakenly paying another person's electricity bill and then seeking restitution.[287] He argues for restitution in that scenario:

> [N]ot requiring restitution will lead all bill-payers to take excessive precautions when they prepare their bills—such as checking the account number four times instead of twice. The extra minute spent, multiplied by thousands or millions of customers, creates great waste, and it likely exceeds the cost of requiring restitution in the few cases of mistaken payment.[288]

The problem with the overpayment of wages, however, is that overpayments are widespread, tilting the scales in favor of greater investment. Moreover, in the employment context, the business's investment in accuracy is important to catch underpayment in favor of the business that the employee may never discover. Underpaid employees do not have a self-help remedy similar to employers' self-help remedy for overpayment. If errors are made and employees unjustly enrich employers by working more than they compensated for, the employee has to go through the process of suing for the difference, although few will do so, so the rights are not reciprocal.[289] The superior collection rights go one way—against the employee. Thus, it is especially important for the employers to invest in paying wages accurately.

In light of the policies animating both debtor/creditor law and tort law, employers' mistaken overpayments should be considered general unsecured debts without a right to offset. This meager change would bring employers under the same umbrella of protections as other debtors.

---

pension payment calculations do not recognize the computation mistake after years of overpayment, it is unreasonable to expect retirees to uncover such an error.").

286. *See* Eric Kades, *Windfalls*, 108 YALE L. J. 1489, 1520 (1999).

287. *Id.*

288. *Id.*

289. *Cf.* Failinger, *supra* note 26, at 122 ("[T]he contract model assumes that each contractor is able to enforce his rights in case of breach by the other party; again, the government as contractor is well aware that few recipients of its services will ever challenge its breaches.").

CONCLUSION

There is a deep and disturbing variance between how current law treats people who take out unsecured debt, like credit cards, and employees who are mistakenly overpaid by their employers. Moreover, the law contradicts basic intuitions—the innocent party that did not agree to the debt and did not know about the debt has significantly fewer rights than the party who volunteered for the transaction. This Article has unmasked this disjunction, showing how employers have special collection rights and how employees cannot use debt collection laws, wage laws, or even bankruptcy effectively to protect themselves if they fall into financial distress.

This inability to find relief in law has serious effects often on low-income Americans, such as soldiers. A soldier who is overpaid for years because of the Defense Finance and Accounting Service's complicated wage rules and archaic computer system can be left scouring food banks and turning to pawnshops when her pay is suddenly reduced and debt collectors are calling her. The judicial and legislative solutions I offer would alter the relationship between employers and employees when the employee is overpaid, bringing that relationship into line with the law governing all unsecured credit. Given the frequency of mistaken overpayment and their harms, the time has come for debtor-creditor law to expand its protection to employees.