COURT OF APPEAL FOR ONTARIO

CITATION: Wright v. Horizons ETFS Management (Canada) Inc., 2020 ONCA 337
DATE: 20200601
DOCKET: C67205 & C67410

Lauwers, Hourigan and Thorburn JJ.A.

BETWEEN

Graham Wright

Plaintiff/Moving Party (Appellant)

and

Horizons ETFS Management (Canada) Inc.

Defendant/Responding Party (Respondent)

Alistair Crawley, Clarke Tedesco, Michael L. Byers, and Alexandra Grishanova, for the appellant

R. Seumas M. Woods and Ryan Morris, for the respondent

Heard: February 27, 2020

On appeal from the order of Justice Paul M. Perell of the Superior Court of Justice, dated June 20, 2019, with reasons reported at 2019 ONSC 3827.

Thorburn J.A.:

1. OVERVIEW

[1] These are two appeals from a certification judge's order refusing to certify an investor class action and dismissing the action on the basis that the pleadings do not disclose a reasonable cause of action.[1]

[2] The proposed class action arises out of the dramatic collapse of a proprietary derivatives-based exchange-traded fund ("the Fund") created and managed by the respondent, Horizons ETFS Management (Canada) Inc. ("Horizons").

[3] The Fund was meant to provide inverse exposure to stock market volatility. The Fund was described in the prospectus as "highly speculative" and "involv[ing] a high degree of risk". Units in the Fund were offered to retail investors, as well as registered brokers and dealers who bought and sold them over stock exchanges.

[1] Pursuant to the order of Zarnett J.A. and on the consent of the parties, the appellant's appeal to the Divisional Court (court file DC-19-399) was transferred to this court pursuant to ss. 6(2) and 6(3) of the *Courts of Justice Act,* R.S.O. 1990, c. C.43 ("*CJA*") to be combined with and heard together with the appellant's appeal from the same judgment in this court (court file C67205). An order dismissing an action lies to the Court of Appeal as of right pursuant to s. 6(1)(b) of the *CJA* and an appeal from an order refusing to certify a proceeding as a class action lies to the Divisional Court as of right pursuant to s. 30(1) of the *Class Proceedings Act, 1992*, S.O. 1992, c. 6.

[4] After two years of growth, the value of the Fund dropped suddenly and dramatically: on February 5, 2018, the Fund lost almost 90% of its value overnight. Investors lost nearly $40 million and the Fund never recovered.

[5] In April 2018, Horizons announced that it was closing the Fund because it "no longer offer[ed] an acceptable risk/reward trade-off for investors".

[6] Graham Wright brought a claim pursuant to the *Class Proceedings Act, 1992*, S.O. 1992, c. 6, as the representative plaintiff for all persons who owned units of the Fund at the close of the Toronto Stock Exchange on February 5, 2018 ("the Class"). He alleged that Horizons was negligent and was liable for making misrepresentations in its prospectus under s. 130 of the *Securities Act*, R.S.O. 1990, c. S.5.

[7] The certification judge held that the statement of claim did not disclose a reasonable cause of action, because it was plain and obvious that:

a. Horizons owed the Class no duty of care and that there was therefore no cause of action in negligence; and

b. Mr. Wright and the Class did not have a cause of action pursuant to s. 130 of the *Securities Act*, as the Fund was offered over stock exchanges and not directly to investors. They could and should have proceeded under s. 138.3 of the *Securities Act,* not under s. 130.

[8] Mr. Wright submits the certification judge erred in both holdings.

[9] First, Mr. Wright submits that the statement of claim discloses a cause of action in negligence. In particular, he claims Horizons was negligent in designing, developing, offering, and promoting a financial product that was not adequately tested before launching, excessively risky, complex and doomed to fail. He also alleges that Horizons failed to explain the nature and extent of the risks of investing in the Fund, monitor the Fund's investment strategy, or diligently perform its duties as manager of the Fund. When the Fund inevitably failed, Horizons failed to take action to prevent investors from sustaining massive losses.

[10] Second, Mr. Wright maintains Horizons made misrepresentations in its prospectus within the meaning of s. 130 of the *Securities Act*. Mr. Wright claims that the prospectus failed to disclose the real risks attached to the Fund, including the disparity in the way gains and losses are experienced, and that it was inevitable that the Fund would lose all or substantially all of its value in a single day.

[11] Horizons argues that the certification judge correctly concluded that Horizons, as the creator of the Fund, had no duty to protect investors from a high-risk investment product or from possible losses. The prospectus clearly indicates that these were "high risk" investments and that large sums could be lost in short

order. Even if there were such a duty, there are sound policy reasons for not allowing such claims where the parties are best left to allocate risks through alternative means.

[12] Second, Horizons claims Mr. Wright has no right of action for misrepresentation under s. 130 of the *Securities Act*. Horizons argues that a remedy under s. 130 is not available for misrepresentations associated with purchases on the *secondary* market (the stock exchange) and is only available for purchases on the *primar*y market. Instead the claim should have been brought pursuant to s. 138.3 of the *Securities Act*.

[13] The only issue on these appeals is whether the certification judge erred in concluding that the pleading discloses no cause of action as required by s. 5(1)(a) of the *Class Proceedings Act, 1992* and the action should therefore be dismissed.

[14] For the reasons that follow, I would allow the appeal, set aside the order of the certification judge dismissing the motion for certification and the action, allow the claim to be amended such that a claim can proceed under s. 130 of the *Securities Act,* and remit the matter to the certification judge to determine whether the remaining criteria for certification are met.

2. THE FACTS

[15] For the purpose of the cause of action criterion on a certification motion, the facts pleaded in the statement of claim are deemed to be true: *Pro-Sys Consultants Ltd. v. Microsoft Corporation*, 2013 SCC 57, [2013] 3 S.C.R. 477, at para. 63.

[16] The significant facts in the pleading and as found by the certification judge are set out in the following paragraphs.[2]

A. <u>The Fund's Design</u>

[17] Horizons designed, managed and marketed the Fund. It was responsible for investing and reinvesting Fund assets. Horizons earned fees based on a percentage of the assets under management in the Fund.

[18] The Fund was a highly complex derivative exchange-traded fund or ETF designed to provide inverse exposure to stock market volatility.

[19] An ETF is an investment vehicle in which an underlying asset class - like a group of stocks, bonds, or commodities - is pooled in an investment portfolio and held in trust for unitholders.

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[2] The facts outlined by the certification judge's decision were drawn, in part, from the evidence filed on the motion and not simply from the statement of claim. However, the appellant does not take issue with the certification judge's formulation of the facts and both parties rely on these facts to support their arguments on this appeal.

[20] Like many ETFs, this ETF was passively, not actively, managed.

[21] It was based on the VIX Index and the S&P 500 VIX Short-Term Futures Index (the “VIX Futures Index”).

[22] The VIX Index measures market volatility. Investors cannot directly invest in the VIX Index.

[23] The VIX Futures Index was developed by S&P Dow Jones Indices LLC and licensed to Horizons in order to provide exposure to the VIX Index. The VIX Futures Index is an index that is comprised of two near term VIX futures contracts – a first month and a second month contract – that are rebalanced daily in order to maintain a continuous one-month maturity.

[24] The value of the VIX Futures Index is determined based on a weighted average of the VIX futures contracts.

[25] Horizons designed the Fund so that when the VIX Futures Index declined by a certain percentage on a given day, the Fund’s net asset value automatically went up by that percentage. Conversely, when the VIX Futures Index increased on a given day, the Fund’s net asset value went down by that percentage.

[26] The Fund was to pursue daily investment results that attempted to correspond to the inverse of the daily performance of the VIX Futures Index. It did so by shorting (selling) “longer term” VIX futures contracts and covering the short position by purchasing “nearer term” VIX futures contracts.

[27] If volatility remained low, the Fund’s strategy generated income by selling longer term VIX futures contracts at a premium in relation to nearer term contracts, since market conditions became easier to predict as the contract date drew closer.

[28] However, where market volatility increased, the price to repurchase a VIX futures contract could increase quickly (to a theoretically unlimited level). The cost of rebalancing at the end of each trading day could erase any gains accrued over months or years, in a single day.

[29] Mr. Wright claims that the risks of “index shorting” have increased significantly due to the growth of algorithmic trading and that only the most sophisticated hedge funds had sufficient expertise to dynamically manage the underlying risk of the Fund’s strategy.

B. The Distribution of the Fund’s Units

[30] Horizons distributed all units in the Fund to a designated broker or dealer through a continuous distribution agreement between Horizons and the broker or dealer. These newly created units were known as Creation Units.

[31] Investors who bought units from a designated broker or dealer did not know whether they were receiving Creation Units or units from the broker’s or dealer’s inventory that were previously in circulation on the stock exchange (the secondary market).

C. The Prospectus and Other Information about the Fund

[32] Before an ETF can begin trading on a Canadian stock exchange, its manager must file a prospectus and the regulator must issue a receipt for the prospectus.

[33] The Ontario Securities Commission issued receipts for an initial and amended Fund prospectus in 2011 and 2012. Units began trading in April 2012.

[34] Mr. Wright relies on the prospectus dated December 22, 2017. The December 2017 prospectus contained a warning that units in the Fund are “highly speculative and involve a high degree of risk”. It warned investors that "[h]istorically, the [VIX Futures] Index has experienced significant one day

increases on days when equity markets have had large negative returns which, if repeated, could cause [the Fund] to suffer substantial losses."

[35] The prospectus provided that "[v]olatility is a market condition that is easier to identify than it is to manage" and that:

> 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.

[36] The ETF Facts document similarly stated:

> 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.

[37] However, the prospectus did not include the note that was on Horizons' website after February 5, 2018 that acknowledged that "[t]his product is only appropriate for investors who understand volatility and its associated risks before they make a trade in [the Fund]."

D. The Fund's Losses on February 5, 2018

[38] From 2016 through January 2018, there was unprecedented low volatility and the Fund grew significantly in value by accruing risk premium and attracting new investor money. Investors made money by betting that the market would continue to remain stable.

[39] However, in 2018, this structure generated sudden and significant losses when volatility increased after a period of low volatility.

[40] On February 5, 2018, reports of strong job numbers caused the S&P 500 to decline by 4.1% as investors speculated about the prospect of rising inflation and interest rates.

[41] Investor anxiety caused the VIX Index to spike significantly in percentage terms, since it had been sitting at historically low levels. The Fund suffered a corresponding loss of 81.42% of its value from February 5 to February 6, 2018. Investors who held units in the Fund during this period lost most of the money they had invested.

[42] To make matters worse, investors bought Fund units on February 5, 2018 at inflated prices, which exacerbated their losses. An unprecedented volume of 4,481,010 units traded over the TSX on February 5, 2018. As the price of units fell,

investors like Wright purchased them, believing that the spike in volatility would not last and that they could reap a profit by holding the units until the VIX Index returned to its mean.

[43] What these investors did not realize was that, because of the pricing mechanism used by the Fund, the market price of the units did not reflect the Fund's net asset value. As a result, purchasers who bought Fund units that afternoon significantly overpaid for units that were going to be marked down in value after the close of the market once the Fund rebalanced and calculated its net asset value.

[44] Mr. Wright alleges 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 the Fund would need to be marked significantly downwards from the net asset value struck by Horizons at 4:00 p.m. Sophisticated market participants who understood the volatile futures market would have also known that the Fund would be obligated to buy a significant number of VIX futures contracts to implement the required daily rebalance.

[45] Mr. Wright pleads that Horizons “could have contacted the TSX to halt trading in the Units of [the Fund on February 5, 2018] as it became apparent that its market price was becoming dislocated from its net asset value” but did not.

[46] The Fund suffered dramatic losses in the after-market (between 4:00 and 4:15 p.m.), as the prices of the near term VIX futures contract continued to rise after 4:00 p.m.

[47] When unitholders 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 than the price at the close on February 2, 2018.

[48] The unitholders were not able to trade units until approximately 2:00 p.m. on February 6, 2018, as Horizons halted trading earlier that day. After trading resumed, the price never recovered.

[49] Under the heading “What Happened when the Inevitable Occurred”, Mr. Wright pleads that investors were not provided with disclosure of the real risks of investing in the Fund and “Horizons took no action as investment manager to reduce or close out [the Fund’s] position in the face of this developing scenario of increased downside risk.”

E. Horizons Closes the Fund

[50] Not until April 10, 2018, did Horizons disclose that the Fund did not have an acceptable risk/reward trade-off. On that date, Horizons announced that it would no longer be accepting any direct subscriptions for Fund units and that it would be terminating the Fund on June 11, 2018. The press release stated:

> *After reassessing the performance of … [the Fund], 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*. [Italics in original; underlining added.]

3. THE CAUSES OF ACTION PLEADED

[51] Mr. Wright issued a lengthy statement of claim against Horizons for negligence and for liability for prospectus misrepresentation under s. 130 of the *Securities Act*.

[52] Horizons has not filed a statement of defence.

A. Allegations of Negligence

[53] The essence of the negligence claim is that Horizons breached its duty of care by:

a. Designing and developing the Fund when it knew or ought to have known that the Fund was excessively complex and risky for any investor (especially retail investors), and doomed to fail;

b. Offering and promoting the Fund to retail investors knowing it contained structural design flaws, offered unreasonable risk/reward trade-offs, and was doomed to fail;

c. Failing to explain the nature and extent of the risks involved in investing in the Fund;

d. Exposing investors to “catastrophic price reductions after the close of trading … when they were unable to protect themselves”, which was “inherent in the design” of the Fund as a passively managed fund; 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 Fund over the TSX on February 5, 2018.

[54] Mr. Wright pleads that as a result of these breaches, the Class suffered economic loss.

B. Allegations of Misrepresentations under s. 130 of the *Securities Act*

[55] Mr. Wright claims these breaches were compounded by various misrepresentations in the Fund’s prospectus, which failed to fully and adequately disclose:

a. The Fund’s strategy of accumulating assets and the risks versus rewards of investing in the Fund;

b. The fact that the intra-day trading value of the Fund might be inflated or inaccurate;
c. The potential for the value of the Fund assets to drop precipitously after the close of the trading day and the fact that the Fund could lose all or substantially all of its value in a single day;
d. The valuation methodologies for the calculation of the Fund's net asset value;
e. The disparity in the way gains and losses would be experienced by the Fund (incremental gains versus rapid losses); and
f. The fact that it was inevitable that the Fund would lose all or substantially all of its value at some point, and that this could occur almost instantly.

4. LEGAL ANALYSIS

[56] The standard of review applicable to a certification judge's determination of law that a claim discloses no reasonable cause of action is correctness: *Hodge v. Neinstein,* 2017 ONCA 494, 136 O.R. (3d) 81, at para. 52, leave to appeal refused, [2017] S.C.C.A. No. 341.

[57] The test to be met in determining whether the pleadings disclose a cause of action for the purposes of s. 5(1)(a) of the *Class Proceedings Act, 1992* is the same as that applied on a motion to strike a pleading under r. 21.01(1)(b) of the *Rules of Civil Procedure*, R.R.O. 1990, Reg. 194: *Pro-Sys*, at para. 63. That is, assuming that the facts as stated in the statement of claim can be proved, is it "plain and obvious" that the claim cannot succeed?

[58] On a motion to strike for failure to disclose a cause of action pursuant to s. 5(1)(a) of the *Class Proceedings Act, 1992*, the following principles apply:

a. No evidence is admissible: *Lipson v. Cassels Brock & Blackwell LLP*, 2013 ONCA 165, 114 O.R. (3d) 481, at para. 87;

b. All allegations of fact pleaded are assumed to be true unless they are patently ridiculous, manifestly incapable of proof, or amount to bald conclusory statements unsupported by material facts: *R. v. Imperial Tobacco Canada Ltd.*, 2011 SCC 42, [2011] 3 S.C.R. 45, at paras. 21-22; *Castrillo v. Workplace Safety and Insurance Board*, 2017 ONCA 121, 136 O.R. (3d) 654, at para. 15; and *Transamerica Life Canada Inc. v. ING Canada Inc.* (2003), 68 O.R. (3d) 457 (C.A.), at para. 38;

c. Cases that are unique or novel, that involve matters of law that are unsettled, or that require a detailed analysis of the evidence should not be resolved without a full factual record: *Transamerica,* at paras. 57-59; *Imperial Tobacco,* at para. 21; and *Hunt v. Carey Canada Inc.,* [1990] 2 S.C.R. 959, at pp. 990-91;

d. The pleading must be read generously to allow for drafting deficiencies and the plaintiff's lack of access to key documents and discovery information. The court should err on the side of permitting an arguable claim to proceed to trial: *Transamerica*, at para. 38; *Raush v. Pickering (City)*, 2013 ONCA 740, 369 D.LR. (4th) 691, at para. 34;

e. A plaintiff cannot rely on the possibility that new facts may be discovered; it must plead the material facts upon which it relies: *Imperial Tobacco,* at para. 22; and

f. The pleading will be struck only if it is plain and obvious that the plaintiff cannot succeed or, in other words, if the claim has no reasonable prospect of success: *Hunt,* at p. 980; *Imperial Tobacco*, at para. 17.

[59] While a motion to strike is a tool that must be used with care, it serves an important function. In *Imperial Tobacco*, at para. 19, the Supreme Court directed that:

> The power to strike out claims that have no reasonable prospect of success is a valuable housekeeping measure essential to effective and fair litigation. It unclutters the proceedings, weeding out the hopeless claims and ensuring that those that have some chance of success go on to trial.

[60] With those principles in mind, I turn now to an analysis of the claims in this case, beginning with the negligence claim.

A. <u>The Negligence Claim</u>

(1) The Certification Judge's Reasons in Respect of the Negligence Claim

[61] The certification judge refused to certify the class action on the basis that the pleadings did not disclose a cause of action.

[62] He held 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.
>
> …
>
> 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. 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. [Footnote omitted.]

[63] The certification judge therefore concluded that the claim was either a novel claim, or a claim that fell within the category of negligent performance of a service.

[64] He acknowledged that "[a]t first blush" there was a "formidable argument that Horizons has a duty of care to the Class Members of investors in the circumstances of the immediate case." However, he ultimately concluded that there was no precedent for the scope of the duty of care advanced by Mr. Wright.

[65] According to the certification judge, Mr. Wright took the position that Horizons breached its 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 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. He held that those allegations amounted to "unprecedented and new

duties of care for investment fund managers" that made it necessary to engage in a more comprehensive duty of care analysis.

[66] The certification judge accepted that there was a "legally proximate relationship" between the Class and Horizons. However, for him, the issue was the scope of the undertaking assumed by Horizons.

[67] He held that Horizons did not undertake to protect the Class against the risk of losing their investment: "Horizons did not warrant or guarantee returns... It warned of the risks. Horizons … did not undertake to change a passively managed ETF into an actively managed one."

[68] He held that Horizons only undertook to place on the exchange a financial product that operated in accordance with the accompanying disclosure documents. He held that Horizons' duty arose "solely by virtue of any representations it made about the product and/or compliance with its requirements to disclose the product's nature." Horizons did not undertake to actively manage the Fund or step in to stop investor losses and could not be held liable for failing to do so.

[69] He also held that, in any event, "there are policy reasons for not extending the scope of the duty of care as far as Mr. Wright would have it extend" as this was

in essence a purchaser-vendor relationship. He held that “[a]s a legal matter, this type of relationship and any associated grievances [are] typically dealt with as a matter of contract bargaining and not by a tort claim for pure economic losses.”

[70] In his view, 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 (d) have the courts take on a significant regulatory function when existing causes of action, the regulators, and the marketplace already provide remedies.

[71] He therefore concluded that it was plain and obvious that there could be no common law negligence claim against Horizons.

(2) The Legal Framework for Negligence Claims for Economic Loss

[72] The negligence claim involves allegations that the Class suffered losses after investing in a fund that was negligently designed and operated.

[73] A plaintiff can plead both negligence and negligent misrepresentation (or, in this case, a misrepresentation under s. 130 of the *Securities Act*) arising out of the

same factual circumstances, as long as the claims are distinct: *Lipson*, at paras. 96-98.

[74] Canadian courts have limited tort recovery for cases involving pure economic loss where there is no physical harm or damage to property: *Arora v. Whirlpool Canada LP*, 2013 ONCA 657, 118 O.R. (3d) 113, at para. 52, leave to appeal refused, [2013] S.C.C.A. No. 498. While there is no automatic bar to recovery for pure economic loss, "such claims warrant more rigorous examination than other claims for negligence": *Lavender v. Miller Bernstein LLP*, 2018 ONCA 729, 142 O.R. (3d) 401, at para. 72, leave to appeal refused, [2018] S.C.C.A. No. 488, citing *Martel Building Ltd. v. Canada*, 2000 SCC 60, [2000] 2 S.C.R. 860, at para. 35; and *Mandeville v. The Manufacturers Life Insurance Company*, 2014 ONCA 417, 120 O.R. (3d) 81, at paras. 148-50, leave to appeal refused, [2014] S.C.C.A. No. 390.

[75] As noted by the late Honourable Allen M. Linden et. al. in *Canadian Tort Law*, 11th ed. (Toronto: LexisNexis Canada, 2018), at p. 408:

> [R]ights-based torts theorists … take the position that negligence duties exist to protect correlative legal rights. The law recognizes a person's right to personal security and it recognizes property rights. These are protected by negligence law. However, neither the law nor acknowledged philosophical thinkers have ever

> recognized a primary right related to purely economic interests.
>
> The rights-based theorists do support recovery for economic loss in misrepresentation cases by either grounding the claim in the right to personal integrity or by treating the misrepresentation action as equivalent to contract. However, they hold that other types of pure economic loss ought not to be recoverable at all in negligence.

[76] Some of the reasons for the refusal to recognize claims for pure economic loss include the possibility of indeterminate liability, the difference between social loss (such as physical harm) and the transfer of wealth from one person or group to another, the relevance of existing and potential contractual allocation of loss, and the fact that negligently-caused purely financial injury does not constitute a violation of a recognized legal right. When looking at a claim for pure economic loss, it is therefore important to consider whether the plaintiff had an opportunity to protect itself by contract from the risk of economic loss and declined to do so.

[77] The Supreme Court recently reviewed the approach to determining the existence and extent of a duty of care in a claim for economic loss. The two-step process is:

a. whether the parties are in a sufficiently close and direct (or proximate) relationship and whether the harm suffered is reasonably foreseeable such that a *prima facie* duty of care exists; and if so,

b. whether there are residual policy considerations that should insulate the defendant from liability.

See *Deloitte & Touche v. Livent Inc. (Receiver of),* 2017 SCC 63, [2017] 2 S.C.R. 855, at paras. 23-45 and *Darmar Farms Inc. v. Syngenta Canada Inc*., 2019 ONCA 789, 148 O.R. (3d) 115, at para. 54, leave to appeal to S.C.C. requested, 38915.

[78] The first issue to be determined is whether the claim fits within or is analogous to a recognized duty of care. If a relationship falls within a previously established duty of care or is analogous to one, then the requisite close and direct relationship is shown: *Livent*, at para. 26.

(a) *The Duty of Care Analysis Where There Is a Previously Established Duty of Care*

[79] Determining whether a proposed duty of care fits within an existing or analogous duty is a matter of precedent:

> [W]here a case is like another case where a duty has been recognized, one may usually infer that sufficient proximity is present and that if the risk of injury was foreseeable, a *prima facie* duty of care will arise.

Childs v. Desormeaux, 2006 SCC 18, [2006] 1 S.C.R. 643, at para. 15.

[80] When a court relies on an established duty of care, “there are no overriding policy considerations that would [negate] the duty of care”: *Livent*, at para. 28,

citing *Cooper v. Hobart*, 2001 SCC 79, [2001] 3 S.C.R. 537, at para. 39. The majority in *Livent* further instructed, at para. 28, that:

> A consequence of this approach however, is that a finding of proximity based upon a previously established or analogous category must be grounded not merely upon the identity of the parties, but upon examination of the particular relationship at issue in each case. Otherwise, courts risk recognizing *prima facie* duties of care without any examination of pertinent second-stage residual policy considerations.

[81] The Supreme Court has recognized five categories of cases in which plaintiffs may recover in negligence for economic loss not causally connected to physical or property harm. These categories were first discussed in *Canadian National Railway Co. v. Norsk Pacific Steamship Co.*, [1992] 1 S.C.R. 1021, at p. 1049, *per* La Forest J., citing Bruce Feldthusen, "Economic Loss in the Supreme Court of Canada: Yesterday and Tomorrow" (1990-91) 17 Can. Bus. L.J. 356, at pp. 357-58, and were later adopted by the full court: see, for instance, *Martel*, at paras. 38, 45. The five categories are:

1. the independent liability of statutory public authorities;
2. negligent misrepresentation;
3. negligent performance of a service;
4. negligent supply of shoddy goods or structures; and
5. relational economic loss.

[82] Mr. Wright asserts that this claim falls under the category of negligent supply of shoddy goods and/or negligent performance of a service.

[83] Professor Feldthusen points out that these categories are helpful when analyzing liability for pure economic loss to the extent that the cases within each category rely on a common justification for imposing liability. Categorization focuses the policy analysis and avoids a case-by-case approach, which risks inconsistent results. Categories will evolve as the jurisprudence evolves: Bruce Feldthusen, *Economic Negligence*, 6th ed. (Toronto: Carswell, 2012), at pp. 16-17, 22.

[84] Within the five categories, courts have recognized specific duties of care such as an auditor’s duty to a corporation when performing a statutory audit and a solicitor’s duty to a potential beneficiary when preparing a will: *Livent,* at paras. 58-66; *Whittingham v. Crease & Co.* (1978), 88 D.L.R. (3d) 353, at p. 373 (B.C.S.C.).

[85] When determining whether a proposed duty of care fits within an existing or analogous duty, a court should avoid construing existing duties of care “in an overly broad manner” and “be attentive to the particular factors which justified recognizing that prior [duty]”: *Livent,* at para. 28. These factors include (in the case of negligent misrepresentation and negligent provision of services) (a) the defendant’s

undertaking to provide a representation or a service and (b) the plaintiff's reasonable reliance on that undertaking such that the risk of injury was reasonably foreseeable: *Livent*, at paras. 30-31.

(b) *The Duty of Care Analysis Where There is No Established Duty of Care*

[86] The Supreme Court has left open the possibility that new categories of recovery for pure economic loss or duties of care might emerge.

[87] Where the case does *not* fall within an established duty or a duty analogous thereto, the court must (just as in the case of an established duty of care) satisfy itself that (a) there is a proximate relationship and (b) that the risk of injury is foreseeable: *Livent*, at paras. 29-32. If so, a *prima facie* duty of care will be established.

[88] To determine whether a close and direct relationship exists, the court must examine all relevant factors arising from the relationship between the plaintiff and defendant. While the factors are diverse and depend on the circumstances of each case, they include factors such as expectations, representations, and the property or other interests involved as well as any statutory obligations. In the case of a duty of care falling within the category of negligent misrepresentation or negligent

performance of a service, two factors are determinative in the proximity analysis: the defendant's undertaking and the plaintiff's reasonable reliance: *Livent*, at paras. 29-30.

[89] Once a *prima facie* duty of care is established, the court must go on to consider whether there are residual policy reasons that would negate the imposition of a duty of care: *Livent,* at paras. 37-45; *Cooper,* at para. 30.

[90] The question is whether, despite the proximate relationship and the reasonable foreseeability of the plaintiff's injury, the defendant should nonetheless be insulated from liability. This inquiry is concerned with the effect of recognizing a duty of care on other legal obligations, the legal system, and society more generally. The court will consider policy objectives that suggest that this duty of care ought not to be recognized, including the existence of other remedies and concerns about creating unlimited liability to an unlimited class: *Livent*, at paras. 37-41.

(3) Application of the Legal Framework for Negligence to the Facts in this Case

[91] In determining whether it is plain and obvious that Mr. Wright's statement of claim discloses no reasonable cause of action in negligence, the facts as stated in the statement of claim are assumed to be true.

[92] The first question to be answered is whether the claim falls within a previously established category of claim for pure economic loss and a duty of care thereunder.

(i) Negligent Supply of Shoddy Goods

(a) Is there a Recognized Claim for Breach of the Duty of Care?

[93] Mr. Wright suggests that this case fits within the established category of cases for pure economic loss resulting from the negligent supply of shoddy goods. Mr. Wright pleads that, like the provider of shoddy physical goods, Horizons inflicted economic devastation on the Class by developing and promoting a Fund that was negligently designed. Unit purchasers were not told of all of the risks of investing in the Fund or how the pricing mechanism worked. When the inevitable happened, they lost all or substantially all of the value of their Units.

[94] The Supreme Court first allowed a claim for pure economic loss for the negligent supply of shoddy goods/structures in *Winnipeg Condominium Corporation No. 36 v. Bird Construction Co.*, [1995] 1 S.C.R. 85. It approved a subsequent purchaser's claim against a building contractor for economic loss resulting from the negligent supply of dangerous and shoddy structures. When a portion of the building's stone cladding fell off, the plaintiff determined that there

was a risk that other portions of the cladding could fall off and injure someone. The plaintiff incurred substantial costs to replace the cladding, which the Supreme Court held were, in principle, recoverable if they were the foreseeable result of the defendant's negligence.

[95] However, *Winnipeg Condominium* did not address whether pure economic loss arising from the negligent supply of a shoddy good is recoverable absent a dangerous physical defect.

[96] In the later decision of *Arora*, Hoy A.C.J.O. held, at para. 83, that "the Supreme Court carefully left the issue of whether there should be no recovery for pure economic loss where goods are shoddy, but not dangerous, for another day." See also Feldthusen, *Economic Negligence*, at p. 195.

[97] The court in *Arora* rejected the claim for pure economic loss resulting from the provision of alleged shoddy but non-dangerous washing machines. Hoy A.C.J.O. observed that "the appellants' economic loss claim is for diminution in value – that is, the difference in value between the product they thought they were getting and the one they actually received": *Arora,* at para. 96. She held that the claim had no reasonable prospect of success and dismissed the appeal from the

certification judge’s decision to deny certification of the proposed class action on the basis that the pleadings did not disclose a cause of action.

[98] In light of this case law, I agree with the certification judge that this case does not fall within the established category of recovery for pure economic loss for the negligent supply of shoddy goods or any established duty within that category.

[99] I will now address the appellant’s main argument: Horizons negligently performed a service.

(ii) Negligent Performance of a Service

(a) Is there a Recognized Claim for Breach of the Duty of Care?

[100] Mr. Wright submits that the certification judge erred in concluding that the claim did not fall within any recognized duty within the category of cases for negligent performance of a service. The certification judge held that there was no precedent for the scope of the duty alleged by Mr. Wright.

[101] Mr. Wright claims this case is analogous to the claim in *Cannon v. Funds for Canada Foundation,* 2012 ONSC 399, 13 C.P.C. (7th) 250, leave to appeal refused, 2012 ONSC 6101, 112 O.R. (3d) 641 (Div. Ct.).

[102] In *Cannon*, at paras. 155-60, and 169-77, Strathy J. (as he then was) held that there was a reasonable cause of action against the creators and promoters of a tax avoidance program that the participants alleged was “negligently designed and … did not work” when they were told that it would. In particular, he held, at para. 177, that:

> Accepting these allegations as true for the purposes of the s. 5(1)(a) test, Appleby as a creator of the Gift Program arguably owed a duty of care to a prospective donor to ensure that the program would work and that the donor would receive a valid charitable donation receipt in return for his or her gift. I conclude that there is a properly pleaded cause of action against Appleby for negligence.

[103] The claim was allowed to proceed against one of the creators of the scheme even though the creator had no direct contractual relationship with investors: *Cannon*, at paras. 173-77, 245.

[104] In my view, this case is analogous to *Cannon*. As in *Cannon*, Mr. Wright alleges that Horizons:

- Created the Fund for investment;
- Earned monies from the promotion and management of the Fund; and
- Undertook to provide a financial product that was suitable for investors.

[105] There is arguably, therefore, a relationship of proximity between Horizons and the Class. Horizons undertook to create and sell a Fund that was suitable for some investors and, on the pleading as drafted, it was not.

[106] Read generously, the pleading provides that investors were not given sufficient information about the nature and extent of the risks and possible rewards to enable them to make an informed decision as to whether to invest, nor were they told that there was a design flaw and that the investment was doomed to fail. Without this information, the undertaking to provide a risky but viable investment was not met, and the risk of injury flowing from producing a product doomed to fail was reasonably foreseeable.

[107] For these reasons, Mr. Wright has a reasonable prospect of demonstrating that the claim falls within a recognized duty of care under the category of negligent performance of a service. As such, it is not clear that the claim discloses no reasonable cause of action in negligence.

(b) Is there a Novel Claim for Breach of the Duty of Care?

[108] In the event I am wrong and this claim for negligent performance of a service does not fall within a recognized duty of care, I will consider whether on the facts

pleaded, a novel claim for economic loss resulting from the negligent performance of a service should be allowed to proceed.

[109] Where there is no recognized duty, the first step is to determine whether there is a proximate relationship between the parties resulting from the defendant's undertaking that invites the plaintiff's reasonable reliance. If so, the defendant becomes obligated to take reasonable care: *Livent*, at para. 30. The proximity analysis includes an examination of "'expectations, representations, reliance, and the property or other interests involved' as well as any statutory obligations": *Livent*, at para. 29 (citations omitted).

[110] In this case, the certification judge correctly determined that there is a legally proximate relationship between the Class of ETF investors and Horizons as ETF fund developer and manager, and that the critical issue is the scope of the undertaking assumed by the fund developer and manager.

[111] However, the certification judge held that "Horizons' [only] undertaking was to place on the exchange a financial product that operated in accordance with the accompanying disclosure documents." In response to Mr. Wright's claim that Horizons breached a duty of care not to develop and market an ETF that was too risky for the retail investment market, the certification judge held that Horizons "did

not undertake responsibility for any gains or losses purchasers might realize in purchasing the units." He concluded that "Horizons cannot be liable for a risk of injury against which it did not undertake to protect."

[112] I disagree. In my view, Horizons' undertaking was broader than the undertaking that the certification judge described.

[113] Horizons, as the Fund manager, undertook to its investors to act honestly, in good faith and in the best interests of the investment fund and exercise the degree of care and diligence that a prudent person would exercise in the circumstances as provided for in s. 116 of the *Securities Act.*

[114] Assuming the allegations in the pleading are proven, Horizons created a Fund that was not suitable for *any* investors because the design flaw rendered it doomed to fail. Moreover, Horizons failed to disclose key features of the Fund's design and trading strategy so that investors would know the real risks before investing. The Fund managers arguably failed to meet their undertaking to investors and the risk of injury was reasonably foreseeable.

[115] The failure to provide full disclosure of the risks and/or the fact that the product was doomed to fail and the Fund manager's failure to develop a viable strategy for the Fund might constitute a breach of a *prima facie* duty of care and/or

a breach of the fund managers' statutory duties as set out in s. 116 of the *Securities Act*: *Growthworks WV Management Ltd. v. Growthworks Canadian Fund Ltd*., 2018 ONSC 3108, at paras. 221 and 321.

[116] It is not plain and obvious that policy considerations should negate the alleged *prima facie* duty of care. The risk of loss cannot be addressed by contract because this was not a vendor-purchaser relationship. Nor, on the claim as pleaded, can it be addressed by insurance, or due diligence by Class members. Moreover, it does not seem apparent that imposing a duty would create liability toward an indeterminate number of persons. Allowing the claim might cause fund managers like Horizons to exercise caution and control in designing investment products and ensure that all material facts are provided to investors.

[117] I also note that on a certification motion, as on a motion to strike, the certification judge is not to assess whether the claim can withstand summary judgment or a trial on the basis of the material adduced on the motion, but only whether the pleadings contain some radical defect such that there is no reasonable prospect of success: *Hunt*, at p. 980. The courts must "err on the side of permitting a novel but arguable claim to proceed to trial": *Imperial Tobacco*, at para. 21. A full evidentiary record that includes information about how the Fund was structured,

the risks associated with investing in the Fund, the responsibilities of the Fund manager and other evidence may assist in determining the merits of the claim. As pleaded, it is not clear that the claim cannot succeed.

[118] For these reasons, I would not agree that the negligence claim should be struck as having no reasonable prospect of success. The certification judge erred in concluding that the statement of claim discloses no reasonable cause of action for the negligent performance of a service.

B. The Claim under s. 130 of the *Securities Act*

[119] Mr. Wright claims the prospectus misrepresented how the Fund operated and the nature of the risks involved, and that these misrepresentations attract a remedy under s. 130 of the *Securities Act*. Mr. Wright makes no common law negligent misrepresentation claim.

[120] Horizons agrees a claim for prospectus misrepresentation can be brought but says the certification judge was correct in holding that the claim must be brought pursuant to s. 138.3, not s. 130, of the *Securities Act*.

(1) The Certification Judge's Decision

[121] The certification judge accepted that "there is and should be a statutory cause of action for misrepresentation in the selling of ETFs" but held that the claim

should be brought under s. 138.3 of the *Securities Act* (which provides a statutory cause of action for misrepresentations for purchasers who acquire securities on the secondary market), not s. 130 (which provides a statutory cause of action for misrepresentations in a prospectus for funds distributed on the primary market). He dismissed the certification motion for a claim under s. 130 without prejudice to Mr. Wright's ability to commence a proposed class action relying on s. 138.3 of the *Securities Act* and to seek leave to assert that cause of action.

[122] The certification judge recognized that sales of ETF Creation Units are primary market sales. However, he noted that all other Fund units are connected to the secondary market and that Creation Units are comingled with those other units. As a result, an ETF purchaser cannot know whether his or her purchase involves a primary sale of a Creation Unit or a resale in the secondary market. He therefore held that "[p]ractically speaking", trading in ETFs is a secondary market phenomenon because units are made available for sale over an exchange, the purchase price is paid to the unitholder not the issuer, and the terms of sale are dictated by the secondary market.

[123] He also held that a trade in ETF units does not qualify as a "distribution" within the meaning of the *Securities Act*:

> They are not securities "offered by the prospectus" in that the 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 not 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.

[124] He concluded that, from a policy perspective, it would be "odd and inconsistent with the overall balanced design of the [*Securities Act*] to treat the trading of ETFs, which are so closely associated with the secondary market, as outside the operation of [s. 138.3] and within the operation of [s. 130]."

[125] The certification judge therefore held that all ETFs should be regulated as a secondary market phenomenon.

(2) The Legal Framework

(a) *Purposes of the Securities Act*

[126] One of the underlying purposes of the *Securities Act* is "the protection of the investing public through full, true and plain disclosure of all material facts relating to securities being issued": *Pacific Coast Coin Exchange v. Ontario Securities Commission*, [1978] 2 S.C.R. 112, at p. 126, citing *Re Ontario Securities*

Commission and Brigadoon Scotch Distributors (Canada) Limited, [1970] 3 O.R. 714, at p. 717.

[127] With some exceptions, the *Securities Act* requires companies to file a prospectus before engaging in a trade in a security that qualifies as a "distribution". The statutory definition of distribution under s. 1(1) of the *Securities Act* captures "that moment of initial distribution when a security first becomes available *to the public*, thereby triggering the disclosure obligations designed to protect investors": David Johnston, Kathleen Rockwell, and Cristie Ford, *Canadian Securities Regulation*, 5th ed. (Toronto: LexisNexis Canada, 2014), at 5.7 (italics in original).

[128] The prospectus must make "full, true and plain disclosure of all material facts relating to the securities issued or proposed to be distributed": *Securities Act,* s. 56(1). Thereafter, companies must meet continuous disclosure obligations under Part XVIII of the *Securities Act*.

(b) *Sections 130 and 138.3 of the Securities Act*

[129] Sections 130 and 138.3 of the *Securities Act* enhance the common law by providing statutory causes of action for misrepresentations that affect the value of securities purchased.

[130] Section 130 provides a statutory cause of action for misrepresentations in a prospectus for funds distributed on the primary market: *Tucci v. Smart Technologies Inc,* 2013 ONSC 802, 114 O.R. (3d) 294, at paras. 21, 40. Section 130 in Part XXIII provides that:

> 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,
>
> (a) the issuer or a selling security holder on whose behalf the distribution is made…

[131] Section 138.3 provides a statutory cause of action for misrepresentations for purchasers who acquire securities on the secondary market: *Sharma v. Timminco Limited*, 2012 ONCA 107, 109 O.R. (3d) 569, at paras. 7-8, leave to appeal refused, [2012] S.C.C.A. No. 157. Section 138.3 in Part XXIII.1 provides that:

> 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; …

[132] Section 138.3 provides fewer remedies to investors than s. 130. Unlike s. 130, s. 138.3 includes a damages cap of the greater of 5% of the issuer's market capitalization or $1 million for a responsible issuer, and a loser pays costs rule: *Securities Act,* ss. 138.1, 138.7, and 138.11. Moreover, a plaintiff who brings a claim pursuant to s. 138.3 must first obtain leave to commence an action, unlike a plaintiff who commences an action under s. 130: *Securities Act,* s. 138.8(1).

[133] As such, there are distinct advantages to pursuing a claim under s. 130 rather than s. 138.3 of the *Securities Act*.

[134] Both sections enhance the remedies available to investors under the common law. The common law tort of negligent misrepresentation requirements are as follows:

a. There must be a duty of care based on a "special relationship" between the representor and the representee;
b. The representation must be untrue, inaccurate, or misleading;
c. The representor must have acted negligently in making the representation;
d. The representee must have relied, in a reasonable manner, on the negligent misrepresentation; and
e. The reliance must have been detrimental to the representee in the sense that damages resulted.

Queen v. Cognos Inc., [1993] 1 S.C.R. 87, at p. 110.

[135] While at common law plaintiffs must demonstrate reasonable reliance, plaintiffs who proceed with a claim for statutory misrepresentation are not required to demonstrate reliance in order to recover damages: *Securities Act,* ss. 130(1), 138.3(1).

(c) *How the Fund Was Distributed*

[136] 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. These units come from other holders or from the inventory of ETF units held by a designated broker or dealer. A designated broker or dealer will issue a unit from its inventory of units, if any, or they will make a subscription order to the ETF manager, who will create a brand-new unit, a “Creation Unit”.

[137] An investor who purchases an ETF unit over an exchange does not know when purchasing a unit whether he or she is receiving a Creation Unit or an ETF unit that has been in circulation previously on a stock exchange (in the secondary market). It is not clear from the certification judge’s findings whether Horizons or anyone else is able to determine whether a particular unit is a Creation Unit.

[138] As described by the certification judge, ETFs are regulated on the understanding that the sale of a Creation Unit is a distribution within the meaning of s. 1(1) of the *Securities Act*:

> 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.
>
> 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.

[139] This position was reflected in the 2014 amendments to the *Securities Act.* Sections 71(1) to (1.3) recognize that the sale of Creation Units constitutes a “distribution” that would otherwise require dealers to deliver a prospectus to purchasers under s. 53(1) but exempt them from having to do so. Dealers are instead permitted to provide investors with a summary document called an ETF

facts document: *Securities Act,* ss. 71(1.1)-(1.3); National Instrument 41-101 – *General Prospectus Requirements*, ss. 3C.2(5)-(6).

(d) *Analysis of the Certification Judge's Decision on the Claim for Prospectus Misrepresentation*

[140] The allegation in the statement of claim is that the Units were distributed by a prospectus that contained misrepresentations. Moreover, since the Fund was continuously distributed, each Class member qualifies as a "purchaser who purchases a security offered by the prospectus during the period of distribution or during distribution to the public" within the meaning of s. 130 of the *Securities Act*.

[141] The parties and the certification judge agreed that there is a statutory cause of action for misrepresentation in an ETF prospectus. The only question is whether the Class may proceed by way of a claim pursuant to s. 130 or whether the Class must proceed by way of s. 138.3.

[142] For the reasons that follow, I disagree with the certification judge's conclusion that all units held by the Class should be treated as secondary market purchases such that only s. 138.3 applies. I agree with the appellant that the certification judge erred in his analysis of the requirements of s. 130 but would

require that the representative plaintiff amend the statement of claim to plead the necessary material facts.

[143] First, Creation Units are considered by the *Securities Act* to be primary market units and owners of those units should be entitled to invoke their rights thereunder. Disclosure documents for Creation Units are incorporated by reference into the prospectus and investors who purchased those Units qualify as purchasers of a security offered by the prospectus during the period of distribution or during distribution to the public within the meaning of s. 130 of the *Securities Act*. Moreover, a resale of a Creation Unit by a designated broker or dealer to an investor qualifies as a "distribution" under the *Securities Act*, because "distribution" includes a purchase and sale of a security that has not been previously issued "in the course of or incidental to a distribution": *Securities Act*, s. 1(1).

[144] Second, denying holders of Creation Units the right to proceed pursuant to s. 130 would deny them the advantages of proceeding by way of s. 130 and would require the Class to seek leave of the court to proceed with a claim under s. 138.3 when holders of Creation Units are eligible to proceed under s. 130 where no leave is required.

[145] Third, the fact that Creation Units are comingled with other ETF Units purchased by the designated broker and dealers in the secondary market should not disentitle holders of Creation Units from invoking their rights under s. 130 of the *Securities Act*.

[146] The Class was not responsible for the way funds are distributed and had no control over what kind of unit they were receiving. At this stage in the proceeding, Class members do not know, through no fault of their own, whether a purchase involved a primary or secondary market sale. This should not be a reason for denying them the right to seek the relief to which they are entitled. It is not clear from the certification judge's findings whether Horizons or anyone else can distinguish between sales of Creation Units and other units. This issue will be canvassed in the course of the litigation including the determination of the best means of addressing this issue, taking into account that some members hold Creation Units and others do not.

[147] Fourth, permitting Mr. Wright to plead a cause of action under s. 130 does not unduly expand the scope of who may recover under that section. At this stage, it is unclear which or how many Class members purchased Creation Units. However, the statutory cause of action under s. 130 ultimately will not apply to

Class members who purchased Fund units that had previously circulated on the secondary market. Investors who purchased securities on the secondary market must seek leave to bring a claim pursuant to Part XXIII.1, section 138.3 of the *Securities Act* if the prospectus contains a misrepresentation. Section 138.3(1) (under Part XXIII.1) extends a remedy to any purchaser alleging a misrepresentation in a document, with different burdens of proof depending on whether the document is a “core document”, which includes a prospectus, or any other document: *Securities Act*, ss. 138.1, 138.4(1).

[148] It would upset the “delicate balance” struck by the legislature to allow all Class members to bypass the requirements of Part XXIII.1 and proceed under s. 130 when only some are entitled to a remedy under that provision: *Canadian Imperial Bank of Commerce v. Green*, 2015 SCC 60, [2015] 3 S.C.R. 801, at para. 69, *per* Côté J. The “limits built into the scheme” of Part XXIII.1 are deliberate and are carefully calibrated to balance the interests of various market participants: *Green,* at para. 69.

[149] While this conclusion creates a somewhat artificial distinction between Class members as none of them knew whether they were purchasing a Creation Unit or a unit which had previously circulated on the secondary market, this interpretation

is consistent with the manner that ETFs are distributed and regulated, as well as the wording of s. 130 itself.

[150] However, I accept that Mr. Wright has not pled the material facts necessary to establish that he has a cause of action under s. 130 as he did not plead that he purchased one or more Creation Units. Under s. 5(1)(a), the representative plaintiff must have a reasonable cause of action against the defendant: *Darmar*, at paras. 37-38, citing *Taylor v. Canada (Attorney General)*, 2012 ONCA 479, 111 O.R. (3d) 161, at para. 21.

[151] As a result, I conclude that the statement of claim discloses no reasonable cause of action under s. 130 but grant leave to amend the statement of claim to allow Mr. Wright to assert that he is a holder of a Creation Unit and is entitled to a remedy under s. 130. Based on the certification judge's findings, it is clear some Class members were holders of Creation Units and Mr. Wright may be a holder of a Creation Unit: *Lawrence v. Atlas Cold Storage Holdings Inc.* (2006), 34 C.P.C. (6th) 41 (Ont. S.C.). The certification judge's order was made "without prejudice to [Mr. Wright] commencing a proposed class action relying on Part XXIII.1 of the Ontario *Securities Act,* R.S.O. 1990, c. S.5 and seeking leave to assert that statutory cause of action."

5. DISPOSITION

[152] I allow the appeal in part on the basis that the statement of claim discloses a reasonable cause of action in negligence. I further hold that there is no reasonable cause of action under s. 130 as pleaded but would allow the appellant leave to amend the statement of claim to assert that he is a holder of a Creation Unit and is entitled to a remedy under s. 130. The certification judge's order is set aside save for the order providing that it is "without prejudice to [Mr. Wright] commencing a proposed class action relying on Part XXIII.1 of the Ontario *Securities Act*, R.S.O. 1990, c. S.5 and seeking leave to assert that statutory cause of action." I would remit the matter to the certification judge to determine whether the remaining criteria for certification are met.

[153] Partial indemnity costs are awarded to the appellant in the amount of $35,000, inclusive of HST and disbursements, as agreed by the parties.

Released: June 1, 2020

Thorburn J.A.

I agree P. Lauwers J.A.

I agree. J.A.