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Tale of Two Policies: Corporate Immunity and its Negative Externalities, the Worst of Times for Consumers, A

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A Tale of Two Policies: Corporate Immunity and Its Negative Externalities, The Worst of Times for Consumers

Kaneff v. Del. Title Loans, Inc.[1]

I. INTRODUCTION

Need quick cash? Payday lenders understand. A short-term loan for instant cash may seem like a good idea at the time, but once borrowers realize that payday lenders charge interest rates three times the actual loan, a feeling of borrower's remorse inevitably sets in. Help is on the way, however. State legislatures are reacting by crafting regulations and consumer protection laws criminalizing the issuance of such loans.[2] This legislative action indicates the existence of a serious societal problem. By choosing to punish payday lenders, state legislatures are pinpointing an area of severe corporate abuse. Regulation is targeted at combating that abuse.

When the Third Circuit Court of Appeals, in *Kaneff v. Del. Title Loans, Inc.*, faced a Pennsylvania statute that prohibited payday loans,[3] the Third Circuit refused to enforce the state statute. This note will explore the reasoning underlying and discuss the effects of the Third Circuit's decision, providing a consequential look at the externalities that *Kaneff* created. As will become evident, these effects are quite serious and far-reaching, both to Pennsylvania's citizens and Pennsylvania's regulatory scheme.

II. FACTS AND HOLDING

Tia Kaneff resided in Plymouth Meeting, Pennsylvania, situated approximately thirty miles from the Delaware border.[4] In November 2005, Kaneff traveled to Delaware to obtain a car title loan from Delaware Title Loans (DTL).[5] The loan agreement included an arbitration provision, requiring both parties to arbitrate any disputes and designating Delaware as the choice of law.[6] Kaneff would later find several provisions within the arbitration agreement objectionable. First, the agreement stipulated that the lender (DTL) was not required to enter arbitration

1. 587 F.3d 616 (3d Cir. 2009).
2. *See* Tara Shinnick, *State Regulation of Payday Loans*, 29 A.L.R 6th 461, pt. I, § 2 (2007).
3. *See* 41 PA. STAT. ANN. § 201 (West current through Act 2010-60).
4. Kaneff v. Delaware Title Loans, Inc., 587 F.3d 616, 618 (3d Cir. 2009).
5. *Id.* The court noted that Kaneff "is representative of a low income borrower." *Id.* Kaneff had just separated from her husband and had moved into a new apartment with her two children. *Id.* She worked as a frozen food manger at a supermarket. *Id.*
6. *Id* at 619.

prior to repossessing the vehicle through self-help.[7] Second, the arbitration provision included a waiver of all class action claims by a borrower.[8] Third, the arbitration clause allocated unfavorable costs to the consumer.[9] Specifically, borrowers were required to pay a $125filing fee and all of their own expenses in arbitration, including attorney fees.[10] Last, a severance provision stipulated that the arbitration agreement was to be enforced regardless of whether any other specific provisions were invalid.[11]

As for the loan itself, Kaneff borrowed a total of $550, payable one month from the issuance of the loan.[12] This total included a fifty dollar charge for recording the car lien and for insurance costs.[13] DTL charged an annual interest rate of 300.01% for the $550 loan amount.[14] Including interest, Kaneff owed DTL a total of $685.62, due in its entirety on December 23, 2005.[15] However, Kaneff misunderstood the payment terms of her loan.[16] She believed that her loan was for six months, requiring her to make six individual payments of $136.[17] Proceeding under this mistaken assumption, Kaneff began making her monthly payments on December 30, 2005.[18] After six months of doing so, Kaneff had paid DTL a total of $842.50.[19] In June 2006, Kaneff contacted DTL only to learn that she still owed the payday lender $783.[20] Kaneff refused to pay DTL more money.[21] In response, DTL repossessed Kaneff's car on September 21, 2006.[22]

Kaneff filed a putative class action against DTL in Pennsylvania state court.[23] The Pennsylvania state court granted Kaneff's preliminary injunction seeking the return of her vehicle.[24] Using the Class Action Fairness Act of 2005,[25] DTL successfully moved to transfer the dispute to the Eastern District of Pennsylvania.[26] DTL then moved to compel arbitration pursuant to the loan agreement with Kaneff.[27] The Eastern District of Pennsylvania granted DTL's motion and dismissed the case with prejudice.[28] Subsequently, Kaneff appealed the dismissal to the Third Circuit. The Third Circuit held that the class arbitration waiver was not unconscionable under Pennsylvania law and because the cost splitting provision

7. *Id.*
8. *Id.* at 620.
9. Kaneff v. Delaware Title Loans, Inc., 587 F.3d 616, 620 (3d Cir. 2009).
10. *Id.*
11. *Id.* at 619.
12. *Id.* at 618.
13. *Id.*
14. *Id.*
15. *Kaneff*, 587 F.3d at 619.
16. *Id.*
17. *Id.* In fact, the total amount of interest that she owed was $135.62 for one month. *Id.*
18. *Id.*
19. *Id.*
20. *Id.*
21. *Id.*
22. *Kaneff*, 587 F.3d at 619.
23. *Id.*
24. *Kaneff*, 587 F.3d at 619. In seeking her preliminary injunction against DTL, Kaneff argued the necessity of her vehicle to continue working at her job. *Id.*
25. 28 U.S.C. § 1332(d)(2) (2006).
26. *Id.*
27. *Id.*
28. *Id.*

was unconscionable, but severable, the arbitration agreement was not unconscionable under Pennsylvania law.[29]

III. LEGAL BACKGROUND

A. Unconscionable Cost Provisions in Arbitration

In *Green Tree Financial Corp.-Ala v. Randolph*, the U.S. Supreme Court addressed an arbitration provision that the plaintiff alleged was unconscionable due to cost allocations.[30] The Court's decision is relevant to *Kaneff* for two reasons. First, *Green Tree* provided an early opportunity for litigants to establish unconscionability due to prohibitively expensive arbitration costs. In *Kaneff*, the borrower alleged that the cost-splitting provision was unconscionable because arbitration would be prohibitively expensive for her. This was the same argument made in *Green Tree*.[31] The Court's early discussion of arbitration costs in *Green Tree* can provide context for the Third Circuit's treatment of the cost-splitting provision in *Kaneff*. Second, the Court in *Green Tree* explained that its primary concern was preserving vindication of statutory rights.[32] The court in *Kaneff* not only refused to preserve consumers' statutory rights but effectively destroyed consumers' statutory rights, which were codified in the Pennsylvania usury statute. The Court's focus and emphasis on preserving statutory vindication can be contrasted with *Kaneff*'s denial of such rights.

Green Tree involved a dispute between a financier and purchaser of a mobile home.[33] The purchaser argued that because the arbitration provision remained silent on allocation of costs, the agreement was unconscionable because it created a "risk that she will be required to bear prohibitive arbitration."[34] The Eleventh Circuit agreed, holding that an arbitration agreement, silent on costs, was unenforceable "because it posed a risk that Randolph's ability to vindicate her statutory rights would be undone by steep arbitration costs."[35] However, the U.S. Supreme Court, in a 5-4 decision, held that an arbitration agreement that remains "silent" on arbitration costs was not unconscionable, unless the litigant could prove his or her actual inability to bear those costs.[36]

According to the Court, "a party seeking to invalidate an arbitration agreement on the ground that arbitration would be prohibitively expensive bears the burden of showing the likelihood of incurring such costs."[37] Of utmost concern to the Court was that "the prospective litigant effectively may vindicate [his or her] statutory cause of action in the arbitral forum."[38] Conceding that "the existence of large arbitration costs may well preclude a litigant . . . from effectively vindicating

29. Kaneff v. Delaware Title Loans, Inc., 587 F.3d 616, 624-25 (3d Cir. 2009).
30. 531 U.S. 79, 82 (2000).
31. *Kaneff*, 587 F.3d at 624.
32. Green Tree Fin. Corp.-Ala. v. Randolph, 531 U.S. 79, 90 (2000).
33. *Id.* at 82.
34. *Id.* at 90.
35. *Id.* at 84.
36. *Id.* at 90-91.
37. *Id.* at 91-92.
38. *Green Tree*, 531 U.S. at 90 (internal quotations omitted).

such rights," the Court pointed out that by remaining "silent" on the issue, the arbitration clause included no such large costs.[39] In the present case, the purchaser provided no evidence that he actually would bear such expensive arbitration costs.[40] Because the purchaser failed to prove that the arbitration clause would likely force him to incur large arbitration costs, he failed to prove that he could not "vindicate his statutory right in the arbitral forum."[41] Although providing an early standard for invalidating arbitration provisions due to cost provisions, *Green Tree* discussed neither class action waivers nor the effects of such waivers on statutory rights. However, after *Green Tree*, Pennsylvania state courts and the Third Circuit did consider class actions as a vehicle to preserve vindication of statutory rights.

B. Class Arbitration Waivers Unconscionable under Pennsylvania Law

Prior to *Kaneff*, Pennsylvania state courts addressed Pennsylvania public policy regarding class arbitration waivers, generally disfavoring class waivers.[42] Yet, *Kaneff* upheld a class arbitration waiver under Pennsylvania law. According to the court in *Kaneff*, Pennsylvania state cases reflected Pennsylvania's public policy prohibiting corporate immunity, not class waivers.[43] Discussing the conflicting views between the Pennsylvania courts and the Third Circuit over Pennsylvania policy regarding class waivers is relevant for two reasons. First, these cases detail the progression and development of Pennsylvania law on class action waivers leading up to *Kaneff*. Second, the Third Circuit, interpreting Pennsylvania state courts, held that Pennsylvania public policy prohibited corporate immunity three months prior to *Kaneff*.[44] Yet, *Kaneff* had the effect of creating corporate immunity. Therefore, discussing cases decided by Pennsylvania state courts and the Third Circuit before *Kaneff* highlights *Kaneff*'s dramatic deviation from the Third Circuit and Pennsylvania precedent.

In *Thibodeau v. Comcast Corp.*, the Superior Court of Pennsylvania addressed a class action arbitration waiver within a service contract between a consumer and a cable television provider.[45] Because the Third Circuit decided *Kaneff* under Pennsylvania law, the Pennsylvania state court's interpretation of class action waivers would be relevant to the Third Circuit's decision in *Kaneff*. In *Thibodeau*, the consumer represented a class of individual consumers alleging that the provider had improperly billed consumers for unnecessary equipment.[46] The

39. *Id.*

40. *Green Tree*, 531 U.S. at 90.

41. *Id.*

42. *See* Dickler v. Shearson Lehman Hutton, 596 A.2d 860, 867 (Pa. Super. Ct. 1991) (allowed class action arbitration although the arbitration agreement was silent on the issue); Lytle v. CitiFinancial Servs., Inc. 810 A.2d 643 (Pa. Super Ct. 2002); McNulty v. H & R Block, 843 A.2d 1267 (Pa. Super. Ct. 2004); Thibodeau v. Comcast Corp., 912 A.2d 874, 883 (Pa. Super. Ct. 2006) ("even language which appears to be facially neutral can nonetheless be unconscionable if its effect is one-sided").

43. Cronin v. CitiFinancial Servs., Inc., 74 Fed. R. Serv. 3d (West) 630, 635 (3d Cir. 2009), *aff'g* 2009 WL 1033613 (E.D. Pa. Apr. 15, 2009).

44. *Cronin*, 74 Fed. R. Serv. 3d (West) at 635.

45. *Thibodeau*, 912 A.2d at 877.

46. *Id.* The consumer had subscribed to basic cable. *Id.* Pursuant to the agreement, the consumer was required to pay monthly charges for use of a cable convertor box and remote control. *Id.* Subse-

central issue was whether the class action waiver was unconscionable under Pennsylvania law.[47] The superior court noted that Pennsylvania law generally favored class action arbitration.[48] In addition, precedent suggested that class action arbitration waivers were considered unconscionable under Pennsylvania law.[49] Appraising these prior state law cases, the superior court concluded, "if the costs associated with arbitrating a single claim effectively deny consumer redress, prohibiting class action litigation or class action arbitration is unconscionable."[50] The superior court further explained that "[i]f class action litigation is the only effective remedy, a contract of adhesion cannot preclude such litigation" because the effect of the class action waiver created corporate immunity.[51] Such a stance, the superior court reasoned, was justified by Pennsylvania public policy.[52]

Explaining its reasoning, the superior court wrote that "[c]lass actions are still of great public importance" serving as an "essential vehicle by which consumers may vindicate their lawful rights."[53] The average consumer stands at a great inequality to the corporate entity, and the class action mechanism serves to resolve this inequality.[54] As the superior court explained, "[I]n Pennsylvania, consumer class action litigation is of such public importance that public policy considerations allow class action arbitration even if an arbitration agreement does not explicitly so provide."[55] Furthermore, such public policy concerns are heightened in the context of consumers bringing small claims.[56] Most consumers "having limited financial resources and time, cannot individually present minor claims in court or in an arbitration."[57] If Pennsylvania requires consumers to arbitrate their small claims individually, "defendant corporations are effectively immunized from redress of grievances."[58] Therefore, the court concluded, "[I]t is clearly contrary to public policy to immunize large corporations from liability by allowing them to preclude all class action litigation or arbitration."[59] Because the consumer and the other class members were seeking minimal damages, the superior court held that the arbitration clause was unconscionable and unenforceable under Pennsylvania law.[60] Although *Thibodeau* held that Pennsylvania public policy

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quently, the consumer learned that neither the cable convertor box nor the remote were required for basic cable. *Id.*

47. *Thibodeau*, 912 A.2d at 876.

48. *Id.* at 881; 883 ("even language which appears to be facially neutral can nonetheless be unconscionable if its effect is one-sided"); *see also* Dickler v. Shearson Lehman Hutton, 596 A.2d 860 (Pa. Super. Ct. 1991) (allowing class action arbitration although the arbitration agreement was silent on the issue); Lytle v. CitiFinancial Servs., Inc. 810 A.2d 643 (Pa. Super. Ct. 2002); McNulty v. H & R Block, 843 A.2d 1267 (Pa. Super. Ct. 2004).

49. *Thibodeau*, 912 A.2d at 883; *see also* Lytle v. CitiFinacial Servs. Inc., 810 A.2d 643 (Pa. Super. Ct. 2002); McNulty v. H & R Block, 843 A.2d 1267 (Pa. Super. Ct. 2004).

50. Thibodeau v. Comcast Corp., 912 A.2d 874, 883 (Pa. Super. Ct. 2006) (discussing a previous holding in Lytle v. CitiFinacial Servs. Inc., 810 A.2d 643 (Pa. Super. Ct. 2002)).

51. *Id.* at 884.

52. *Id.* at 886.

53. *Id.* at 884.

54. *Id.* at 884-85.

55. *Id.* at 882.

56. *Thibodeau*, 912 A.2d at 886.

57. *Id.* at 884.

58. *Id.* at 885.

59. *Id.* at 886.

60. *Id.*

prohibited class arbitration waivers, the Third Circuit disagreed with the Pennsylvania Superior Court's interpretation of Pennsylvania public policy in *Cronin v. CitiFinancial Services Inc.*

In *Cronin*, the Third Circuit dealt with a class action suit against a lender for allegedly violating the Fair Credit Reporting Act.[61] The borrower alleged that by providing inaccurate loan information to consumer credit agencies, the lender had damaged borrowers' credit scores.[62] The loan agreement required binding arbitration and waiving class relief.[63] The borrower argued that *Thibodeau* held that class arbitration waivers were unconscionable under Pennsylvania public policy.[64] The Third Circuit disagreed with the borrower's interpretation of *Thibodeau*.[65]

The Third Circuit agreed that *Thibodeau* represented Pennsylvania public policy rejecting contracts precluding class action relief, but only where "defendant corporations are effectively immunized from redress or grievances."[66] Specifically, *Thibodeau* involved small damages, and the Third Circuit recognized that "[n]o individual will expend the time, fees, costs, and or other expenses necessary for individual litigation or arbitration for this small potential recovery."[67] Because the litigant in *Thibodeau* sought small damages and therefore, had no incentive to litigate individually, class waiver would destroy the litigant's claim.[68] The Third Circuit concluded that Pennsylvania law did not hold class arbitration waivers unconscionable *per se* but would only do so if the agreement created corporate immunity.[69] Therefore, the Third Circuit stressed that "the critical issue is whether the particular class action waiver effectively ensures that a defendant will never face liability for wrongdoing."[70] According to the Third Circuit, this distinguished *Thibodeau* from *Cronin*.

In *Cronin*, the borrower sought both actual and punitive damages, so his claim did not involve small damages as in *Thibodeau*.[71] Seeking significant damages, the Third Circuit found that the borrower had plenty of incentive to litigate individually.[72] Because the potential litigants had incentive to litigate their claims, the lender was not immunized from liability.[73] Because the lender had no such immunity, the Third Circuit held that the arbitration clause was not unenforceable.[74] Yet, the Third Circuit explicitly left open the issue of whether class arbitration waivers were unconscionable due to Pennsylvania public policy.[75] The Third Circuit again refused to resolve that issue in *Kaneff*, a mere seventy-six days after

61. *Cronin*, 352 Fed. App'x. at 634; Fair Credit Reporting Act, 15 U.S.C. § 1681 (2006).
62. *Id.* at 632.
63. *Id.* at 634.
64. *Id.* at 635.
65. *Id.*
66. *Cronin*, 352 Fed. App'x. at 635 (quoting *Thibodeau*, 912 A.2d at 885).
67. *Id.* (quoting *Thibodeau*, 912 A.2d at 885-86).
68. *See id.*
69. *Id.*
70. *Id.*
71. *Cronin*, 352 Fed. App'x. at 635-36.
72. *Id.* at 636. The class representative borrower was a licensed attorney. *Id.*
73. *Id.*
74. *Id.*
75. *Cronin*, 352 Fed. App'x. at 635 ("[W]e have not yet directly addressed whether the Pennsylvania decisions on certain class action waivers set forth a public policy unique to arbitration agreements . . . we need not resolve that issue today").

Cronin was decided. [76] Perhaps, the Third Circuit did not want to discuss Pennsylvania policy regarding class action waivers because *Kaneff* provided the court with two additional policy considerations: the federal policy favoring arbitration and Pennsylvania's policy prohibiting usurious loans.

C. Third Circuit Severance of Unconscionable Provisions

Although upholding the arbitration agreement, the Third Circuit severed a provision from the arbitration agreement in *Kaneff*.[77] The Third Circuit provided little explanation for why severance was appropriate, except that it recognized that "as a matter of substantive federal law, an arbitration provision is severable from the remainder of the contract."[78] The Third Circuit recognized this same federal policy earlier in *Spinetti v. Service Corp. International,* which like *Kaneff*, was decided under Pennsylvania law.[79] Because *Spinetti* discussed federal policy favoring severance and arbitration (the same policies mentioned in *Kaneff*) and provided more explanation on the severance device itself, the Third Circuit's decision in *Spinetti* assists in understanding the issues in *Kaneff*.

In *Spinetti*, an employee alleged that her employer terminated her due to her age and gender, violating Title VII[80] and the Civil Rights Act of 1964.[81] Within the arbitration agreement, a provision required that both parties pay equal costs in arbitration and their own attorneys fees.[82] The district court concluded that the employee had met her factual burden of proof, establishing that she could not afford the cost arrangements in the arbitration agreement.[83] Accordingly, the Third Circuit affirmed that the cost-splitting provision for arbitration was unconscionable.[84] However, the court still enforced arbitration despite two unconscionable provisions within the agreement.[85]

The Third Circuit chose to sever the unconscionable cost-splitting provision, enforcing the remainder of the arbitration agreement.[86] The court emphasized that federal public policy favored enforcement of arbitration agreements.[87] Despite the unconscionable provisions, "[I]t would be contrary to federal policy to undermine an entire arbitration agreement based upon a single potentially unenforceable term."[88] The claimant in *Spinetti*, however, argued that federal policy could not justify severance in absence of a severance provision, which her contract lacked.[89] The court disagreed, finding federal policy more persuasive.

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76. *See* Kaneff v. Del. Title Loans, Inc., 587 F.3d 616, 625 (3d Cir. 2009).
77. *Id.* at 625.
78. *Id.* at 624 (quoting Buckeye Check Cashing, Inc. v. Cardegna, 546 U.S. 440, 445 (2005))
79. Spinetti v. Serv. Corp. Int'l, 324 F.3d 212, 214 (3d Cir. 2003).
80. 42 U.S.C. § 2000e-5(k) (2006).
81. *Id.;* 29 U.S.C. §§ 626(b), 216(b) (2006).
82. *Spinetti,* 325 F.3d at 215.
83. *Id.* at 217.
84. *Id.*
85. *Id.* at 223.
86. *Id.* at 220.
87. *Id.* at 213.
88. *Spinetti,* 325 F.3d at 220 (citing Gannon v. Circuit City Stores, Inc., 262 F.3d 677, 682 (8th Cir. 2001)).
89. *Id.* at 221.

The Third Circuit, echoing concerns voiced by the Eighth Circuit, opined that invalidating entire arbitration agreements every time a provision was determined invalid would discourage parties from forming contracts under the Federal Arbitration Act (FAA). [90] Therefore, parties would be prevented from structuring agreements in the most efficient manner possible.[91] Such a result, the Third Circuit cautioned, "would represent the antithesis of the liberal federal policy favoring arbitration agreements."[92] Therefore, the Third Circuit concluded that the FAA's policy favoring enforcement of arbitration agreements supported its decision to sever unconscionable provisions, while still compelling arbitration.[93]

Spinetti provides an example of how the federal policy favoring arbitration necessitates the use of severance. In *Spinetti* however, the litigant sought to vindicate her rights under a federal statute.[94] Because *Spinetti* relied on federal policy to deny relief under a federal statute, no conflict existed between state and federal policy. In *Kaneff*, however, a conflict between state and federal policy did exist.

IV. INSTANT DECISION

The first issue the Third Circuit in *Kaneff* addressed was whether to apply Pennsylvania or Delaware's choice of law rules.[95] Kaneff brought her claim in district court based on diversity of citizenship. Diversity jurisdiction required the Third Circuit to apply the choice of law rules in the state in which the petition was originally filed.[96] Because Kaneff filed her case in Pennsylvania state court, the Third Circuit followed Pennsylvania's choice of law rules.[97] The Third Circuit then applied Pennsylvania choice of law rules to determine whether there was a true conflict between application of Delaware law and Pennsylvania law to the arbitration agreement.[98] A true conflict exists if applying the two state laws would reach different results. If a true conflict existed, then the court had to decide whether to apply Pennsylvania or Delaware law in evaluating the unconscionability of the arbitration agreement. If no true conflict existed, the court could decide whether the arbitration provisions were unconscionable directly.

The Third Circuit found that a true conflict existed between application of Delaware and Pennsylvania law.[99] Pennsylvania law appeared more favorable to Kaneff's claim.[100] Specifically, Pennsylvania Act 6[101] prohibits charging over a 6% interest rate and allows borrowers, charged in excess of the statutory rate, to

90. *Id.* (citing Gannon v. Circuit City Stores, Inc., 262 F.3d 677, 682 (8th Cir. 2001)).
91. *Id.*
92. *Id.*
93. *See id.* at 221-22.
94. *Id.* at 214. The litigant alleged violations under Title VII and the Civil Rights Act. *Id.*
95. Kaneff v. Del. Title Loans, Inc., 587 F.3d 616, 621 (3d Cir. 2009). Recall that Kaneff, a Pennsylvania resident, had traveled across state lines into Delaware to form her loan agreement. *Id.* at 618.
96. *Id.* at 621 (quoting Berg Chilling Sys., Inc. v. Hull Corp., 435 F.3d 455, 462 (3rd. Cir. 2006)).
97. *Id.*
98. *Id.*
99. *Id.*
100. *Id.* at 622.
101. 41 PA. CONST. STAT. ANN. §§ 408, 503.

sue and recover attorneys' fees.[102] The Third Circuit found the act's provision providing recovery of attorneys' fees significant because a key provision in the arbitration agreement stipulated that the borrower could not recover attorneys' fees in arbitration.[103] Although Pennsylvania statutes included a usury law[104], the Delaware legislature had created no similar statutes.[105] Phrased differently, though Pennsylvania provided Kaneff with a statutory right to recover for receiving a usurious loan, Delaware provided no such statutory right. Having found a true conflict, the Third Circuit then applied a choice of law analysis to decide whether Pennsylvania or Delaware substantive law should apply in evaluating the unconscionability of the arbitration agreement.[106]

Generally, under Pennsylvania choice of law rules, contract cases must apply the law of the state that the contract specified as choice of law.[107] Delaware Title Loans (DTL) argued that the terms of the contract specified Delaware as choice of law.[108] Therefore, DTL urged the court to enforce the contract as agreed upon. However, the Third Circuit stated two exceptions to the general rule that the state specified in the contract must serve as the choice of law.[109] First, if the contract specified as choice of law a state with "no substantial relationship to the parties or the transaction and there is no reasonable basis for the parties' choice," the Third Circuit would not enforce the contracted for choice of law.[110] Second, if "application of the law of the chosen state would be contrary to a fundamental policy of a[nother] state which has a materially greater interest than the chosen state in the determination of the particular issue," the chosen state could not serve as choice of law.[111] Because the contract was signed in Delaware, the court found a substantial relationship existed between choice of law and the agreement, holding that the first exception did not apply.[112] However, the parties disagreed over whether the second exception would apply, arguing about whether Pennsylvania's "fundamental policy" was implicated so that Pennsylvania had a "materially greater interest" in the case.[113]

Kaneff argued that Pennsylvania had the greater interest in deciding the transaction.[114] First, Kaneff argued that she was a consumer residing in Pennsylvania, and Pennsylvania had a strong policy interest in applying its own consumer protection laws.[115] Second, as Kaneff's counsel argued in her appeal brief, Pennsylvania law should apply "because Pennsylvania will have to live with the aftermath of the transaction."[116] Kaneff posited that should her car be repossessed, causing

102. Kaneff v. Del. Title Loans, Inc., 587 F.3d 616, 622 (3d Cir. 2009).
103. *Id.*
104. Usury statutes cap the maximum interest rates that a lender may charge. *Id.* at 622.
105. *Id.*
106. *Id.* at 623.
107. *Id.* at 621.
108. *Kaneff*, 587 F.3d at 623.
109. *Id.* at 621-22.
110. *Id.* at 621 (citing Berg Chilling Systems, Inc. v. Hull Corp., 435 F.3d 455, 463-64 (3rd. Cir. 2006)).
111. *Id.* at 621-22 (citing *Berg*, 435 F.3d at 463-64).
112. *Id.* at 622.
113. *Id.* at 622-23.
114. *Kaneff*, 587 F.3d at 623.
115. *Id.*
116. *Id.*

her to lose her job, Pennsylvania would bear the obligation of paying her unemployment and medical benefits. In such a case, Pennsylvania would also be deprived of taxes from her former income.[117] Kaneff further argued that the collateral of the case, her car, was located in Pennsylvania.[118] In addition, the Pennsylvania usury statute included a non-waiver provision that the statute applies "[n]ot withstanding any other law."[119]

However, DTL contended that Delaware law should apply because Delaware had a greater interest in the transaction.[120] First, DTL argued that it should be held to the laws and regulations in the state in which it was incorporated. DTL was a Delaware corporation, with offices only in Delaware.[121] Delaware's regulatory and licensing laws governed DTL and were made by the Delaware State Bank Commissioner.[122] Second, DTL argued Delaware law should apply because the contract was formed in Delaware; after all, Kaneff had traveled across state lines to seek their business.[123] Ultimately, the court held that Pennsylvania had a greater interest than Delaware.[124]

In determining that Pennsylvania law should apply, the court relied upon the Pennsylvania's usury statute as representative of Pennsylvania public policy.[125] Specifically, the court noted the statute's "antipathy to high interest rates such as the 300.01% interest charged in the contract at issue, represents such a fundamental policy that we must apply Pennsylvania law."[126] Second, Pennsylvania state court precedent recognized that regulation of usurious lending touched on public policy.[127] Looking to state precedent, the Third Circuit noted that loans "can affect the social life of the community" and usurious lenders often deploy subterfuge in their methods in attempt to circumvent public policy.[128] Third, Pennsylvania had a materially greater interest in regulating usurious loans when they involve "small loans, which profoundly affect the social life of the community."[129] DTL was a payday lender, and a payday loan "generally is for a small amount of money."[130] Having determined Pennsylvania's usury statute applied to Kaneff, implicating Pennsylvania public policy prohibiting usurious loans, the Third Circuit discussed federal policy on arbitration.[131]

The Third Circuit found two federal policies material to the dispute.[132] First, "federal law, favors the enforcement of arbitration agreements."[133] Second, "as a matter of substantive federal arbitration law, an arbitration provision is severable

117. *Id.*
118. *Id.* at 623.
119. *Id.* at 622.
120. *Kaneff*, 587 F.3d at 623.
121. *Id.*
122. *Id.*
123. *Id.* at 623.
124. *Id.* at 624.
125. *Id.* at 623-24
126. *Kaneff*, 587 F.3d at 624.
127. *Id.* at 623-24.
128. *Id.* at 623.
129. *Id.* at 623-24.
130. Tara Shinnick, *State Regulation of Payday Loans*, 29 A.L.R. 6th 461, pt. I, § 2 (2007).
131. *Kaneff*, 587 F.3d at 624.
132. *Id.* (citing Salley v. Option One Mortgage Corp., 925 A.2d 115, 119 n.2 (2007)).
133. *Id.*

from the remainder of the contract."[134] The latter federal policy favoring severance of unconscionable arbitration provisions furthers the broader federal policy favoring arbitration. If severance allows for enforcement of the arbitration agreement overall, federal policy encourages severance of unconscionable arbitration provisions.[135] Otherwise, one unconscionable provision could render the entire arbitration agreement unenforceable, and arbitration would give way to litigation, counter to federal policy. Having recognized both federal and state policies in its consideration, the Third Circuit addressed Kaneff's argument that the arbitration agreement was unconscionable.

Kaneff proffered five reasons why the arbitration provision was unconscionable.[136] First, Kaneff asserted that the provision allowing the creditor to seek repossession before seeking arbitration left the borrower defenseless against adverse lender claims.[137] Second, the class action waiver shielded DTL from injunctive relief because the arbitrator had no power to compel DTL to stop illegal acts.[138] Third, cost-sharing in arbitration and requiring borrowers to pay for their own counsel in arbitration made the process too expensive for consumers to pursue.[139] Fourth, the mandatory $125 filing fee prevented low-income borrowers from seeking arbitration and served as a substantial impediment to bringing small claims.[140] Last, the severance clause insulated DTL from all legal liability.[141]

Rather than address each argument individually, the Third Circuit disposed of Kaneff's claim collectively. The Third Circuit wrote "with one exception, we find for our purposes that those challenges are wanting."[142] The one exception was the cost-splitting provision.[143] The Third Circuit wrote that although the cost-splitting provision "is likely unconscionable . . . [t]he provision, however, is severable pursuant to the severability clause of the agreement."[144] Because the Third Circuit found one unconscionable provision and severed that provision from the arbitration agreement, the court held that the arbitration agreement was not unconscionable, but enforceable under Pennsylvania law.[145] Although the Third Circuit provided little explanation for its decision, the use of severance and the effect of compelling arbitration coincide with the two federal policies that the Third Circuit previously mentioned in *Kaneff*.

The direct effect of the Third Circuit's decision was that by severing an unconscionable provision, the arbitration agreement could be enforced.[146] Recall, however, that the Third Circuit had previously noted the federal policy favoring arbitration and severance in order to enforce arbitration.[147] Federal policy ultimately compelled the Third Circuit to sever one provision to uphold the arbitra-

134. *Kaneff*, 587 F.3d at 624 (quoting Buckeye Check Cashing Inc., v. Cardegna, 546 U.S. at 445).
135. *See* Spinetti v. Serv. Corp. Int'l, 324 F.3d 212, 220-21 (3d Cir. 2003).
136. *Kaneff*, 587 F.3d at 624.
137. *Id.*
138. *Id.*
139. *Id.*
140. *Id.*
141. *Id.*
142. *Kaneff*, 587 F.3d at 624.
143. *Id.* at 624-25
144. *Id.* at 625.
145. *Id.*
146. *Id.*
147. *Id.* at 624-25.

tion agreement. This was hardly novel for the Third Circuit. The Third Circuit in *Spinetti* had also relied upon federal policy favoring arbitration to sever unconscionable provisions while compelling arbitration.[148] Recognizing and enforcing federal policy was appropriate, but what the Third Circuit failed to recognize was the effect of its decision on Pennsylvania public policy. As explained below, the two policies were incompatible.

V. COMMENT

When the Third Circuit decided *Kaneff*, the Pennsylvania legislature had a usury statute in place that represented Pennsylvania's public policy regarding usury loans.[149] Pennsylvania's public policy, however, was not the only policy considered by the Third Circuit. On one hand, Pennsylvania, through its legislature, had crafted a state statute representing public policy prohibiting usurious lending practices. On the other hand, the Third Circuit had long recognized the strong federal policy, as codified by the Federal Arbitration Act (FAA), favoring resolution of disputes through arbitration. As *Kaneff* demonstrates the two policy considerations were incompatible in the resolution of the case.

A. Conflict Between Federal and State Policies

Enforceability of the arbitration agreement depended on whether the class waiver provision was deemed unconscionable. In *Kaneff*, the Third Circuit was effectively left with two options, either: uphold or strike down the class waiver. If the class waiver was held unconscionable, the arbitration agreement would also be unconscionable. In such a case, Kaneff would not be bound by arbitration, and Kaneff's class would remain intact. If the class waiver was upheld, however, the arbitration agreement would be enforced. Kaneff would be bound by arbitration, but Kaneff's class would be forced to decertify into individual claims. One key fact complicated the issue—each borrower sought to recover only small damages.

A claim seeking a small recovery amount is often referred to as a "negative value suit."[150] Professor Edward Sherman explains a negative value suit to be a "suit in which the potential recovery to any individual would be too small and the costs of litigation too large to have an adequate incentive to litigate individually."[151] In the context of *Kaneff*, without adequate incentive to arbitrate individually, no individuals will bring claims against DTL. Without any individual claims against DTL for issuing usurious loans, Pennsylvania's statute prohibiting usurious loans would often go unenforced. Therefore, the only way to enforce Pennsylvania's usury statute would have been for the court to keep the class intact by holding the class waiver unconscionable. However, as previously mentioned, the court in *Kaneff* also gave weight to the federal policy favoring arbitration. If the Third Circuit held that the class waiver was unconscionable, Pennsylvania policy

148. Spinetti v. Serv. Corp. Int'l, 324 F.3d 212, 223 (3d Cir. 2003).
149. 41 PA. STAT. ANN. § 201 (West current through Act 2010-60).
150. Thomas Metzloff, *Arbitration to Elimate Consumer Class Actions: Efficient Business Practice or Unconscionable Abuse?*, 67 L. & CONTEMP. PROBS. 75, 88 (2008).
151. *Id.*

would be effectuated, but the federal policy favoring arbitration would not. If the Third Circuit upheld the class waiver, the federal policy would be effectuated but the Pennsylvania policy prohibiting usurious loans would not. In this irreconcilable conflict between federal and state policy, the Third Circuit had to make a choice. Giving force to one policy consideration necessarily ignored the other.

Because the Third Circuit upheld the class waiver in *Kaneff*, the Third Circuit chose federal policy favoring arbitration over state policy prohibiting usurious loans. As a result, the Third Circuit enforced arbitration at the expense of permitting the violation of Pennsylvania's usury laws without consequence. The Third Circuit's recent preference for federal policy over state policy has not gone unnoticed by legal scholars. One commentator has pointed to the Third Circuit's similar favoring of federal policy over state policy in New Jersey, upholding a class waiver in order to effectuate the arbitration agreement. [152] The consequence of federal policy trumping state policy in *Kaneff* has created significant negative externalities in Pennsylvania. *Kaneff* created corporate immunity for usurious lenders. As a result, the Third Circuit prevented deterrence of corporate misconduct and interfered with Pennsylvania's public policy and statutory scheme.

B. Externalities and Spillover Effects of Class Actions

As Professor Elizabeth Burch explains, "[c]lass action does more than aggregate claims; it augments government policing and generates external societal benefits. These societal benefits—externalities—are the spillover effects of allowing class actions to proceed."[153] Commentators have discussed numerous positive externalities of the class action mechanism. Some of these positive externalities include shaping standards of appropriate conduct, reducing judicial costs, preserving judicial resources, deterring corporate misconduct, making attorneys private enforcers to supplement public regulation, innovation, information sharing, and preservation of individuals' rights.[154]

These positive externalities apply broadly to all class actions. However, some of these externalities do not apply in the context of *Kaneff*, and, therefore, this note will not discuss every positive externality that class actions generate. Rather, the scope of this note only encompasses the externalities implicated by *Kaneff*, externalities that the Third Circuit should have considered in deciding the case. By choosing federal policy over state policy and upholding the class waiver provision, the Third Circuit's decision in *Kaneff* ignored the externalities or spillover effects of preventing consumers like *Kaneff* from proceeding through class action arbitration. The remainder of this note will be devoted to explaining three related externalities as a result of the Third Circuit's decision in *Kaneff*.

Part C discusses *Kaneff*'s effect of creating corporate immunity. Part D will explore how *Kaneff* failed to deter, and therefore, encouraged corporate miscon-

152. Dave Winters, Note, *Third Circuit Buyer Beware: District Court in* Litman *Holds Unconscionable Defense Contravened By Federal Arbitration Act*, 2010 J. DISP. RESOL. 223 (2010).

153. Elizabeth C. Burch, *CAFA's Impact on Litigation as a Public Good*, 29 CARDOZO L. REV. 2517, 2518 (2008).

154. William B. Rubenstein, *Why Enable Litigation? A Positive Externalities Theory of Small Claims Class Actions*, 74 UMKC L. REV. 709, 721, 723-25 (2006).

duct. Part E explains how *Kaneff* eviscerated and negated Pennsylvania's state policies and statutory scheme. Taken as a whole, the Third Circuit's decision created significant externalities for the state of Pennsylvania, considerations that should not have been ignored by the court.

C. Upholding Class Arbitration Waiver Creates Corporate Immunity

In *Kaneff*, the Third Circuit upheld the class arbitration waiver under Pennsylvania law. Because the class waiver remained valid, the class that Kaneff was representing necessarily had to decertify. Without class certification, Kaneff, along with all the other members of her class, would have to pursue their claims in arbitration individually. Yet, recall that *Kaneff* involved small arbitral claims because the loan agreement was for a payday loan, which "generally is for a small amount of money."[155] The Third Circuit previously recognized that "[n]o individual will expend the time, fees, costs, and or other expenses necessary for individual litigation or arbitration for this small potential recovery."[156] Simply put, consumers will not bring claims when the effort, both personal and financial, does not justify the potential reward.

Not only are consumers unlikely to individually seek small recovery amounts, attorneys are unlikely to take on such clients.[157] Attorneys have inadequate financial incentive to take on small, individual claims. Attorneys' testimonies in cases challenging class action bans corroborate this fact, even when the individual claims have merit.[158] The disincentive to consumers and attorneys to bring small claims individually, as was the case in *Kaneff*, signifies that de-certification of Kaneff's class necessarily signifies the end of any claim against DTL. Nor are future class actions against DTL likely. Upholding DTL's class waiver preempts any class actions that may be pursued against DTL in the future. The nature of DTL's business remains unchanged. It is allowed to continue issuing payday loans for small amounts, which translates into small damages in litigation. By upholding DTL's class waiver in *Kaneff*, the Third Circuit fully immunized the company from all liability. Creating corporate immunity fails to deter corporate misconduct and eviscerates Pennsylvania's statutory scheme.

D. Deterring Corporate Misconduct

The possibility of lawsuits generally serves two corporate deterrence functions.[159] First, corporations are less likely to perform illegal acts when there is the "threat effect" from potential lawsuits.[160] Second, the threat of a lawsuit provides incentive for corporations to change unlawful practices and conform their policies to acceptable business standards, thus benefiting society.[161] Because *Kaneff* pro-

155. Tara Shinnick, *State Regulation of Payday Loans,* 29 A.L.R. 6th 461, pt. I, § 2 (2007)
156. Thibodeau v. Comcast Corp., 912 A.2d 874, 886 (Pa. Super. Ct. 2006).
157. Metzloff, *supra* note 150, at 88.
158. *Id.*
159. Elizabeth C. Burch, *Securities Class Actions as Pragmatic Ex Post Regulation*, 43 GA. L. REV. 63, 95 (2008).
160. *Id.*
161. *Id.* at 95-96.

vided corporate immunity to loan companies, neither deterrence function will exist to protect Pennsylvania consumers from illegal lending practices.

Social studies have long inquired as to why corporate officers lie. The most often cited reasons include "greed, fear, opportunity, ethical plasticity, and pollyannaism."[162] These studies then "suggest that if managers rationally engage in cognitive cost-benefit analysis before outwardly exhibiting false optimism (lying), then knowing that they will personally suffer some penalty could combat and lessen those tendencies."[163] In other words, corporate officers are less likely to lie when they know that if they are caught, they will be punished. Therefore, the "threat effect" of lawsuits "deters risky behaviors taken without due care and increases candor among corporate managers."[164] By upholding the class waiver in *Kaneff*, the Third Circuit removed the "threat effect" of punishment under Pennsylvania's usury statute and established class waivers as a viable option for use by corporations to insulate themselves from liability.

Kaneff established that class arbitration waivers were legitimate and valid contractual instruments in Pennsylvania. After the Third Circuit's decision in *Kaneff*, any lender in Pennsylvania can craft a class waiver and have a reasonable expectation that it will be upheld by judicial entities. Nothing will stop usurious lending corporations from deciding for themselves whether to create corporate immunity through a class waiver. Allowing corporations to decide for themselves whether to end the class action mechanism is bad policy. Commentators have pointed out that "[c]orporate defendants are, however, quick to complain about excessive American litigation and decry class actions as legalized blackmail."[165] In light of corporate animosity towards the class mechanism, companies, if provided with the right to use class waivers, will exercise that right.

For example, JAMS is the third largest private arbitral body in the United States.[166] In 2004, JAMS issued a policy disavowing class waivers in arbitration, "out of the concern that prohibitions unfairly curtail the rights of consumers and employees."[167] This policy change immediately upset the organization's corporate clientele, including Discover and Citibank.[168] These corporations alleged that JAMS was attempting to "insert itself as a guardian of social policy."[169] As a result, many of these corporations removed JAMS as an acceptable arbitral forum for their disputes.[170] Under this corporate pressure, JAMS abandoned its no class waiver policy in March of 2005.[171] Commentators have concluded that JAMS

162. *Id.* at 93.

163. *Id.* Ethical plasticity is defined as the process by which one "seeks to make one's rivals look bad and oneself look good." Donald C. Langeport, *Resetting the Corporate Thermostat: Lessons from the Recent Financial Scandals About Self Deception, Deceiving Others and the Design of Internal Controls*, 93 GEO. L.J. 285, 302 (2004). A "Pollyanna" is defined as "a person characterized by irrepressible optimism and a tendency to find good in everything." MERRIAM-WEBSTER'S COLLEGIATE DICTIONARY 899 (10th ed. 1993).

164. *Id.* at 95.

165. Burch, *supra* note 159, at 2526.

166. Myriam Gilles, *Opting Out of Liability: The Forthcoming, Near-Total Demise of the Modern Class Action*, 104 MICH. L. REV. 373, 411 (2005).

167. *Id.*

168. *Id.* at 411-12.

169. *Id.* at 411.

170. *Id.* at 411-12.

171. *Id.* at 412

abandoned its policy because "the pressure put on JAMS by its corporate clients was too much to bear."[172]

The example of JAMS illustrates that if corporations have the right to demand class waivers to limit or remove liability, they will exercise that right. The Third Circuit's decision in *Kaneff* provides such a right to lending corporations in Pennsylvania. By approving class waivers, the Third Circuit provides companies with a roadmap to limit or remove liability altogether. Not only does *Kaneff* fail to deter, but implicitly encourages companies to escape liability. Corporations do not need more protection. Recently, scholars have concluded, "in the ongoing and ever-mutating battle between plaintiffs' lawyers and protectors of corporate interests, the corporate guys are winning."[173] Nor does "the obvious asymmetrical litigation power seen in such cases" between consumers and corporations warrant additional corporate protection.[174] Allowing lending companies in Pennsylvania to choose for themselves whether to create corporate immunity through class arbitration waivers will not only promote corporations to do so, but corporate immunity will also prevent companies already practicing usurious practices from changing those practices.

A second deterrence function that class arbitration can serve is to "catalyze policy and management changes, the effects of which benefit the public."[175] Class actions force policy change in three ways. First, companies who have evaded punishment for an unlawful policy have no incentive to change that policy.[176] For example, after *Kaneff*, having faced no consequences under the Pennsylvania's usury statute, DTL may continue to issue loans with interest rates of 300%. After all, if a class waiver provided immunity once, there is no reason for DTL to believe that it cannot rely on the class waiver time and time again.

Second, class actions have a greater deterrent effect on corporate policies than individual claims.[177] Professor Jean Sternlight points out that individual claims may not necessarily compel policy changes.[178] For example, a "company may find it worthwhile to pay off a few individual claims but keep its overall policy."[179] Compensating "those very few customers who are enterprising enough to complain about an illegal policy" may be justified if keeping that illegal policy is economically lucrative.[180] In *Kaneff*, borrowers challenging individual loans can be bought out relatively inexpensively because the loan amounts are small. If individual loans were aggregated, however, the settlement amounts would be substantial, creating a greater likelihood that DTL would stop issuing usurious loans.

Third, allowing the class to proceed through arbitration helps shape guidelines and norms for companies to follow.[181] If claims are allowed to continue through the class mechanism, "legal principles developed in the case will create

172. *Id.*
173. Gilles, *supra* note 166, at 375.
174. David Rosenberg, *Decoupling Deterrence and Compensation Functions in Mass Tort Class Actions for Future Loss*, 88 VA. L. REV. 1871, 1906 n.62 (2002).
175. Burch, *supra* note 159, at 96.
176. *Id.* at 95, 102.
177. *See* Metzloff, *supra* note 150, at 90.
178. *Id.*
179. *Id.*
180. *Id.*
181. Rubenstein, *supra* note 154, at 726.

more certainty in structuring social behavior,"[182] providing explanation and examples of appropriate conduct. Corporations like DTL are given guidance regarding what to do to avoid future lawsuits. Had the Third Circuit allowed the claim against DTL to proceed, a final and binding decision would have provided instructions and appropriate guidelines to DTL and other lending companies with appropriate guidelines. Even if the parties settled and no final decision was ever reached, deterrence of illegal policies would still have been achieved. According to Professor William Rubenstein, "settlements, as well as judicial decrees, produce positive externalities: they change behavior beyond the parties to the initial suit."[183] Therefore, settling with Kaneff's class may have forced DTL to stop issuing usurious loans to avoid future settlement payments. Because *Kaneff* eliminated the lawsuit against DTL, no instruction is provided for other lending companies to follow.

By creating corporate immunity, the Third Circuit provided DTL no incentive to change its usurious lending practices and denied judicial or settlement clarification to other lenders. The Third Circuit in *Kaneff* sent a clear message to lending corporations to disregard Pennsylvania laws and public policy. Along with sending such a pro-corporate message, the Third Circuit clearly upset Pennsylvania's statutory scheme and diminished legislative law-making authority.

E. Interference with Pennsylvania's Policy and Regulatory Scheme

Because Pennsylvania had a usury statute prohibiting usurious lending practices and *Kaneff* created corporate immunity for usurious lenders, the Third Circuit overrode Pennsylvania public policy prohibiting usurious loans. By overriding Pennsylvania's policy with federal policy favoring arbitration, the Third Circuit disrupted Pennsylvania's regulatory scheme and public policy in two ways. First, the Third Circuit's decision has completely eviscerated a Pennsylvania state statute of any meaningful force. As a result, the entire Pennsylvania state regulatory scheme is at risk of judicial destruction. Second, diminishing the force of state statutes naturally decreases the validity and authority of the legislature to create laws.

In *Kaneff*, the Third Circuit concluded that Pennsylvania had a "materially greater interest" than Delaware in deciding the dispute because the Pennsylvania legislature had crafted a usury statute.[184] The usury statute constituted Pennsylvania's "fundamental policy . . . particularly when it comes to cases involving small loans."[185] However, the Third Circuit, by creating corporate immunity in *Kaneff*, negated any validity or force that "fundamental policy" may have had.

Pennsylvania's usury statute is clear. Lenders may not charge an annual interest rate of over six percent.[186] DTL's loan to Kaneff included an annual interest rate of 300%, in clear violation of the statute.[187] However, as previously discussed, DTL will face no consequences for violating the statute because *Kaneff*

182. *Id.*
183. *Id.* at 724.
184. *Kaneff*, 587 F.3d at 624.
185. *Id.* at 623-24.
186. *Id.* at 622; 41 PA. STAT. ANN. § 201 (West current through Act 2010-60).
187. *Kaneff*, 587 F.3d at 622.

provided the lender with corporate immunity. When violations of a statute occur but enforcement is lacking, the statute becomes meaningless. If including a class waiver can fully immunize usurious lenders, then Pennsylvania's usury statute has no force whatsoever. All corporate lenders can now follow the lead of DTL and include class waivers to circumvent Pennsylvania public policy. Essentially, the statute may still bark, but there is no bite. By negating the force of one Pennsylvania statute, *Kaneff* risks interference with Pennsylvania's entire regulatory scheme.

The effect of the Third Circuit's decision does more than merely void one Pennsylvania statute. Narrowly, *Kaneff* represents federal policy favoring arbitration overriding Pennsylvania policy prohibiting usury loans. Broadly, *Kaneff* represents federal law overriding an unrelated state law. The larger implication is that *Kaneff* can be read to permit federal statutes to supersede state statutes, even when the two statutes do not directly conflict. Therefore, the effect of diminishing the validity of one particular Pennsylvania statute creates the larger risk that additional Pennsylvania state laws can be voided through application of the FAA in similar fashion. Reading *Kaneff* expansively, the state's entire regulatory scheme is at risk of judicial interference. Weakening state-crafted laws has additional implications because it weakens a state legislature's authority to craft those laws.

State laws are crafted by legislatures. If the legitimacy of state laws is implicated, then so is the legitimacy of state legislatures. The Third Circuit in *Kaneff* has not only eviscerated the legitimacy of state regulation, but it has also diminished the power of state legislative branches to form state regulation. Yet, the Third Circuit in *Kaneff* recognized the uniqueness of legislatures in crafting state statutes. *Kaneff* recognized that the legislature, or specifically the Pennsylvania Department of Banking, had "*special knowledge* of how such loans can affect the social life of the community."[188] By recognizing that the social life of the Pennsylvania community required protection from usurious lenders, the Pennsylvania legislature utilized their "special knowledge" in crafting the usury statute. Negating the usury statute decreases the legitimacy of the legislature in crafting enforceable state laws. Without absolute assurance that statutes will be upheld and enforced, legislative lawmaking power becomes speculative, lacking the absolute force legislators deserve with their "special knowledge" of their constituents' needs. These constituents are Pennsylvanian consumers, and without legislative or statutory protection, the worst of times for consumers has arrived.

VI. CONCLUSION

The Third Circuit in *Kaneff* upheld the class arbitration waiver at issue in the case. The court determined that it was not unconscionable under Pennsylvania law and because the cost-splitting provision was unconscionable but severable, the arbitration agreement as a whole was not unconscionable under Pennsylvania law.[189] The court's decision reflects an indirect conflict between federal and state policies. In order to effectuate the federal policy favoring arbitration, the Third Circuit had to override Pennsylvania's policy prohibiting usurious loans. *Kaneff*

188. *Kaneff*, 587 F.3d at 623 (emphasis added).
189. *Id.* at 624-25.

had a larger impact than merely ignoring one state policy, however. The externalities arising from non-enforcement of the state policy are substantial.

By creating corporate immunity for lending companies in Pennsylvania, the Third Circuit deprived Pennsylvania consumers of their statutory right to be protected from usurious lending practices. Without fear that consumers may sue under Pennsylvania's usury statute, lending companies face no consequences for their actions under Pennsylvania law. Pennsylvania law on usurious practices, then, has no force. The state's entire regulatory scheme is at risk of being diminished or negated altogether by federal policies. Without absolute assurance that legislative acts will receive judicial enforcement, the power of legislatures is also diminished. These externalities, if considered by the Third Circuit, may have compelled the court to a different result in *Kaneff*. In absence of such consideration, commentators have suggested two potential solutions to preserve the external benefits of class actions.

First, Congressional action could depart from the case-by-case approach and disparate judicial treatment of class actions by completely prohibiting class waivers in arbitration.[190] Professor Sternlight suggests that even "[i]f Congress thought such a general prohibition too broad, it could at least prohibit the practice with respect to arbitration agreements imposed on consumers and employees."[191] Such legislative action targeted specifically at consumers would protect small payday borrowers like Kaneff. Even without Congress, the executive branch "might step in to fill the enforcement vacuum created by the absence of collective litigation."[192]

Second, *Green Tree* may provide a workable framework for litigants to preserve their statutory rights through class arbitration.[193] In order to render an arbitration agreement unconscionable, *Green Tree* placed the burden on litigants to prove that arbitration would be too expensive for the litigant to bear.[194] In the context of *Kaneff*, the burden could be placed on Kaneff to prove that the class action waiver would deny her statutory right to vindication in arbitration. Faced with creating corporate immunity, courts would likely find that Kaneff satisfies this burden. However, until Congressional action or *Green Tree* is extended to class arbitration, impetus for change is left to the courts. Until the Third Circuit realizes the necessity of the class action mechanism in the context of payday loans, Pennsylvania consumers will continue to be deprived of the statutory protection that their legislature, as elected by citizens of Pennsylvania, chose to provide.

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190. *See* Gilles, *supra* note 166, at 428; Metzloff, *supra* note 151, at 101.
191. Metzloff, *supra* note 150, at 101.
192. Gilles, *supra* note 166, at 428.
193. Thomas Metzloff, *supra* note 150, at 77, 100.
194. Green Tree Fin. Corp.-Ala. v. Randolph, 531 U.S. 79, 81 (2000).