

## **On Misclassification, Efficient Deterrence, and the Mandatory Character of Employment Regulation**

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A regulatory system's ability to advance its underlying goals depends on its capacity to deter those it governs from escaping its purview. In the domain of employment law, this challenge manifests itself in cases where an employer and employee label their relationship as one of principal and contractor. Such misclassification typically leads to two concurrent ramifications: the first is that the employee's rights are violated, the second that the employee is paid a higher wage, reflecting the reduced cost of her employment.

The prospect of misclassification raises the question as to what means ought to be used in order to deter it. The primary sanction used by extant doctrine is the denial of the employer's right of deduction: when required to compensate the employee for violation of her rights, the employer is barred from deducting the excess wage that she paid on the basis of the erroneous classification. Thus, the employee fully recovers for the value of her unfulfilled rights, but is not required to pay back the extra payment she received as a result of the same violation.

This article highlights a number of significant drawbacks underlying this sanction as an instrument of deterrence. First, denial of the right of deduction is shown to produce under-deterrence in some cases, and over-deterrence in others. Second, it incentivizes employers who have already decided to violate the law, to do so in a form that severely undermines the employee's welfare. Finally, it is inconsistent with the general principle of proportionality, as it imposes a mild sanction for severe violations, and a severe sanction for mild violations.

The article therefore suggests a shift from the extant regime to one that is premised on the imposition of punitive damages. Under the proposed regime, the severity of the sanction will be set proportionally to the gravity of the violation, and will thereby rectify the failings of the current regime, from both the deterrence and the equity perspectives. The sanction's magnitude will depend on a normative determination regarding the precise goal of legal policy—whether it should seek to deter all misclassifications, or rather only those that undermine the welfare of employees. The article considers both normative possibilities, and then examines the scope of compensation that corresponds to each of them.