CITATION: Wright v. Horizons ETFS Management (Canada) Inc., 2019 ONSC 3827
COURT FILE NO.: CV-18-00597284-00CP
DATE: 2019/06/20

ONTARIO
SUPERIOR COURT OF JUSTICE

BETWEEN:	)	
	)	
GRAHAM WRIGHT	)	*Alister Crawley, Clarke Tedesco, Michael L. Byers* and *Alexandra Grishanova* for the Plaintiffs
Plaintiff	)	
- and -	)	
	)	
HORIZONS ETFS MANAGEMENT (CANADA) INC.	)	
Defendant	)	*Seumas M. Woods* and *Ryan A. Morris* for the Defendant
	)	
Proceeding under the *Class Proceedings Act, 1992*	)	**HEARD**: June 6-7, 2019

PERELL, J.

REASONS FOR DECISION

A. Introduction

[1] The Defendant Horizons ETFS Management (Canada) Inc. ("Horizons") created and managed a complex derivatives-based exchange traded fund (an "ETF") known as the "Horizons BetaPro S&P 500 VIX Short-Term Futures Daily Inverse ETF" (the "HVI-ETF".). Horizons' HVI-ETF is purchased through stock exchanges and is available to retail investors, one of whom is the Plaintiff Graham Wright.

[2] Overnight on February 5, 2018, the value of the HVI-ETF collapsed. The collapse eliminated nearly 90% of the assets of the Fund accumulated over several years. Investors in the HVI-ETF lost almost their entire investment, totaling tens of millions of dollars. Mr. Wright, who owed 15,375 units lost approximately $210,000 when he sold his units on February 6, 2018.

[3] On May 4, 2018, pursuant to the *Class Proceedings Act, 1992,*[1] Mr. Wright commenced a proposed class action against Horizons. Mr. Wright's primary cause of action is a common law negligence claim. His ancillary cause of action is the statutory cause of action under s. 130 of the

[1] S.O. 1992, c. 6.

Ontario *Securities Act*[2] for alleged misrepresentations in the primary market for securities. It shall prove important to note and to keep in mind that Mr. Wright does not advance a statutory cause of action under Part XXIII.1 of the Ontario *Securities Act,* which provides a statutory cause of action for misrepresentations in the secondary market for securities.

[4] It shall also prove important to note that Mr. Wright does not allege a common law negligent misrepresentation claim. Rather, his negligence claim is not based on words but is based on alleged to be careless acts of commission or omission. Mr. Wright alleges that Horizons breached a duty of care to investors by:

a. developing the HVI-ETF, when it knew or ought to have known that it provided an excessively complex and risky investment strategy that was inappropriate for the retail investment market;

b. developing the HVI-ETF as a passively managed fund that irrespective of market conditions relied on Toronto Stock Exchange ("TSX") trading to provide distribution, liquidity, and throughout-the-day pricing of the units and a rebalanced pricing after the close of TSX trading;

c. offering the HVI-ETF to investors notwithstanding that the investment product lacked a coherent investment thesis, contained structural design flaws that exacerbated the investment risks, and presented an unreasonable risk/reward trade-off for investors;

d. promoting the HVI-ETF on the erroneous premise that it was suitable for use as a short-term trading strategy; and,

e. failing to exercise its powers as manager to mitigate the risk to investors of changing market conditions or to address evident problems with the trading of the HVI-ETF over the TSX on February 5, 2018.

[5] Mr. Wright moves for certification of his action as a class proceeding.

[6] For the reasons that follow, Mr. Wright's motion for certification is dismissed and his action is also dismissed for not disclosing a reasonable cause of action.

B. Factual Background

1. Graham Wright

[7] Mr. Wright is a 35-year-old high school graduate with a financial advisor's licence which he obtained in the last five years. During his working life, he was employed mainly as a salesperson for radio stations. For six months, he worked at Edward Jones, a financial advisory firm, where he sold investments. He was trained so that he could obtain a financial advisor's license. The training included training on mutual funds, stocks, and insurance.

[8] In May 2017, Mr. Wright began trading in HVI-ETF units among other Horizons' ETFs. He made his trades through his broker Interactive Brokers Canada Inc.

---

[2] R.S.O. 1990, c. S.5.

[9] Mr. Wright traded in HVI-ETF units on February 5, 2018. As of the close of the stock market on February 5, 2018, Mr. Wright held 15,375 HVI-ETF units. He sold the units on February 6, 2018 at prices in the range of $2.20 per unit. Mr. Wright estimates that he lost approximately $210,000 on his investment.

2. Horizons ETFS Management (Canada) Inc.

[10] Horizons, which is headquartered in Toronto, Ontario, is registered under the Ontario *Securities Act* in the categories of Commodity Trading Adviser, Commodity Trading Manager, Exempt Market Dealer, Investment Fund Manager and Portfolio Manager. It is part of the Mirae Asset Financial Group, a global investment management enterprise headquartered in Seoul, South Korea.

[11] Horizons is the fourth largest ETF provider in the Canadian market. It currently manages over 85 ETFs. It markets itself as an innovator within the ETF industry bringing forward new and innovative ETFs. As of January 11, 2019, Horizons had over $10.3 billion in AUM (assets under investment). Horizons generates its revenue through management fees charged as a percentage of AUM in its funds. For example, Horizons earned 1.15% of the net asset value of the HVI-ETF on an annual basis.

[12] Horizons was the registered promoter and investment fund manager of the HVI-ETF, and it was also the trustee of the HVI-ETF pursuant to a Trust Declaration. Horizons designed, managed, and marketed the HVI-ETF. As manager, Horizons had the responsibility for investing and reinvesting the funds within the HVI-ETF portfolio in accordance with HVI-ETF investment objectives. As trustee, Horizons held the assets of the HVI-ETF in trust for its unitholders,

3. ETFs

[13] ETFs are an investment vehicle in which an underlying asset class such as a group of stocks, bonds, or commodities are pooled in an investment portfolio, which are held in trust for the unitholders.

[14] ETFs have grown in popularity. In 2009, there was $31.5 billion invested in Canadian ETFs, and by 2018, investments had grown to $160 billion in ETF assets in Canada across 615 different ETFs.

[15] The value of an ETF generally represents the value of the underlying investments; however, the market price of the ETF's units is determined by the bid and ask of buyers and sellers on the stock exchanges on which the ETF units are listed. The bid is the highest price a buyer is willing to pay for an ETF unit, while the ask is the lowest price a seller is willing to accept for an ETF unit.

[16] A defining feature of ETFs that makes them different from mutual funds is the arbitrage mechanism, the purpose of which is to bring together the price at which an ETF's shares trade on a stock exchange and the *pro rata* value of the fund's underlying assets, which is known as its net asset value ("NAV"). An ETF will have one or more "market makers;" these are brokers or dealers who purchase units from the ETF's manager at NAV. The market makers then buy or sell their ETF units on the stock exchange with the aim of making the market price close to the NAV.

[17] The Designated Broker and Dealers that act as the market makers for the ETFs attempt to profit from the difference between the market price and the NAV of the unit. If the trading price of the ETF unit on the stock exchanges exceeds the NAV of the unit, the Designated Broker and Dealers will typically sell ETF units either from their inventory or by subscribing for new ETF units for a price equal to NAV and profit from the difference. If the trading price of the ETF unit is less than NAV, the Designated Brokers and Dealers will typically seek to redeem ETF units for a price equal to NAV, either from their inventory or by purchasing ETF units on the exchanges that can then be redeemed.

[18] Through this market making function, the Designated Brokers and Dealers help to ensure that the NAV and market price of the ETF units are closely aligned. The Designated Broker and Dealers typically hedge their exposure to the ETFs to protect themselves from significant negative changes in value.

[19] The manager of the ETF distributes ETF units to a "Designated Broker" or a "Dealer" through a continuous distribution dealer agreement. When a retail investor wishes to purchase or have redeemed ETF units, he or she does so through the broker or dealer. When a retail investor purchases an ETF, the dealer will issue a unit from its inventory of units, if any, or the broker or dealer will make a subscription order to the ETF manager, who will create a brand-new unit, a "Creation Unit".

[20] Retail investors can only buy or sell ETF units through registered brokers and dealers who buy or sell them over the stock exchanges on which the units are listed. The ETF units purchased by retail investors come from other holders or from the inventory of ETF units held by a Designated Broker or Dealer. A purchaser of an ETF units over an exchange cannot determine if he or she is receiving a Creation Unit, a new unit issued by the ETF manager or an ETF unit that has been in circulation previously on stock exchange, which is to say the secondary market.

[21] In Canada, ETFs are regulated by Canada's securities regulatory authorities. Before an ETF can begin trading on a stock exchange, its manager must file a prospectus and the regulator must issue a receipt for the prospectus.

[22] Canadian regulators take the position that the first sale of a Creation Unit of an ETF constitutes a distribution of the unit under the securities statutes and National Instrument 41-101 and, therefore, the Designated Broker and the Dealers are subject to the prospectus delivery requirements set out in that legislation.

[23] However, because Creation Units are generally comingled with other ETF units purchased by the Designated Broker and the Dealers in the secondary market it is not practicable for the Designated Broker or the Dealers to determine whether a particular re-sale of ETF units involved Creation Units, ETF units purchased in the secondary market, or both. Therefore, the securities regulator grants the Designated Broker and the Dealers an exemption from the obligation to deliver a prospectus with each re-sale of a Creation Unit. Instead, the Designated Broker and Dealers are required to provide a summary document to an investor purchasing units in a particular ETF for the first time.

4. The HVI-ETF

[24] The HVI-ETF is the BetaPro S&P 500 VIX Short-Term Futures Daily Inverse ETF or HVI Fund.

[25] The Ontario Securities Commission issued receipts for the HVI-ETF initial prospectuses on December 29, 2011 and March 27, 2012. Units began trading on April 3, 2012.

[26] As of December 31, 2017, the HVI-ETF had 1,140,000 units outstanding. The units were held in 1,624 different investment accounts. The NAV of the HVI-ETF was $26 million.[3]

[27] HVI-ETF units continued to trade until the close of business on June 11, 2018, when Horizons elected to terminate the HVI-ETF.

[28] Horizons was the HVI-ETF's manager and trustee pursuant to an amended and restated master declaration of trust. National Bank Financial Inc. was its Designated Broker, while National Bank Financial Inc., CIBC World Markets Inc., and Société Générale Capital Canada Inc. were its Dealers. The Designated Broker and the Dealers acted as the market makers. They would facilitate trades over the TSX and would redeem or subscribe for new units depending on their perception of market demand.

[29] The HVI-ETF was not actively managed. In a passive way, the fund was designed to allow the market to determine what purchases of assets should be made. The HVI-ETF was designed to provide daily investment results, before fees, expenses and distributions, brokerage commissions, and other transaction costs that attempted to correspond to the inverse of the daily performance of the S&P 500 VIX Short-Term Futures Index (the "VIX Futures Index"). Thus, the HVI-ETF invested in securities, futures contracts and other financial instruments that were capable of providing a return substantially similar to the inverse of the VIX Futures Index.

[30] The HVI-ETF was one of three ETFs Horizons offered based on the VIX Futures Index. The BetaPro S&P 500 VIX Short-Term Futures ETF was designed to provide daily investment results that attempted to correspond to the performance of the VIX Futures Index. The BetaPro S&P 500 VIX Short-Term Futures 2x Daily Bull ETF was designed to provide daily investment results that attempted to correspond to twice the daily performance of the VIX Futures Index.

[31] The VIX Futures Index seeks to offer exposure to market volatility through publicly traded futures markets. The index is calculated based on the prices of put and call options on the S&P 500 over the next 30-day period. This represents a measure of the market's expectation of volatility over the next 30-day period. A relatively high VIX Futures Index indicates a greater degree of market uncertainty, while a relatively low level is consistent with greater stability.

[32] The VIX Index is known in the investment industry as the "fear gauge" of the U.S. equities market. It is a measure of implied and expected volatility of the S&P 500 over a 30-day period. The implied level of volatility of the S&P 500 typically increases in periods of market instability, increasing the level of the VIX Index. The VIX Index tends to rally quickly and decline slowly.

[33] As an inverse ETF, HVI-ETF was designed so that when the VIX Futures Index declined by a certain percentage on a given day, the NAV of the assets in HVI-ETF went up by that same percentage. Conversely, when the VIX Futures Index increased on a given day, the NAV of the assets in the HVI-ETF went down by that same percentage.

[34] The HVI-ETF was a high-risk speculative investment that was marketed for diversification or as a partial hedge against certain market conditions such as declining market volatility.

---

[3] By way of comparison, as of the same date, Horizons' S&P 500 Index ETF had 10.7 million units issued and outstanding with a NAV of $673 million. Horizons' S&P/TSX 60 Index ETF had 52.4 million units issued and outstanding, and a NAV of more than $1.7 billion.

[35] In the December 22, 2017 prospectus, in bold type in a box on its first page, investors are cautioned about all three of Horizons' VIX Futures Index ETFs, as follows:

> The ETFs are speculative investment tools, are very different from other Canadian exchange traded funds, and can be used for diversification or as a partial hedge against market conditions.
>
> These are not conventional investments. The ETFs are designed to provide investment results that endeavour to correspond to: (i) the performance of; (ii) two times the daily performance of; or (iii) one times the inverse (opposite) multiple of, the daily performance of the S&P 500 VIX Short-Term Futures Index™ (the "Underlying Index"). The Underlying Index tracks market volatility, not market returns and has tended to have a low to negative correlation to equity market returns. The Underlying Index is highly volatile. As a result, it is not generally viewed as a stand-alone investment.
>
> Historically, the Underlying Index has tended to revert to a historical mean. As a result, the performance of the Underlying Index is expected to be negative over the longer term and none of HUV, HVU or the Underlying Index are expected to have positive long-term performance.
>
> Historically, the Underlying Index has experienced significant one day increases when equity markets have had large negative returns which, if repeated, could cause HVI to suffer substantial losses.
>
> Investors should monitor their investment in an ETF daily.

[36] The second page of the December 2017 Prospectus reinforced the warnings about the risks associated with the VIX-related ETFs, stating:

> Each investor should carefully consider whether their financial condition and/or retirement savings objectives permit them to buy Units of an ETF. Units of the ETFs are highly speculative and involve a high degree of risk, some not traditionally associated with mutual funds. No ETF by itself constitutes a balanced investment plan. An investor may lose a portion or even all of the money that they place in an ETF.
>
> The risk of loss in investing through derivatives can be substantial. In considering whether to buy Units of an ETF the investor should be aware that investing through derivatives can quickly lead to large losses as well as large gains. Such losses can sharply reduce the net asset value of an ETF and consequently the value of an investor's Units in the ETF. Market conditions may also make it difficult or impossible for an ETF to liquidate a position.

[37] These warnings were repeated in the December 2017 Prospectus, including a twelve-page section of the prospectus entitled "Risk Factors," which describes the risks associated with purchasing units in the three ETFs. The HVI-ETF Fact document contained a similar warning, stating in bold print:

> This ETF is a commodity pool and is highly speculative and involves a high degree of risk. It is intended for use in daily or short-term trading strategies by sophisticated investors. You should carefully consider whether your financial condition permits you to participate in this investment. You may lose a substantial portion or even all of the money you place in the commodity pool.

[38] The investment strategy underlying HVI-ETF is known as "shorting volatility" by selling VIX futures contracts. This "volatility shorting" strategy is an income strategy, known as "risk-premium harvesting". In exchange for the gains that accumulate during periods of low volatility, investors who take short positions in VIX Index futures take on the risk of a spike in volatility.

[39] The concept behind shorting volatility is to generate revenue by collecting premium from selling (shorting) longer term VIX futures contracts, which, during periods of low volatility, trade

at a premium in relation to nearer term VIX futures contracts. The return generated from the difference between the selling and buying of the futures contracts is known as "roll yield". The difference in value is referred to as "contango" and "rolling" refers to the process whereby futures contracts that are close to expiration are sold and futures contracts with a farther expiration date are purchased in order to avoid having to settle the contracts on their expiration date.

[40] Selling volatility is a strategy to gradually accumulate income. However, volatility can increase extremely rapidly, reflected in a spike in the VIX Index, with the result that a trader who is short volatility futures can lose all of their entire investment, including all accrued gains (and potentially more as the exposure is unlimited) within hours or even less. A notable feature of a short volatility strategy is the lack of symmetry between the way in which gains are realized - by way of an incremental accumulation of risk premium during a sustained period of low market volatility - and how losses are experienced, which are sudden, unexpected, and typically catastrophic.

[41] In order to achieve its performance objective, HVI-ETF was required to rebalance its exposure to VIX futures contracts on a daily basis. HVI-ETF obtained exposure by selling longer-term VIX futures contracts and subsequently rebalanced by repurchasing shorter-term VIX futures contracts at the end of the trading day to match the weighted average maturity of the VIX futures contracts underlying the Reference Index. Horizons' counterparty for these contracts was the National Bank of Canada.

5. The Collapse of HVI-ETF

[42] Throughout 2016 and 2017, volatility – and the VIX Index – remained historically low. As a result, short-volatility funds like HVI-ETF were very profitable as they accumulated assets incrementally through roll yield. This had a compounding (positive) effect on the net asset value of HVI-ETF. The fund gained 72.60 % in 2016.

[43] However, a prolonged period of low volatility left the VIX Index susceptible to a large and rapid increase in percentage terms. Market analysts expressed concerns that a one-day market decline of 3% or 4% could cause a significant spike in the VIX Index (in percentage terms) and trigger catastrophic losses for volatility-contingent strategies such as that employed by HVI-ETF.

[44] There were particular concerns that the daily rebalancing that short volatility funds needed to undertake could lead to very limited liquidity in periods of market stress, which would rapidly drive up the price of VIX futures contracts. This presented a significant risk for HVI-ETF. A significant spike in the VIX Index, causing a corresponding increase in the price of VIX Index futures contracts, could force HVI-ETF to use all or substantially all of its accumulated asset base to close its position on rebalancing.

[45] The value of HVI-ETF continued on a generally upward trajectory through late 2017 (the average daily increase was 0.27% in the six months ending February 1, 2018), during which time the VIX stayed at historically low levels.

[46] The number of units in HVI-ETF grew by 1,675,000 (approximately 147%) between January 1 and February 5, 2018, as the Designated Broker and the Dealers subscribed for additional units during this period of elevated risk. Mr. Wright alleges that Horizons took no steps to address the increasing risk to HVI-ETF and its unitholders.

[47] On February 1, 2018, HVI-ETF closed at a value of $21.64. It declined in price to $18.76 by the close of business on Friday, February 2, 2018. On Monday, February 5, 2018, the S&P 500 declined by 4.1%, causing a spike in volatility – the VIX Index increased by 115% – during the course of the trading day.

[48] An unprecedented volume of 4,481,010 HVI-ETF Units traded over the TSX on February 5, 2018. Mr. Wright submits that it would have been apparent to Horizons during the day on February 5, 2018 that the nearer term VIX futures contracts were going to be priced at a much higher level and that the net asset value of HVI-ETF would need to be marked significantly downwards from the net asset value struck by Horizons at 4:00 pm. He submits that sophisticated market participants who understood the volatility futures market, would have known that HVI-ETF was obligated to buy a significant number of VIX futures contracts to implement the required daily rebalance.

[49] On February 5, 2018, HVI-ETF suffered dramatic losses in the aftermarket (between 4:00 and 4:15 pm), when HVI-ETF and other short volatility funds had to complete their rebalancing, as the prices of the near term VIX futures contract continued to rise after 4:00 pm. When the unitholders who held HVI-ETF's units overnight woke up the next day, the value of their units was $2.49 – a decline of 81.42% from the previous night's close and nearly 87% less from its price at the close on February 2, 2018.

[50] The extreme and unexpected volatility in the VIX-futures market after markets closed impaired the trading of the derivatives used to provide inverse exposure to the VIX Futures Index. As a result, although Horizons had struck a NAV of $12.68 for units in HVI as of February 5, 2018, the units opened at a price of $2.49 on February 6, 2018. To address this situation, on February 6, 2018, Horizons requested and received a temporary halt in trading of the units. Trading resumed later that same day.

[51] HVI-ETF investors were not able to trade their units on February 6, 2018 until approximately 2:00 pm as Horizons had halted trading of HVI-ETF. After trading was resumed, the price of HVI-ETF never recovered.

6. Horizons Closes HVI-ETF

[52] On March 1, 2018, Horizons published an amendment to the prospectus, pursuant to which it amended HVI-ETF's investment objective so that it was expected to deliver only one half of the inverse of the Underlying Index. Horizons did not explain why it materially lowered HVI-ETF's exposure to volatility in response to the losses of February 5, 2018.

[53] On April 10, 2018, Horizons announced that it would be closing HVI-ETF. In its press release, Horizons offered the following explanation for its decision to close HVI-ETF:

> After reassessing the performance of HVU and HVI-ETF, particularly their respective performance following the first week of February, when volatility futures contracts spiked by more than 100% during one 24-hour trading period, we have come to the conclusion that these ETFs no longer offer an acceptable risk/reward trade-off for investors," said Steve Hawkins, President and Co-CEO of Horizons ETFs. "...Ultimately, we do not want to be offering investment products that have the potential to lose the majority of an investor's capital in such a short period of time.

[54] On April 17, 2018 Horizons published a second amended Prospectus for HVI-ETF and HVU, announcing that the two ETFs were being terminated effective June 11, 2018.

[55] HVI-ETF ceased trading on June 6, 2018. On June 11, 2018, Horizons shut down HVI-ETF permanently, when it paid out investors a net asset value of $2.41 per unit – approximately 11% of the value of a unit of HVI-ETF on February 1, 2018.

7. The Claim Against Horizons and the Proposed Class Proceeding

[56] On May 4, 2018, Mr. Wright commenced a proposed class action against Horizons. Horizons has not delivered its Statement of Defence.

[57] In his action, Mr. Wright seeks general damages, calculated based on the capital losses experienced by HVI-ETF, on behalf of himself and the proposed class. He sues Horizons for common law negligence and for breach of s. 130 of the Ontario *Securities Act.*

[58] Mr. Wright seeks to be appointed as the representative plaintiff for all people and entities in Ontario and elsewhere who held units of HVI-ETF at the close of the TSX on February 5, 2018 (the "Class" and "Class Members"). The proposed class definition is:

> All persons and entities, wherever they may reside, who held units in BetaPro S&P 500 VIX Short-Term Futures Daily Inverse ETF ("HVI-ETF") on the Toronto Stock Exchange ("TSX") as at the close of business on February 5, 2018, excluding the defendants, their past and present subsidiaries, affiliates, officers, directors, senior employees, partners, legal representatives, heirs, predecessors, successors and assigns, and any individual who is a member of the immediate family of an individual defendant.

[59] Mr. Wright alleges that Horizons owed a duty of care to the proposed Class pursuant to the common law, the prospectus, the Trust Declaration, s. 116 of the Ontario *Securities Act*, and Ontario Securities Commission Rule 31-505 (*Conditions of Registration).*

[60] Mr. Wright pleads that Horizons had: (a) a duty to exercise the powers and discharge the duties of its office honestly, in good faith and in the best interests of HVI-ETF and its unitholders; (b) a duty to act fairly, honestly and in good faith with its clients, which included the unitholders; and a duty to exercise the degree of care, diligence and skill that a reasonably prudent trustee, investment fund manager, and investment manager would exercise in comparable circumstances.

[61] Mr. Wright alleges that Horizons breached its duty of care and failed to meet the applicable standard by designing, marketing and managing a proprietary and notionally innovative investment product that was excessively complex and contained fundamental design flaws that inappropriately exposed investors to excessive risk. He alleges that HVI-ETF was an entirely untenable and inappropriate investment product. Specifically, the Statement of Claim alleges that Horizons breached its duties to HVI-ETF's unitholders by:

a. developing the underlying strategy of HVI-ETF into an ETF when it knew or ought to have known that an ETF structure would put Class Members at a disproportionate risk of loss;

b. designing a product that was too complex to be marketed to retail investors;

c. failing to ensure that HVI-ETF tracked its net asset value during intra-day trading;

d. failing to structure HVI-ETF in a manner that would avoid significant changes in its net asset value after the close of markets;

e. structuring HVI-ETF with an inflexible investment mandate that required HVI-ETF to close out its positions in VIX futures contracts after 4:00 pm each day regardless of the cost of doing so;

f. failing to address the dislocation of HVI-ETF from its net asset value on February 5, 2018;

g. failing to conduct proper or adequate testing of HVI-ETF prior to launching it;

h. failing to ensure that HVI-ETF could withstand significant increases in market volatility without a significant drop in value or, in the alternative, failing to warn investors of that risk;

i. failing to ensure that HVI-ETF would not lose a majority of its value in a single day or, in the alternative, failing to warn investors of that risk;

j. promoting, marketing and selling HVI-ETF, which it knew or should have known was based on an excessively complex and risky strategy, organized into an unsuitable retail investment product;

k. failing to disclose in the Prospectus the material facts necessary to understand HVI-ETF, including the rationale for the investment strategy of HVI-ETF and the manner in which HVI-ETF would increase or decrease in value;

l. failing to adequately warn unitholders of the nature and extent of the risks of investing in HVI-ETF;

m. simultaneously marketing HVI-ETF as a short-term and a long-term investment;

n. failing to foresee the ways in which unitholders might buy, sell or hold HVI-ETF;

o. implying through the Prospectus and other disclosure that HVI-ETF could generate short-term profits commensurate with the potential for short-term losses;

p. failing to diligently perform its duties as manager of HVI-ETF;

q. failing to conclude that HVI-ETF did not have an "acceptable risk/reward trade-off" for investors prior to February 5, 2018;

r. failing to continuously monitor or update HVI-ETF's investment strategy to reflect the risks disclosed by academic, scholarly and industry research;

s. continuing the operation of HVI-ETF when it knew or should have known that the downside risk of the investment was becoming more extreme and potentially more imminent;

t. failing to warn investors when it knew or should have known that the downside risk of the investment was becoming more extreme and potentially more imminent; and/or

u. engaging in a continuous offering of HVI-ETF in light of the above.

[62] With respect to his statutory cause of action, Mr. Wright pleads that the prospectus and the documents incorporated in it by reference, including the HVI-ETF Facts, contained misrepresentations by omitting to state material facts necessary to make the prospectus not misleading, including that the prospectus failed to disclose, or in the alternative fully or adequately disclose:

a. the fundamental strategy of HVI – the accumulation of assets through an income strategy by selling VIX futures contracts;

b. the risks of investing in HVI as compared to the potential rewards;

c. that the during-the-day trading value of HVI over the TSX might be inflated or inaccurate;

d. the potential for HVI's assets to drop rapidly in value after the close of the trading day;

e. the fact that HVI could lose all or substantially all of its value in a single day in volatile markets; and/or

f. the valuation methodologies for the calculation of the net asset value.

[63] In addition, Mr. Wright alleges that Horizons failed to disclose that the Designated Broker and Dealers were engaging in arbitrage trading for their own account to take advantage of price discrepancies between the market price on the TSX and the net asset value of the Fund.

[64] Mr. Wright delivered his motion record for certification on October 2, 2018. Responding materials were served in late January and early March 2019, with cross-examinations held shortly thereafter.

[65] In his notice of motion and factum, Mr. Wright proposed the following common issues:

Negligence

1. Did Horizons owe the Class Members a duty of care?

(a) Did Horizons owe a duty to the Class Members with respect to the development, promotion and management of HVI-ETF?

2. If the answer to questions 1 is 'yes', what is the applicable standard of care?

3. If the answer to question 1 is 'yes', did Horizons' acts and omissions breach the applicable standard of care? In particular:

(a) By developing and promoting HVI-ETF to the public, did Horizons breach its statutory duty to:

(1) act fairly, honestly, in good faith and in the best interests of HVI-ETF and its unitholders; and

(2) exercise the degree of care, diligence and skill that a reasonably prudent investment fund manager would exercise in comparable circumstances?

(b) Did Horizons breach its duty to Class Members to ensure that HVI-ETF was an appropriate product to offer to investors? In particular, did Horizons fail to properly consider the following questions, a negative answer to any one of which should have caused Horizons to decide not to offer HVI-ETF:

(1) Was HVI-ETF a product that was reasonably capable of being understood by investors?

(2) Was there a coherent and tenable investment thesis to support investing in HVI-ETF?

(3) Were the risks and rewards of HVI-ETF proportionate and reasonable for investors, particularly when considered over a daily or short term period?

(4) Did a passive management structure for HVI-ETF create unnecessary risk for investors compared to an actively managed portfolio?

(5) Was it reasonable to rely on trading over the TSX to provide investors with a fair and reasonable price for HVI-ETF?

(6) Was it reasonable to rely on arbitrage trading by the Designated Broker and Dealers to maintain a market price that accurately reflected the net asset value of HVI-ETF?

(7) Would the market price of HVI-ETF during the trading day accurately represent the net asset value of HVI-ETF during periods of market stress?

(c) Did Horizons breach a duty to the Class Members to ensure that HVI-ETF was appropriately tested with respect to the matters in (b) above, particularly with respect to how it would perform in periods of increased market volatility?

(d) Did Horizons breach its duty to monitor and continually assess whether HVI-ETF was an appropriate investment product given market conditions?

(e) Was the strategy employed by HVI-ETF prudent during the first quarter of 2018 in the context of the market conditions at the time?

(f) Did Horizons breach its duty of care by failing to appropriately monitor the trading activities of National Bank of Canada and/or National Bank Financial, a derivative counterparty, Designated Broker and Dealer for HVI-ETF?

4. Did Horizons' breaches of duty, if any, cause the Class Members to suffer damages?

Alternative Claim: Civil Liability under the OSA

5. Was Horizons a responsible issuer within the meaning of the *OSA*?

6. Was Horizons obliged to disclose all material facts in the Prospectus?

7. Is Horizons liable for any misrepresentations in the Prospectus pursuant to section 130 of the *OSA*?

8. If the answer to questions 6 to 8 is 'yes', did the Prospectus contain misrepresentations with respect to HVI-ETF?

(a) In particular, did the Prospectus misrepresent that HVI-ETF was appropriate as a short-term or daily investment?

9. If the answer to question 7 is 'yes', did the Prospectus omit material facts about HVI-ETF?

(a) In particular, did Horizons misrepresent the risk of HVI-ETF by failing to disclose one or more of the following material facts:

(1) that HVI-ETF was based on an income strategy and not a short-term trading strategy;

(2) that HVI-ETF could lose its entire value during the course of a single day;

(3) that HVI-ETF could become dislocated from its net asset value during the trading day;

(4) that HVI-ETF was vulnerable due to the programmed daily rebalancing of the portfolio;

(5) that HVI-ETF's underlying investment strategy had become very risky by the end of 2017; and

(6) that there was industry concern that the VIX could be subject to manipulation?

10. If the answer to questions above is 'yes', did the misrepresentations and/or omissions cause Class Members to suffer damages?

Damages and General

11. What is the quantum of damages suffered by Class Members during the Class Period?

12. Does the conduct of Horizons justify an award of punitive and/or exemplary damages?

13. If a Class Member is entitled to a damages award, can some or all of that award be determined commonly? If so, what is the quantum and how?

14. If Horizons is liable to the Class, and if the Court considers that the participation of the Class Members is required to determine individual issues:

(a) are any directions necessary?

(b) should any special procedural steps be authorized?

(c) should any special rules relating to the admission of evidence and means of proof be made?; and

(d) what directions, procedural steps, or evidentiary rules ought to be given or authorized?

[66] At the hearing of the certification motion, Mr. Wright provided a revised list of common issues as follows:

Negligence

1. Did Horizons owe the Class Members a duty of care?

2. If the answer to question 1 is 'yes', what is the applicable standard of care?

3. If the answer to question 1 and any part of question 2 is 'yes', did Horizons' acts and/or omissions breach the applicable standard of care?

4. If the answer to question 3 is yes, did Horizons' breaches of the standard of care cause the Class Members to suffer damages?

Alternative Claim: Civil Liability under the OSA

5. Was Horizons obliged to disclose all material facts concerning HVI in the Prospectus?

6. Can some or all Class Members advance a claim against Horizons under section 130 of the OSA?

7. If the answer to question 6 is 'yes', did the Prospectus contain misrepresentations concerning HVI?

8. If the answer to question 6 is 'yes', did the Prospectus omit material facts about HVI?

9. If the answer to any of questions 6 or 7 is 'yes', did the misrepresentations and/or omissions cause Class Members to suffer damages?

Damages and General

10. If Class Members are entitled to damages, can some or all of those damages be determined commonly?

11. What is the quantum of damages suffered by Class Members during the Class Period?

12. Does the conduct of Horizons justify an award of punitive and/or exemplary damages?

C. Certification

1. Introduction

[67] The court has no discretion and is required to certify an action as a class proceeding when the following five-part test in s. 5 of the *Class Proceedings Act, 1992* is met: (1) the pleadings disclose a cause of action; (2) there is an identifiable class of two or more persons that would be represented by the representative plaintiff; (3) the claims of the class members raise common issues; (4) a class proceeding would be the preferable procedure for the resolution of the common issues; and (5) there is a representative plaintiff who: (a) would fairly and adequately represent the interests of the class; (b) has produced a plan for the proceeding that sets out a workable method of advancing the proceeding on behalf of the class and of notifying class members of the proceeding, and (c) does not have, on the common issues for the class, an interest in conflict with the interests of other class members.

[68] As foreshadowed at the very outset of these Reasons for Decision, I am dismissing Mr. Wright's certification action and also his action. I do so because, as I shall explain below, his action does not satisfy the cause of action criterion, which is the first criterion for certification. Without a common law or statutory cause of action there is no action and no action to certify, and I, therefore, do not propose to comment about the other certification criteria.

2. The Cause of Action Criterion

[69] The first criterion for certification is that the plaintiff's pleading discloses a cause of action. The "plain and obvious" test for disclosing a cause of action from *Hunt v. Carey Canada,*[4] is used to determine whether a proposed class proceeding discloses a cause of action for the purposes of s. 5(1)(a) of the *Class Proceedings Act, 1992*. To satisfy the first criterion for certification, a claim

[4] [1990] 2 S.C.R. 959.

will be satisfactory, unless it has a radical defect, or it is plain and obvious that it could not succeed.[5]

[70] In a proposed class proceeding, in determining whether the pleading discloses a cause of action, no evidence is admissible, and the material facts pleaded are accepted as true, unless patently ridiculous or incapable of proof. The pleading is read generously, and it will be unsatisfactory only if it is plain, obvious, and beyond a reasonable doubt that the plaintiff cannot succeed.[6]

[71] As I shall explain below, in my opinion, it is plain and obvious that Mr. Wright's common law negligence action is a failed attempt to add to the list of negligence claims for pure economic loss, and it is plain and obvious that his statutory claim under s. 130 of the Ontario *Securities Act* is not available for misrepresentations in a prospectus associated with the selling of ETFs in a secondary market.

[72] As I shall explain below, in my opinion, although there is a statutory cause of action for misrepresentations in the trading of ETFs, that statutory claim is pursuant to Part XXIII.1 of the Ontario *Securities Act*, which is a claim for which the court must grant leave before it can be asserted. Mr. Wright has not pleaded a claim under Part XXIII.1 and so I shall dismiss the statutory claim that he has brought, which is a cause of action that is not available to him or the putative Class Members.

3. The Common Law Negligence Claim

[73] One aspect of Mr. Wright's common law negligence claim upon which the parties agree is that it is a claim for pure economic loss. The parties also agree what are the elements of a common law negligence cause of action and about the approach a court should use to determine whether there is a duty of care between a plaintiff and defendant.

[74] Where the parties disagree is about how the law and legal principles about which they are in general agreement apply to the circumstances of the creation, sale, and management of an ETF.

[75] Horizon's argument is that Mr. Wright's negligence claim is a products liability claim for pure economic loss; however, it is plain and obvious that a negligence claim for a pure economic loss from an allegedly carelessly designed, developed, marketed, and managed investment product is not a reasonable cause of action. Further, Horizons argues that if Mr. Wright's negligence claim is not a product's liability claim but is a novel attempt to extent the categories of pure economic loss claims, then it fails the Canadian duty of care analysis for new claims.

[76] Without conceding a precise categorization of his pure economic loss claim, Mr. Wright's argument is that it within the boundaries of established categories of claim or, if necessary, his negligence claim is an appropriate extension of the current law about pure economic loss claims that satisfies the traditional duty of care analysis. He adds, of course, that it is not plain and obvious

---

[5] *176560 Ontario Ltd. v. Great Atlantic & Pacific Co. of Canada Ltd.* (2002), 62 O.R. (3d) 535 at para. 19 (S.C.J.), leave to appeal granted, 64 O.R. (3d) 42 (S.C.J.), aff'd (2004), 70 O.R. (3d) 182 (Div. Ct.); *Anderson v. Wilson* (1999), 44 O.R. (3d) 673 at p. 679 (C.A.), leave to appeal to S.C.C. ref'd, [1999] S.C.C.A. No. 476.

[6] *Cloud v. Canada (Attorney General)* (2004), 73 O.R. (3d) 401 at para. 41 (C.A.), leave to appeal to the S.C.C. refused, [2005] S.C.C.A. No. 50, rev'g, (2003), 65 O.R. (3d) 492 (Div. Ct.); *Hollick v. Toronto (City)*, 2001 SCC 68 at para. 25; *Abdool v. Anaheim Management Ltd.* (1995), 21 O.R. (3d) 453 at p. 469 (Div. Ct.).

that he has not pleaded a reasonable cause of action for negligence and that it should be left to a trial or a summary judgment motion to determine whether he has a cause of action; and, therefore, he submits that he satisfies the cause of action criterion for the certification of his action as a class proceeding.

[77] The analysis of Mr. Wright's common law negligence claim begins by more precisely characterizing and noting the features of his claim. The following features should be noted: (a) it is a claim for negligence and not breach of contract or breach of trust; (b) it is not a common law negligent misrepresentation claim and is distinct from his statutory misrepresentation claim under s. 130 of the Ontario *Securities Act*; (c) it is a claim for pure economic loss, *i.e.*, a financial loss arising in respect of the value of the units themselves and not a loss resulting from physical injury to the Class Member's person or property; and (d) it is primarily or essentially about Horizons' conduct as a creator and manager of the HVI-ETF.

[78] Mr. Wright synthesizes that nature of his common law negligence claim in paragraph 94 of his factum where he states:

> 94. The Plaintiff alleges that Horizons breached its duty of care and failed to meet the applicable standard by designing, marketing and managing a proprietary and notionally 'innovative' investment product that was excessively complex and contained fundamental design flaws that inappropriately exposed investors to excessive risk. Rather, as noted above, it is alleged that HVI was an entirely untenable and inappropriate investment product.

[79] The point that Mr. Wright's claim is essentially about Horizons' responsibilities as the creator and manager of the HVI-ETF shall prove to be particularly important to the analysis below, because ultimately the Class Member's grievance is that they assert that Horizons created and sold an investment product that was designed to be passively managed but was too risky precisely because of its passive management. Ultimately, the Class Members grievance is that they were sold an ETF that had an investment strategy that was too risky to be passively managed.

[80] Upon close analysis, it emerges that Class Members submit that it was reasonably foreseeable that Horizons knew or ought to have known that selling a passively managed ETF would cause the Class Members who purchased the HVI-ETF financial harm. The Class Members submit that Horizons breached its duty of care by designing and selling a too risky ETF. The Class Members submit that it was reasonably foreseeable that Horizons ought to have actively managed the HVI-ETF and it breached its duty of care by not eschewing its passive management when it knew or ought to have known that active management was required because of what was happening on the stock exchange.

[81] The circumstances in which Canadian courts have allowed recovery in negligence for pure economic loss are limited. As the Supreme Court of Canada noted in *Martel Building Ltd. v. R* at paragraphs 36 and 37:[7]

> 36. An historical review of the common law treatment of recovery for economic loss has been undertaken by this Court on several occasions. See *Rivtow Marine Ltd. v. Washington Iron Works*, [1974] S.C.R. 1189; *Canadian National Railway Co. v. Norsk Pacific Steamship Co.*, [1992] 1 S.C.R. 1021; and *D'Amato, supra*. Rather than re-canvassing the jurisprudential genealogy reviewed in these cases, it is enough to say that the common law traditionally did not allow recovery of economic loss where a plaintiff had suffered neither physical harm nor property damage. *See Cattle v. Stockton Waterworks Co.* (1875), L.R. 10 Q.B. 453.

---

[7] *Martel Building Ltd. v. R*, 2000 SCC 60 at paras. 36 and 37.

> 37. Over time, the traditional rule was reconsidered. In *Rivtow* and subsequent cases it has been recognized that in limited circumstances damages for economic loss absent physical or proprietary harm may be recovered. The circumstances in which such damages have been awarded to date are few. To a large extent, this caution derives from the same policy rationale that supported the traditional approach not to recognize the claim at all. First, economic interests are viewed as less compelling of protection than bodily security or proprietary interests. Second, an unbridled recognition of economic loss raises the spectre of indeterminate liability. Third, economic losses often arise in a commercial context, where they are often an inherent business risk best guarded against by the party on whom they fall through such means as insurance. Finally, allowing the recovery of economic loss through tort has been seen to encourage a multiplicity of inappropriate lawsuits.

[82] While new categories of pure economic loss are theoretically possible, the currently recognized categories of recoverable pure economic loss are: (a) the independent liability of statutory public authorities; (b) negligent misrepresentation; (c) negligent performance of a service; (d) negligent supply of shoddy goods or structures; and (e) relational economic loss.[8]

[83] Of the established categories, I agree with Horizons' argument that Mr. Wright's pure economic loss claim does not come within the currently recognized category for the negligent supply of a shoddy good, which in this case would be a carelessly designed investment product that Mr. Wright alleges ought not to have been designed and sold.

[84] Mr. Wright's claim may constitute a new category, or it may be within the negligent performance of a service category but it is not a viable product's liability claim for pure economic loss. The category for pure economic losses for a shoddy goods is a narrow category that involves products that have a prospect of causing physical harm to persons or property unless repaired.[9] Apart from common law and statutory negligent misrepresentation claims, there is no precedent for recovery of pure economic losses from a negligently created financial products such as an ETF.

[85] As far as existing categories are concerned, Mr. Wright's pure economic loss claim fits, if at all, as a negligent performance of a service claim. Mr. Wright builds his negligence action and a duty of care based on Horizons' role as a fund manager. His argument is that Horizons had a duty of care to properly manage the HVI-ETF. In particular, as sources for a duty of care, he relies on: (a) s. 116 of the Ontario *Securities Act;* (b) s. 2.1 of OSC Rule 31-505; (c) section 9.7 of the Declaration of Trust for the HVI-ETF; and (d) the statements made in the prospectus for the HVI-ETF.

a. Section 116 of the Ontario *Securities Act* states:

> *Standard of care, investment fund managers*
>
> 116 Every investment fund manager,
>
> (a) shall exercise the powers and discharge the duties of their office honestly, in good faith and in the best interests of the investment fund; and
>
> (b) shall exercise the degree of care, diligence and skill that a reasonably prudent person would exercise in the circumstances.

---

[8] *Martel Building Ltd. v. R,* 2000 SCC 60 at para. 38.

[9] *Arora v. Whirlpool Canada LP,* 2012 ONSC 4642, aff'd 2013 ONCA 657, leave to appeal to S.C.C. refused, [2013] S.C.C.A. No. 498; *Quenneville v. Robert Bosch GmbH,* 2017 ONSC 7422.

b. Section 2.1 of OSC Rule 31-505 (Conditions of Registration) states that a registered dealer or adviser shall deal fairly, honestly and in good faith with its clients." In its 2016 annual report, Horizons specifically refers to unitholders in its funds as its 'clients'.

c. Section 9.7 of the Declaration of Trust for the HVI-ETF specifies that as Trustee, Horizons is required to exercise the powers and discharge the duties of its office honestly, in good faith and in the best interests of each ETF and, in connection therewith, shall exercise the degree of care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.

d. The Prospectus states that Horizons is required to exercise its powers and discharge its duties honestly, in good faith and in the best interests of the Unitholders of the ETFs, and to exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.

[86] He also relies on a group of cases where investment fund managers or investment advisers have been sued in negligence for pure economic losses. In this regard, he relies on: *Collette v Great Pacific Management Ltd.*;[10] *Fischer v IG Investment Management Ltd.*;[11] *Dobbie v Arctic Glacier Income Fund.*;[12] *Re Sextant Capital Management Inc.*;[13] *Cannon v Funds for Canada Inc.*;[14] *Re Juniper Fund Management Corp.*;[15] and *Growthworks WV Management Ltd. v. Growthworks Canadian Fund Ltd.* [16]

[87] At first blush the four sources of a duty of care and Mr. Wright's list of cases present a formidable argument that Horizons has a duty of care to the Class Members of investors in the circumstances of the immediate case. However, a deeper analysis reveals that while investment managers will and do have a duty of care to investors, none of the sources of duty or the list of cases provides a precedent for the scope of that duty of care as contented for by Mr. Wright in the immediate case.

[88] Upon analysis, it turns out that the thesis of Mr. Wright's negligence case is that Horizons had and breached a duty of care: (a) not to develop and market an ETF that was too risky for the retail investment market; and (b) to actively manage the passively managed HVI- ETF when it became evident that the investment risks of this particular ETF were being actualized because of the TSX trading that occurred on February 5, 2018. These are unprecedented and new duties of care for investment fund managers.

[89] If a negligence case does not come within an established category, it is necessary to undertake a duty of care analysis. As developed by the case law in Canada, there is a four-step analysis. The first step is to determine whether the case falls within a recognized category of negligence case. In Canada, if the relationship between the plaintiff and the defendant does not fall

---

[10] 2003 BCSC 332, rev'd on other grounds and certification granted 2004 BCCA 110, leave to appeal ref'd [2004] S.C.C.A. No. 174.
[11] 2010 ONSC 296, rev'd on other grounds and certification granted 2010 ONSC 2839 (Div. Ct.), aff'd 2012 ONCA, aff'd 2013 SCC 69.
[12] 2011 ONSC 25, leave to appeal granted 2012 ONSC 773.
[13] (2011), 34 O.S.C.B. 5829 (O.S.C.), aff'd 2014 ONSC 2467 (Div. Ct.).
[14] 2012 ONSC 399, leave to appeal ref'd, 2012 ONSC 6101 (Div. Ct.).
[15] (2013), 36 O.S.C.B. 4243 (O.S.C.).
[16] 2018 ONSC 3108.

within a recognized class of negligence cases where the defendants have a duty of care to others, then whether a duty of care to another exists involves satisfying the requirements of the next three steps: (1) foreseeability, in the sense that the defendant ought to have contemplated that the plaintiff would be affected by the defendant's conduct; (2) sufficient proximity, in the sense that the relationship between the plaintiff and the defendant is sufficiently close *prima facie* to give rise to a duty of care; and (3) the absence of overriding policy considerations that would negate any *prima facie* duty established by foreseeability and proximity.

[90] Thus, in a new category of case, as is the situation in the case at bar, whether a relationship giving rise to a duty of care exists depends on foreseeability, moderated by policy concerns.[17]

[91] To determine the foreseeability element, the court asks whether the harm that occurred was the reasonably foreseeable consequence of the defendant's act.[18] A reasonable foreseeability analysis requires only that the general harm, not its manner of incidence, be reasonably foreseeable.[19]

[92] Proximity focuses on the type of relationship between the plaintiff and defendant and asks whether this relationship is sufficiently close that the defendant may reasonably be said to owe the plaintiff a duty to take care not to injure him or her.[20] Proximate relationships giving rise to a duty of care are of such a nature as the defendant in conducting his or her affairs may be said to be under an obligation to be mindful of the plaintiff's legitimate interests.[21] The proximity inquiry probes whether it would be unjust or unfair to hold the defendant subject to a duty of care having regard to the nature of the relationship between the defendant and the plaintiff.[22] The focus of the probe is on the nature of the relationship between victim and alleged wrongdoer and the question is whether the relationship is one where the imposition of legal liability for the wrongdoer's actions would be appropriate.[23]

[93] The proximity focuses on the connection between the defendant's undertaking, the breach of which is the wrongful act, and the loss claimed.[24]

[94] The proximity analysis involves considering factors such as expectations, representations, reliance, and property or other interests involved.[25] Proximity is not concerned with how intimate the plaintiff and defendant were or with their physical proximity, so much as with whether the actions of the alleged wrongdoer have a close or direct effect on the victim, such that the wrongdoer ought to have had the victim in mind as a person potentially harmed.[26] The proximity analysis is intended to be sufficiently flexible to capture all relevant circumstances that might in any given

---

[17] *Anns v. Merton London Borough Council,* [1978] A.C. 728 (H.L.); *Mustapha v. Culligan of Canada Ltd.* 2008 SCC 27 at para. 4.
[18] *Cooper v. Hobart*, 2001 SCC 79 at para. 30.
[19] *Bingley v. Morrison Fuels, a Division of 503373 Ontario Ltd.*, 2009 ONCA 319 at para. 24.
[20] *Donoghue v. Stevenson,* [1932] A.C. 562 (H.L.); *Eliopoulos v. Ontario (Minister of Health & Long-Term Care)* (2006), 82 OR (3d) 321 (CA), leave to appeal to SCC ref'd [2006] SCCA No 514.
[21] *Odhavji Estate v. Woodhouse,* 2003 SCC 69 at para. 49; *Hercules Managements Ltd. v. Ernst & Young,* [1997] 2 SCR 165 at para. 24.
[22] *Syl Apps Secure Treatment Centre v. D. (B.),* 2007 SCC 38 at para. 26.
[23] *Hill v. Hamilton-Wentworth Regional Police Services Board*, 2007 SCC 41 at para. 23.
[24] *Deloitte & Touche v. Livent Inc. (Receiver of),* 2017 SCC 63.
[25] *Cooper v. Hobart,* 2001 SCC 79 at para. 34; *Hill v. Hamilton-Wentworth Regional Police Services Board*, 2007 SCC 41 at para. 23; *Odhavji Estate v. Woodhouse*, 2003 SCC 69 at para. 50.
[26] *Hill v. Hamilton-Wentworth Regional Police Services Board,* 2007 SCC 41 at para. 29.

case go to seeking out the close and direct relationship that is the hallmark of the common law duty of care.[27]

[95] In cases of negligent misrepresentation or performance of a service, proximity will be more usefully considered before foreseeability because what the defendant reasonably foresees as flowing from his or her negligence depends upon the characteristics of his or her relationship with the plaintiff, and specifically, the purpose of the defendant's undertaking.[28]

[96] In cases of pure economic loss arising from negligent misrepresentation or performance of a service, two factors are determinative in the proximity analysis: the defendant's undertaking and the plaintiff's reliance.[29] Any reliance on the part of the plaintiff which falls outside of the scope of the defendant's undertaking of responsibility falls outside the scope of the proximate relationship and, therefore, of the defendant's duty of care.[30]

[97] In *Deloitte & Touche v. Livent Inc. (Receiver of),*[31] Justices Gascon and Brown stated that what the defendant reasonably foresees as flowing from his or her negligence depends upon the purpose of the defendant's undertaking. The crux of Justice Gascon's and Justice Brown's explanation is that a discrete duty of care and proximity analysis is required and it does not follow that because a proximate relationship and a duty of care was found to exist for some purposes that a proximate relationship and a duty of care exists for other purposes. The key passages in their judgment are paragraphs 30-31, 34-35, and 47, which state:

> 30. In cases of pure economic loss arising from negligent misrepresentation or performance of a service, two factors are determinative in the proximity analysis: the defendant's undertaking and the plaintiff's reliance. Where the defendant undertakes to provide a representation or service in circumstances that invite the plaintiff's reasonable reliance, the defendant becomes obligated to take reasonable care. And, the plaintiff has a right to rely on the defendant's undertaking to do so. .... These corollary rights and obligations create a relationship of proximity. ....
>
> 31. Rights, like duties, are, however, not limitless. Any reliance on the part of the plaintiff which falls outside of the scope of the defendant's undertaking of responsibility -- that is, of the purpose for which the representation was made or the service was undertaken -- necessarily falls outside the scope of the proximate relationship and, therefore, of the defendant's duty of care. .... This principle, also referred to as the "end and aim" rule, properly limits liability on the basis that the defendant cannot be liable for a risk of injury against which he did not undertake to protect. .... By assessing all relevant factors arising from the relationship between the parties, the proximity analysis not only determines the existence of a relationship of proximity, but also delineates the scope of the rights and duties which flow from that relationship. In short, it furnishes not only a "principled basis upon which to draw the line between those to whom the duty is owed and those to whom it is not" (*Fullowka*, at para. 70), but also a principled delineation of the scope of such duty, based upon the purpose for which the defendant undertakes responsibility. As we will explain, these principled limits are essential to determining the type of injury that was a reasonably foreseeable consequence of the defendant's negligence.
>
> ....

---

[27] *Saadati v. Moorhead*, 2017 SCC 28 at para. 24.
[28] *Deloitte & Touche v. Livent Inc. (Receiver of)*, 2017 SCC 63 at para. 24.
[29] *Deloitte & Touche v. Livent Inc. (Receiver of)*, 2017 SCC 63 at para. 30.
[30] *Deloitte & Touche v. Livent Inc. (Receiver of)*, 2017 SCC 63 at para. 31. See also *Odhavji Estate v. Woodhouse*, 2003 SCC 69 at paras. 47 to 50.
[31] 2017 SCC 63.

> 34. As we have already observed, however, reasonable foreseeability of injury is no longer the sole consideration at the first stage of the *Anns/Cooper* framework. Since *Cooper*, both reasonable foreseeability and proximity -- the latter expressed in *Cooper* as a distinct and more demanding hurdle than reasonable foreseeability -- must be proven in order to establish a *prima facie* duty of care. And, in cases of negligent misrepresentation or performance of a service, the proximate relationship -- grounded in the defendant's undertaking and the plaintiff's reliance -- informs the foreseeability inquiry. Meaning, the purpose underlying that undertaking and that corresponding reliance limits the type of injury which could be reasonably foreseen to result from the defendant's negligence.
>
> 35. As a matter of first principles, it must be borne in mind that an injury to the plaintiff in this sort of case flows from the fact that he or she detrimentally relied on the defendant's undertaking, whether it take the form of a representation or the performance of a service. It follows that an injury to the plaintiff will be reasonably foreseeable if (1) the defendant should have reasonably foreseen that the plaintiff would rely on his or her representation; and (2) such reliance would, in the particular circumstances of the case, be reasonable (*Hercules*, at para. 27). Both the reasonableness and the reasonable foreseeability of the plaintiff's reliance will be determined by the relationship of proximity between the parties; a plaintiff has a right to rely on a defendant to act with reasonable care for the particular purpose of the defendant's undertaking, and his or her reliance on the defendant for that purpose is therefore both reasonable and reasonably foreseeable. But a plaintiff has no right to rely on a defendant for any other purpose, because such reliance would fall outside the scope of the defendant's undertaking. As such, any consequent injury could not have been reasonably foreseeable.
>
> ....
>
> 47. In summary, at the first stage of the *Anns/Cooper* framework, a duty of care is established where proximity and reasonably foreseeability of injury are found. In our view, Deloitte's undertakings in relation to soliciting investment, and the 1997 Audit, gave rise to proximate relationships. The purpose of those undertakings, in turn, determines the type of injury that was reasonably foreseeable as a result of Livent's reliance. Livent relied on the 1997 Audit for the purpose it was provided. Thus, a resulting injury was reasonably foreseeable. The same cannot be said, however, in respect of Deloitte's negligent assistance in soliciting investment.

[98] Also key to understanding the current state of the law about a duty of care in the context of or performance of a service (or a negligent misrepresentation claim) are paras. 146 and 147 of the dissenting reasons of Chief Justice McLachlin in *Deloitte & Touche v. Livent Inc. (Receiver of)*, which paragraphs were endorsed by Justices Gascon and Brown in their majority judgment. The Chief Justice stated:

> 146. The first step of the *Anns* test asks whether there is proximity, or a sufficiently close relationship, between the parties. It focuses on the connection between the defendant's undertaking (the breach of which is the wrongful act) and the loss claimed. Did the defendant owe the plaintiff a *prima facie* duty of care to prevent the loss, having regard to, on one hand, the reasonably foreseeable consequences of the defendant's conduct given the proximity of the parties and, on the other hand, factors concerning the relationship between the parties that negate tort liability? (see *Cooper*, at paras. 30 and 34). Questions of policy relating to the relationship between the parties should be considered at this step of the *Anns* analysis: *Cooper*, at para. 37.
>
> 147. The purpose for which the statement was made (the undertaking) is pivotal in determining whether a particular type of economic loss was the reasonably foreseeable consequence of the negligence: *Hercules*, at paras. 37-40. Was it made to enable the company to raise capital? If so, a loss due to failure to raise capital may be recoverable. Was it made for the purpose of permitting shareholders to review the management of the company? If so, shareholders may recover for loss due to their inability to hold the company to account: *Hercules*, at paras. 51-57. In each case, one

> must determine the purpose for which the statement was made, and ask whether the loss in question is proximate, or closely connected to the failure of the defendant to fulfill that purpose.

[99] Moving on to the final stage of the duty of care analysis, if the plaintiff establishes a *prima facie* duty of care, the evidentiary burden of showing countervailing policy considerations shifts to the defendant, following the general rule that the party asserting a point should be required to establish it.[32] Policy concerns raised against imposing a duty of care must be more than speculative, and a real potential for negative consequences must be apparent.[33]

[100] The final stage of the analysis is not concerned with the type of relationship between the plaintiff and the defendant. At this stage of the analysis, the question to be asked is whether there exist broad policy considerations that would make the imposition of a duty of care unwise, despite the fact that harm was a reasonably foreseeable consequence of the conduct in question and there was a sufficient degree of proximity between the plaintiff and the defendant such that the imposition of a duty would be fair.[34] The final stage of the analysis is about the effect of recognizing a duty of care on other legal obligations, the legal system and society more generally.[35]

[101] Turning to the case at bar, there is no doubt that that there was and there is a legally proximate relationship between an ETF investor and an ETF fund developer and manager, but the critical question is what is the scope of the undertaking assumed by the fund developer and manager. When a proximate relationship and a duty of care exists for some purposes, as it did in the series of cases relied upon by Mr. Wright, it does not follow that a proximate relationship and a duty of care exists for other purposes.

[102] Here Horizons developed an investment product in the form of the HVI-ETF. It did not so in accordance with Canadian securities law and it prepared a prospectus disclosing information about the HVI-ETF, including detailed warnings and disclosures of the risks associated with the HVI-ETF. Horizons did not warrant or guarantee returns, and it did not suggest that there was anything other than high risks associated with the HVI-ETF. It warned of the risks. Horizons did not hide that the HVI-ETF was a passively managed ETF and it did not undertake to change a passively managed ETF into an actively managed one. It did not undertake this service.

[103] Horizons' undertaking was to place on the exchange a financial product that operated in accordance with the accompanying disclosure documents. Its responsibility to unit purchasers arose solely by virtue of any representations it made about the product and/or compliance with its requirements to disclose the product's nature. It did not undertake responsibility for any gains or losses purchasers might realize in purchasing the units. In accordance with the "end and aim" rule, referred to Justices Gascon and Brown in the *Livent* case, Horizons cannot be liable for a risk of injury against which it did not undertake to protect.

[104] The undertaking in this case was the operation of a passively-managed ETF tied to the performance of a particular index, namely the VIX. Horizons did not undertake to actively manage the ETF, nor did it undertake to step in to stop investor losses. These were not services that it undertook to perform. Rather, Horizons undertook to provide investors with exposure to a

---

[32] *Childs v. Desormeaux*, 2006 SCC 18 at para. 13.
[33] *Hill v. Hamilton-Wentworth Regional Police Services Board*, 2007 SCC 41 at paras. 47-48; *Fullowka v. Pinkerton's of Canada Ltd.*, 2010 SCC 5 at para. 57.
[34] *Cooper v. Hobart*, 2001 SCC 79 at para. 37; *Odhavji Estate v. Woodhouse*, 2003 SCC 69 at para. 51.
[35] *Cooper v. Hobart*, 2001 at para. 37; *Odhavji Estate v. Woodhouse*, 2003 SCC 69 at para. 51.

particular market index. As such, it had no duty of care in negligence to monitor market conditions and to stop trading in the ETF in certain circumstances.

[105] Turning to the proximity and foreseeability analysis that is part of the first stages of the duty of care analysis, there are policy reasons for not extending the scope of the duty of care as far as Mr. Wright would have it extend. Looking again at the nature of the relationship between Horizons and the Class Members and considering the nature of their grievance, it emerges that it is the relationship between a vendor of a product and a purchaser who is disappointed in the performance of that product. As a legal matter, this type of relationship and any associated grievances is typically dealt with as a matter of contract bargaining and not by a tort claim for pure economic losses.

[106] In *LBP Holdings Ltd. v. Hycroft Mining Corp.*,[36] which was about a claim against an underwriter selling securities under a bought deal, I stated at paragraphs 126 and 135:

> 126. These acknowledgements by LBP Holdings reveal both the novelty and also the tenuousness of the alleged duty of care. In general, there is no recognized duty of care to properly price goods to reflect their genuine value in the marketplace or to perform due diligence in the pricing of the goods sold. In general, while vendors of goods will have contractual duties to purchasers, sometimes statutory duties to purchasers, and duties to not manufacture dangerous or potentially dangerous goods, generally speaking, the law of the sale of goods is *caveat emptor* and permits self-interested hard bargaining. Apart from negligent misrepresentation and warranty in contract, vendors of goods typically do not have a duty of care to purchasers.
>
> [...]
>
> 135. Returning to the case at bar, assuming that the Underwriters had a duty of care for negligence independent of their duty of care for representations, then in my opinion, policy factors similar to those that were identified in the *Martel Building Ltd.* case negate the duty of care. I accept that there is no problem of indeterminate liability on the particular facts of the case at bar; however, extending an underwriter's liability for pure economic losses beyond an underwriter's current liability for negligent misrepresentation or for statutory liability under the Ontario *Securities Act* would: (a) deter useful economic activity where the parties are best left to allocate risks through the autonomy of contract, insurance, and due diligence; (b) encourage a multiplicity of inappropriate lawsuits; (c) arguably disturb the balance between statutory and common law actions envisioned by the legislator; and (e) introduce the courts to a significant regulatory function when existing causes of action and the marketplace already provide remedies.

[107] Much the same thing can be said about the case at bar where a fund manager of a passively managed fund is to be exposed to a pure economic loss claim for creating and putting into the secondary market for securities a high risk passively managed ETF. Extending a duty of care for pure economic loss to the creator of an index tracking ETF would: (a) deter useful economic activity where the parties are best left to allocate risks through the autonomy of contract, insurance, and due diligence; (b) encourage a multiplicity of inappropriate lawsuits; (c) arguably disturb the balance between statutory and common law actions envisioned by the legislator; and (e) introduce the courts to a significant regulatory function when existing causes of action, the regulators, and the marketplace already provide remedies.

---

[36] 2017 ONSC 6342 at paras. 126 and 135.

[108] I conclude that it is plain and obvious that Mr. Wright and the putative Class Members do not have a common law negligence claim against Horizons.

4. The Statutory Cause of Action

[109] Mr. Wright's other cause of action for Horizons' alleged misconduct is a statutory cause of action under s. 130 of the Ontario *Securities Act,* which is a remedy provided in Part XXIII of the Act for misrepresentations in the primary market for securities. Section 130 states:

> *Liability for misrepresentation in prospectus*
>
> 130 (1) Where a prospectus, together with any amendment to the prospectus, contains a misrepresentation, a purchaser who purchases a security offered by the prospectus during the period of distribution or during distribution to the public has, without regard to whether the purchaser relied on the misrepresentation, a right of action for damages against,
>
> the issuer or a selling security holder on whose behalf the distribution is made;
>
> each underwriter of the securities who is required to sign the certificate required by section 59;
>
> every director of the issuer at the time the prospectus or the amendment to the prospectus was filed;
>
> every person or company whose consent to disclosure of information in the prospectus has been filed pursuant to a requirement of the regulations but only with respect to reports, opinions or statements that have been made by them; and
>
> every person or company who signed the prospectus or the amendment to the prospectus other than the persons or companies included in clauses (a) to (d),
>
> or, where the purchaser purchased the security from a person or company referred to in clause (a) or (b) or from another underwriter of the securities, the purchaser may elect to exercise a right of rescission against such person, company or underwriter, in which case the purchaser shall have no right of action for damages against such person, company or underwriter.
>
> *Defence*
>
> (2) No person or company is liable under subsection (1) if he, she or it proves that the purchaser purchased the securities with knowledge of the misrepresentation.
>
> *Idem*
>
> (3) No person or company, other than the issuer or selling security holder, is liable under subsection (1) if he, she or it proves,
>
> (a) that the prospectus or the amendment to the prospectus was filed without his, her or its knowledge or consent, and that, on becoming aware of its filing, he, she or it forthwith gave reasonable general notice that it was so filed;
>
> (b) that, after the issue of a receipt for the prospectus and before the purchase of the securities by the purchaser, on becoming aware of any misrepresentation in the prospectus or an amendment to the prospectus he, she or it withdrew the consent thereto and gave reasonable general notice of such withdrawal and the reason therefor;
>
> (c) that, with respect to any part of the prospectus or the amendment to the prospectus purporting to be made on the authority of an expert or purporting to be a copy of or an

extract from a report, opinion or statement of an expert, he, she or it had no reasonable grounds to believe and did not believe that there had been a misrepresentation or that such part of the prospectus or the amendment to the prospectus did not fairly represent the report, opinion or statement of the expert or was not a fair copy of or extract from the report, opinion or statement of the expert;

(d) that, with respect to any part of the prospectus or the amendment to the prospectus purporting to be made on his, her or its own authority as an expert or purporting to be a copy of or an extract from his, her or its own report, opinion or statement as an expert but that contains a misrepresentation attributable to failure to represent fairly his, her or its report, opinion or statement as an expert,

(i) the person or company had, after reasonable investigation, reasonable grounds to believe and did believe that such part of the prospectus or the amendment to the prospectus fairly represented his, her or its report, opinion or statement, or

(ii) on becoming aware that such part of the prospectus or the amendment to the prospectus did not fairly represent his, her or its report, opinion or statement as an expert, he, she or it forthwith advised the Commission and gave reasonable general notice that such use had been made and that he, she or it would not be responsible for that part of the prospectus or the amendment to the prospectus; or

(e) that, with respect to a false statement purporting to be a statement made by an official person or contained in what purports to be a copy of or extract from a public official document, it was a correct and fair representation of the statement or copy of or extract from the document, and he, she or it had reasonable grounds to believe and did believe that the statement was true.

Idem

(4) No person or company, other than the issuer or selling security holder, is liable under subsection (1) with respect to any part of the prospectus or the amendment to the prospectus purporting to be made on his, her or its own authority as an expert or purporting to be a copy of or an extract from his, her or its own report, opinion or statement as an expert unless he, she or it,

(a) failed to conduct such reasonable investigation as to provide reasonable grounds for a belief that there had been no misrepresentation; or

(b) believed there had been a misrepresentation.

Idem

(5) No person or company, other than the issuer or selling security holder, is liable under subsection (1) with respect to any part of the prospectus or the amendment to the prospectus not purporting to be made on the authority of an expert and not purporting to be a copy of or an extract from a report, opinion or statement of an expert unless he, she or it,

(a) failed to conduct such reasonable investigation as to provide reasonable grounds for a belief that there had been no misrepresentation; or

(b) believed there had been a misrepresentation.

Limitation re underwriters

(6) No underwriter is liable for more than the total public offering price represented by the portion of the distribution underwritten by the underwriter.

Limitation in action for damages

(7) In an action for damages pursuant to subsection (1), the defendant is not liable for all or any portion of such damages that the defendant proves do not represent the depreciation in value of the security as a result of the misrepresentation relied upon.

Joint and several liability

(8) All or any one or more of the persons or companies specified in subsection (1) are jointly and severally liable, and every person or company who becomes liable to make any payment under this section may recover a contribution from any person or company who, if sued separately, would have been liable to make the same payment provided that the court may deny the right to recover such contribution where, in all the circumstances of the case, it is satisfied that to permit recovery of such contribution would not be just and equitable.

Limitation re amount recoverable

(9) In no case shall the amount recoverable under this section exceed the price at which the securities were offered to the public.

No derogation of rights

(10) The right of action for rescission or damages conferred by this section is in addition to and without derogation from any other right the purchaser may have at law. R.S.O. 1990, c. S.5, s. 130 (10).

[110] It is undoubtedly the case that there is and should be a statutory cause of action for misrepresentations in the selling of ETFs, which now represent a substantial and growing share of the investment marketplace. The case at bar is a case of first instances about whether the statutory cause of action for misrepresentations in the selling of ETFs is the statutory cause of action under Part XXIII for misrepresentations in the primary market for securities or under Part XXIII.1 for misrepresentations in the secondary market for securities.

[111] For its part, Horizons does not dispute that there is a statutory cause of action that is and should be available when a fund developer makes misrepresentations about an ETF, but it says that it is not under Part XXIII but is exclusively a statutory cause of action under s. 138.3 of Part XXIII.1 of the Act, which states:

Liability for secondary market disclosure

Documents released by responsible issuer

138.3 (1) Where a responsible issuer or a person or company with actual, implied or apparent authority to act on behalf of a responsible issuer releases a document that contains a misrepresentation, a person or company who acquires or disposes of the issuer's security during the period between the time when the document was released and the time when the misrepresentation contained in the document was publicly corrected has, without regard to whether the person or company relied on the misrepresentation, a right of action for damages against,

(a) the responsible issuer;

(b) each director of the responsible issuer at the time the document was released;

(c) each officer of the responsible issuer who authorized, permitted or acquiesced in the release of the document;

(d) each influential person, and each director and officer of an influential person, who knowingly influenced,

(i) the responsible issuer or any person or company acting on behalf of the responsible issuer to release the document, or

(ii) a director or officer of the responsible issuer to authorize, permit or acquiesce in the release of the document; and

(e) each expert where,

(i) the misrepresentation is also contained in a report, statement or opinion made by the expert,

(ii) the document includes, summarizes or quotes from the report, statement or opinion of the expert, and

(iii) if the document was released by a person or company other than the expert, the expert consented in writing to the use of the report, statement or opinion in the document.

Public oral statements by responsible issuer

(2) Where a person with actual, implied or apparent authority to speak on behalf of a responsible issuer makes a public oral statement that relates to the business or affairs of the responsible issuer and that contains a misrepresentation, a person or company who acquires or disposes of the issuer's security during the period between the time when the public oral statement was made and the time when the misrepresentation contained in the public oral statement was publicly corrected has, without regard to whether the person or company relied on the misrepresentation, a right of action for damages against,

(a) the responsible issuer;

(b) the person who made the public oral statement;

(c) each director and officer of the responsible issuer who authorized, permitted or acquiesced in the making of the public oral statement;

(d) each influential person, and each director and officer of the influential person, who knowingly influenced,

(i) the person who made the public oral statement to make the public oral statement, or

(ii) a director or officer of the responsible issuer to authorize, permit or acquiesce in the making of the public oral statement; and

(e) each expert where,

(i) the misrepresentation is also contained in a report, statement or opinion made by the expert,

(ii) the person making the public oral statement includes, summarizes or quotes from the report, statement or opinion of the expert, and

(iii) if the public oral statement was made by a person other than the expert, the expert consented in writing to the use of the report, statement or opinion in the public oral statement. 2002, c. 22, s. 185; 2004, c. 31, Sched. 34, s. 12 (3).

Influential persons

(3) Where an influential person or a person or company with actual, implied or apparent authority to act or speak on behalf of the influential person releases a document or makes a public oral statement that relates to a responsible issuer and that contains a misrepresentation, a person or company who acquires or disposes of the issuer's security during the period between the time when the document was released or the public oral statement was made and the time when the misrepresentation contained in the document or public oral statement was publicly corrected has, without regard to whether the person or company relied on the misrepresentation, a right of action for damages against,

> (a) the responsible issuer, if a director or officer of the responsible issuer, or where the responsible issuer is an investment fund, the investment fund manager, authorized, permitted or acquiesced in the release of the document or the making of the public oral statement;
>
> (b) the person who made the public oral statement;
>
> (c) each director and officer of the responsible issuer who authorized, permitted or acquiesced in the release of the document or the making of the public oral statement;
>
> (d) the influential person;
>
> (e) each director and officer of the influential person who authorized, permitted or acquiesced in the release of the document or the making of the public oral statement; and
>
> (f) each expert where,
>
> > (i) the misrepresentation is also contained in a report, statement or opinion made by the expert,
> >
> > (ii) the document or public oral statement includes, summarizes or quotes from the report, statement or opinion of the expert, and
> >
> > (iii) if the document was released or the public oral statement was made by a person other than the expert, the expert consented in writing to the use of the report, statement or opinion in the document or public oral statement.

[...]

[112] Since Mr. Wright brings only a claim under Part XXIII, s. 130 and not under s. 138.3, Horizons submits that Mr. Wright has not pleaded a reasonable or legally viable statutory cause of action that is appropriate for the trading of ETFs.

[113] But for one critical problematic difference between the Part XXIII and the Part XXIII.1 remedies and given that this is a case of first instance about whether ETFs should be subject to Part XXIII or Part XXIII.1 of the Ontario *Securities Act,* Mr. Wright could have pleaded both causes of action in support of his proposed class action. The problem, however, is that for an action to be asserted under Part XXIII.1 of the Act, leave must be first granted by the court. Mr. Wright, however, did not plead a claim under Part XXIII.1 and obviously he did not seek leave to assert a claim he had not pleaded.

[114] I agree with Horizons that the only legally viable statutory claim available to Mr. Wright and his Class Members is under Part XXIII.1.

[115] In every respect but one and that one respect is attenuated, ETFs are connected to the secondary market which is regulated by Part XXIII.1 of the Ontario *Securities Act*. The only connection between ETFs and the primary market is that before an ETF can begin trading on a stock exchange, its manager must file a prospectus and the regulator must issue a receipt for the prospectus. However, for purchasers of ETFs units, for all practical purposes, they are trading in the secondary market.

[116] The Creation Units of the ETFs are comingled with other ETF units purchased by the Designated Broker and the Dealers in the secondary market and an ETF purchaser cannot know whether his or her purchase involves a primary sale of a Creation Unit or a re-sale in the secondary market.

[117] Further, the securities regulator grants the Designated Broker and the Dealers an exemption from the obligation to deliver a prospectus with each re-sale of a Creation Unit if that is in fact what is being sold. Instead, the Designated Broker and Dealers are required to provide a summary document to an investor purchasing units in a particular ETF for the first time. Practically speaking, apart from the initial prospectus requirement, the trading in ETFs is a secondary market phenomenon.

[118] ETFs are funds that trade on an exchange and purchasers purchase ETF units from a seller who has made them available for sale over an exchange, as opposed to from the issuer of the securities or an underwriter. The purchase price is paid to the person or persons who held the units rather than the issuer of the securities; *i.e.,* it is a secondary market trade. The sale and purchase prices, as well as the terms of the sale, are dictated by the secondary market rather than the issuer of the securities in a prospectus. Trading in ETF units over an exchange is similar to trading in the share of a company over an exchange. It thus makes sense to regulate similar trades in a similar fashion which is to say that ETFs should be regulated under Part XXIII.1 and s. 138.3 of the Ontario *Securities Act* rather than Part XXIII and s. 130 of the Ontario *Securities Act*.

[119] Horizons makes a further argument about why s. 130 of the Ontario *Securities Act* cannot be the proper choice to regulate the trading of ETFs. It argues that for s. 130 to operate there must be a "distribution" but the manner of trading of ETFs does not involve a distribution and therefore s. 130 cannot operate.

[120] Section 1(1) of the Ontario *Securities Act* defines "distribution" as follows:

> "distribution", where used in relation to trading in securities, means,
>
> (a) a trade in securities of an issuer that have not been previously issued,
>
> (b) a trade by or on behalf of an issuer in previously issued securities of that issuer that have been redeemed or purchased or donated to that issuer,
>
> (c) a trade in previously issued securities of an issuer from the holdings of any control person,
>
> [. . .]
>
> (f) any trade that is a distribution under the regulations...

[121] I agree with Horizons' argument. Sales of an ETF unit over an exchange do not satisfy of the requirements of the definition of distribution because they are not sales of "a security offered by the prospectus during the period of distribution or during distribution to the public". They are

not securities "offered by the prospectus" in that their vendor is not offering to sell them under the prospectus, and the sale is not occurring "during the period of distribution or during distribution to the public" because the sale is not a trade in a security that has not been previously issued, not a trade by or on behalf of an issuer in previously issued securities of that issuer that have been redeemed or purchased or donated to that issuer, not a trade in previously issued securities of that issuer from the holdings of any control person, and not a trade that is a distribution under the regulations.

[122] From a policy perspective, it is worth remembering that Part XXIII.1, which regulates the secondary market, was the culmination in 2002 of a prolonged and pervasive law reform project that was designed to provide investor protection balanced against the overreach of so called strike-suit class actions. Thus, for example, on the one hand, the reliance element of the common law tort of negligent misrepresentation, which would have necessitated individual issues trials that might make a class proceeding unmanageable and not a preferable procedure, was not made an constituent element of the statutory cause of action, but, on the other hand, the statutory tort could be asserted only if a court granted leave pursuant to s. 138.8 of the Ontario *Securities Act*. From a policy perspective it would be odd and inconsistent with the overall balanced design of the Act to treat the trading of ETFs, which are so closely associated with the secondary market, as outside the operation of Part XXIII.1 and within the operation of Part XXIII.

[123] I, therefore, conclude that Mr. Wright and the Class Members do not have a cause of action pursuant to s. 130 of the Ontario *Securities Act*. Since they also do not have a legally viable cause of action for common law negligence, Mr. Wright fails to satisfy the cause of action criterion for certification and his action should be dismissed.

[124] This order is made without prejudice to Mr. Wright commencing a proposed class action relying on Part XXIII.1 of the Ontario *Securities Act* and seeking leave to assert that statutory cause of action.

D. Conclusion

[125] For the above reasons, I dismiss the certification motion and I dismiss Mr. Wright's action.

[126] If the parties cannot agree about the matter of costs, they may make submissions in writing beginning with Horizons' submissions within twenty days of the release of these Reasons for Decision followed by Mr. Wright's submissions within a further twenty days.

Perell, J.

Released: June 20, 2019

CITATION: Wright v. Horizons ETFS Management (Canada) Inc., 2019 ONSC 3827
COURT FILE NO.: CV-18-00597284-00CP
DATE: 2019/06/20

ONTARIO
SUPERIOR COURT OF JUSTICE

BETWEEN:

GRAHAM WRIGHT

Plaintiff

- and -

HORIZONS ETFS MANAGEMENT (CANADA) INC.

Defendant

REASONS FOR DECISION

PERELL J.

Released: June 20, 2019