

Employers – Proceed with Caution: Ontario Court of Appeal Holds Material Changes to Employment Duties can Void Employment Agreement

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In a recent decision, the Ontario Court of Appeal (the “ONCA”) applied the changed substratum doctrine in refusing to enforce an employment agreement due to material changes in the employee’s role after the agreement was signed. As a result, an employee whose duties had substantially increased during employment was not bound by the terms of his employment contract and was entitled to over \$400,000 in damages for common law reasonable notice.

Background

In *Celestini v Shoplogix*, 2023 ONCA 131 (“*Celestini*”), the Plaintiff Mr. Celestini was hired by Shoplogix Inc. (“Shoplogix”) as Chief Technical Officer (“CTO”). He signed a written employment agreement dated May 17, 2005 (the “2005 Contract”) which stated he would perform the duties of a CTO, as set by Shoplogix’s by-laws and as specified by the CEO, as well as “any other duties that may reasonably be assigned to him by the CEO or the board.” The 2005 Contract also stated that Mr. Celestini’s employment could be terminated without cause upon provision of 12 months’ pay and benefits, including a pro-rated bonus.

In 2008, a new CEO was appointed and implemented structural changes that included reducing the number of senior management personnel at the company. Mr. Celestini took on new responsibilities which included managing aspects of sales and marketing, directing managers and senior staff, handling the company’s infrastructure responsibilities and soliciting investment funds. During the same period, Mr. Celestini and Shoplogix entered a new Incentive Compensation Agreement (“ICA”) which significantly changed his compensation.

In 2017, Shoplogix was purchased by another company and Mr. Celestini’s employment was terminated without cause. Shoplogix relied on the 2005 Contract and paid Mr. Celestini’s base salary and group health coverage for twelve months, and a pro-rated bonus.

Mr. Celestini brought an action against Shoplogix for wrongful dismissal. Relying on the changed substratum doctrine, which provides that where the material foundation, or substratum, of a written contract has fundamentally changed, the terms of that contract will not survive, he argued that fundamental changes to his employment meant the 2005 Contract was unenforceable, and he was therefore entitled to substantially higher damages at common law. Mr. Celestini brought a motion for summary judgment.

The Motion Judge’s Decision

The motion judge held in favour of Mr. Celestini, finding that Shoplogix could not rely on the 2005 Contract to limit his termination entitlements because his job duties and compensation had changed fundamentally over the course of his employment. There was no other basis to void the 2005 Contract.

The decision noted the absence of any language in the 2005 Contract stating its terms would continue to survive notwithstanding any changes to Mr. Celestini's duties; the motion judge stated such a clause may have averted the application of the changed substratum doctrine.

The motion judge awarded Mr. Celestini 18 months in common law reasonable notice, totalling damages over \$420,000. Shoplogix appealed to the ONCA, arguing the motion judge had improperly expanded the scope of the changed substratum doctrine, and improperly awarded damages.

The ONCA's Decision

On appeal, Shoplogix made two main arguments that the motion judge had erred in applying the changed substratum doctrine. First, it argued that the doctrine requires a fundamental change in duties arising specifically from a promotion and change in title. Shoplogix argued that Mr. Celestini was never "promoted" in title beyond the CTO role, so the doctrine should not apply. Second, Shoplogix argued that the changes to Mr. Celestini's duties were incremental over time, and therefore not sufficiently dramatic or fundamental to abrogate the 2005 Contract.

In rejecting the first argument, the ONCA held that a change in title is not a required element of the changed substratum doctrine. There is nothing that suggests the doctrine can only apply to an employee that began in a non-executive role. The fact an employee was given a new title is just one factor that should be considered. Rather, the changed substratum doctrine focuses on the *actual* responsibilities of the employee, and whether there were changes of a fundamental nature to those responsibilities.

the ONCA rejected Shoplogix's second argument, concluding that the motion judge's findings supported his decision to apply the changed substratum doctrine and the decision was entitled to deference. The changes to Mr. Celestini's duties and responsibilities were substantial and exceeded any predictable or incremental change.

The ONCA dismissed Shoplogix's appeal. In its decision, the ONCA echoed the motion judge by stating the application of the changed substratum doctrine may have been averted by including a clause that indicated the terms of the 2005 Contract applied notwithstanding any changes in employment duties.

Takeaways for Employers

Employers must be cognizant of the changed substratum doctrine not only when promoting employees or changing positions, but whenever an employee receives a significant change in responsibilities or compensation. When duties, responsibilities or compensation are altered in a manner that could be considered fundamental, the changed substratum doctrine presents a risk that the employee's employment agreement may become unenforceable. The result, as shown in *Celestini*, can be significant and unanticipated employee termination entitlements.

To reduce this risk, employers should follow the direction of the ONCA that employment agreements contain sufficient language that prevents the application of the changed substratum doctrine. To further avoid the wrong end of the changed substratum doctrine, employers should consider whether the parties should enter into a new employment agreement in conjunction with fundamental changes to an employee's terms of employment.

The information and comments herein are for the general information of the reader and are not intended as advice or opinion to be relied upon in relation to any particular circumstances. For particular application of the law to specific situations, the reader should seek professional advice.

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