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Celestini v. Shoplogix Inc. - Court of Appeal for Ontario Upholds Use of “Changed Substratum” Doctrine to Invalidate Termination Provision

Alessandra Fusco

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In *Celestini v. Shoplogix Inc.,* 2023 ONCA 131, the Court of Appeal for Ontario (ONCA) held that if an employee’s terms and conditions of employment have materially changed since the employment agreement was signed, the employment agreement may no longer be enforceable. This decision provides valuable insight into the changed substratum doctrine and serves as a reminder for employers to assess and update employment agreements in the event of a significant change in an employee’s duties.

What is the “Changed Substratum” Doctrine?

A well-drafted employment agreement will have terms that provide certainty to the parties. From an employer’s perspective, one of the most important terms is a termination provision limiting the amount of notice an employee is entitled to upon termination of employment. However, the changed substratum doctrine provides that such contractual terms may not be enforceable if, over time, the employee’s responsibilities and status have significantly changed. In these types of situations, the employment agreement is said to be obsolete, or the “substratum” (the foundation) of the employment contract is said to have disappeared.

It is important to note that the employment agreement may still override the changed substratum doctrine if the agreement expressly provides that its provisions (such as its termination provisions) continue to apply even if the employee’s position, responsibilities, or benefits change.

Factual Background

Mr. Celestini was a co-founder and originally the Chief Executive Officer of Shoplogix. In 2005, a venture capital firm purchased Mr. Celestini’s shares in the company. In connection with this transaction, Mr. Celestini stepped down as the CEO and became Shoplogix’s Chief Technology Officer instead. Mr. Celestini signed a written employment contract in this capacity dated May 17, 2005 (the Employment Agreement) which, among things, provided as follows:

1. Celestini would be employed as CTO and would report directly to the CEO.

2. Celestini would carry out the duties of the office of CTO as set out in Shoplogix's by-laws and as directed by the CEO, subject to the overall direction of the board and "consistent with such office."

3. Celestini would perform any other duties reasonably assigned to him by the CEO or the board.

The termination provision in the Employment Agreement stated that Shoplogix could terminate Mr. Celestini's employment without cause upon providing him with: (i) one month's written notice; and (ii) continuing to pay his base salary and provide his group health insurance benefits for twelve months from the date of termination. Mr. Celestini was also entitled to a bonus payment, pro-rated based on the date of termination.

In 2008, Mr. Celestini and Shoplogix entered into an Incentive Compensation Agreement (ICA), a bonus plan aimed at rewarding employees at the management level. The ICA significantly increased Mr. Celestini's compensation from the 2005 Employment Agreement. The ICA also introduced new eligibility criteria and Mr. Celestini's target bonus increased from $125,000 under his Employment Agreement to $175,000 under the ICA. When entering into the ICA, Shoplogix did not refer to Mr. Celestini's Employment Agreement.

Upon the appointment of a new CEO at Shoplogix, several changes were implemented, including a reduction in the number of senior management personnel. This resulted in a significant increase in Mr. Celestini's workload and responsibilities. Managers and senior staff were now required to report to Mr. Celestini. Before, Mr. Celestini did not have to travel as CTO, but, due to his increased responsibilities, he was now required to travel in order to establish international sales. In addition, he was tasked with overseeing all of the company's infrastructure, managing certain aspects of sales and marketing, as well as seeking out and attracting potential investors to provide financial support. In 2016, Mr. Celestini's base salary increased substantially from $300,000 to $518,850.

In 2017, Shoplogix's shares were acquired by another company. Mr. Celestini's employment was terminated without cause. In accordance with the termination provision of the 2005 Employment Agreement, Shoplogix provided Mr. Celestini with his contractual entitlements, including a pro-rated bonus accrued up to the date of termination.

Mr. Celestini brought an action for wrongful dismissal. He took the position that the termination provision in his Employment Agreement was not enforceable, as a result of the significant changes to his employment duties since 2005. Accordingly, he argued that the foundation of the Employment Agreement had been substantially eroded and that he was entitled to common law damages for wrongful dismissal.

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The Motion Judge's Decision

The motion judge granted summary judgment in favour of Mr. Celestini, finding that Mr. Celestini's duties had changed "substantially and fundamentally over the course of his employment," despite the fact that Mr. Celestini's job title as CTO remained the same. As CTO, Mr. Celestini's role had fundamentally changed under the new CEO's leadership causing the foundation of the Employment Agreement to become obsolete. The motion judge noted that Shoplogix had also failed to obtain an acknowledgement from Mr. Celestini that the Employment Agreement remained in force while the changes were occurring.

Shoplogix pointed to the language at section 1.4 of the Employment Agreement, which stated that Mr. Celestini was required to perform duties that were reasonably assigned to him. In rejecting this argument, the motion judge found that the language of the Employment Agreement did not expressly provide that it would continue to apply notwithstanding *any* changes in Mr. Celestini's responsibilities.

Mr. Celestini was awarded an additional six months of salary and benefits, which amounted to an 18-month notice period. He was also awarded his car allowance and bonus entitlements over an 18-month notice period. The 18 months bonus award was reduced by the amount for the accrued bonus that Shoplogix had already paid to Mr. Celestini upon termination of his employment.

The Court of Appeal for Ontario's Decision

Shoplogix appealed the decision and argued that the motion judged improperly applied the changed substratum doctrine. The ONCA rejected this argument and found in favour of Mr. Celestini. On cross-appeal, Mr. Celestini argued that the motion judge erred when he deducted the bonus payment that Shoplogix paid to Mr. Celestini upon termination of employment from his damages award. The ONCA agreed in part.

In its appeal, Shoplogix made two main arguments. First, Shoplogix argued Mr. Celestini's role as CTO had not fundamentally changed. Shoplogix noted that Mr. Celestini had retained the same title and seniority status since 2005. Shoplogix argued that the changed substratum doctrine does not apply to employees who have always held an executive role, claiming that the doctrine requires not only a significant expansion of the employee's responsibilities, but also a promotion which entails a change in the employee's job title.

Second, Shoplogix argued that the changes to Mr. Celestini's duties were incremental, and therefore they were not sufficiently dramatic to justify invalidating the Employment Agreement.

The ONCA rejected both of Shoplogix's arguments and held that a change in the employee's title was not required for the changed substratum doctrine to apply. The ONCA also rejected the idea that the changed substratum doctrine only applies to employees in non-executive roles. The ONCA also agreed with the motion judge's findings that Mr. Celestini's duties had changed substantially and fundamentally over the course of his employment.

Finally, the ONCA held that the motion judge was correct in finding that the Employment Agreement "did not feature a term which expressly stated that its terms continue to apply notwithstanding any changes to Mr. Celestini's responsibilities, which otherwise may have averted the application of the substratum doctrine in this case."[1]

Takeaways

This decision provides a useful reminder for employers to review and revise their employment agreements when there is a significant change to an employee's duties and responsibilities, compensation, reporting structure, or duties. The decision also highlights that a change in an employee's title is not required for the changed substratum doctrine to apply to an employment agreement: a significant change in an employee's duties and responsibilities can still trigger the operation of the doctrine. In order to help avoid the application of the changed substratum doctrine, employers should consider including a provision that provides that the termination provision, and other key provisions, continue to apply notwithstanding any changes to the employee's responsibilities or duties.

For further information or advice on revising employment agreements, please contact a member of our Employment & Labour Group.

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[1] *Celestini v. Shoplogix Inc.,* 2023 ONCA 131 (CanLII) at para 45.