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CHARITY & NFP LAW BULLETIN NO. 520

MARCH 28, 2023

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COURT OF APPEAL RULES OUT OF DATE EMPLOYMENT CONTRACT UNENFORCEABLE

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A. INTRODUCTION

The Court of Appeal for Ontario released its reasons for decision in the case of *Celestini v. Shoplogix Inc.*[1] on February 28, 2023. This was an appeal from the Superior Court of Justice in regard to the common law concept of "changed substratum".

Briefly, the changed substratum doctrine provides that where an employment position has fundamentally changed, the original written agreement between employer and employee should no longer apply as it does not reflect the actual role and duties of the employee. This is because an employment contract should accurately state what is expected of employees, and likewise, what employees can expect from their employer.

At common law, there is a positive duty on employers to provide reasonable notice before dismissing an employee without cause. The period of reasonable notice is determined by examining a number of factors, such as years of service, seniority, qualifications, etc. Employers and employees are free to contract out of these, provided that the statutory minimums under the *Employment Standards Act, 2000*[2] for an employee's entitlements on termination are met.

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[1] *Celestini v. Shoplogix Inc.*, 2023 ONCA 131 (CanLII) [*Celestini*].
[2] SO 2000, c 41, online: https://www.ontario.ca/laws/statute/00e41.

The changed substratum doctrine prevents an employee's rightful entitlements from being restricted via reliance on a contract that is no longer an accurate representation of their position as an employee. As the court stated in *MacGregor v. National Home Services*, the doctrine can be summarized as such:

> The changed substratum doctrine is a part of employment law. The doctrine provides that if an employee enters into an employment contract that specifies the notice period for a dismissal, the contractual notice period is not enforceable if over the course of employment, the important terms of the agreement concerning the employee's responsibilities and status has significantly changed.
>
> The idea behind the changed substratum doctrine is that with promotions and greater attendant responsibilities, the substratum of the original employment contract has changed, and the notice provisions in the original employment contract should be nullified. [Citations omitted.][3]

The doctrine can be contracted out of if proper language is included in the employment agreement.[4] Also, an explicit agreement to continue the application of the original agreement can be made by the parties.[5]

B. BACKGROUND

In the case at hand, the plaintiff/respondent, Stefano Celestini, was employed by the defendant/appellant company, Shoplogix. Mr. Celestini was the co-founder[6] and later Chief Technology Officer ("CTO")[7] of Shoplogix when he was dismissed without cause in 2017. The last employment contract which Mr. Celestini had signed was from 2005, 12 years before he was dismissed. The contract provided for 12 months' salary and group health insurance coverage, as well as a pro-rated payment for his annual bonus accrued up until termination. These provisions were intended to satisfy any claims against the company related to the termination.[8]

In the description of his position, the 2005 employment agreement stated that he was to carry out the duties of his office specified in company by-laws and by the Chief Executive Officer ("CEO"), to whom Mr.

[3] *MacGregor v. National Home Services*, 2012 ONSC 2042, at paras. 11-12.
[4] *Miller v. Convergys CMG Canada Limited Partnership*, 2013 BCSC 1589, 10 C.C.E.L. (4th) 187, at paras. 35-36.
[5] *Schmidt v. AMEC Earth & Environment et al.*, 2004 BCSC 1012, at paras. 32-33.
[6] *Celestini*, *supra* note 1 at para 9.
[7] *Ibid* at para 10.
[8] *Ibid* at para 2.

Celestini reported.[9] Practically, this included "transferring product and corporate knowledge" internally, and did not include "sales, travel, infrastructure responsibilities, or financing."[10]

In 2008, the parties entered into an Incentive Compensation Agreement ("ICA"). In doing so, Shoplogix made no mention of the 2005 employment agreement.[11] The ICA was spurred by a replacement of the CEO, as the incoming executive reduced the number of senior level employees. These changes left Mr. Celestini with an increased workload and responsibilities, which included managing the sales and marketing of the company, travelling related to sales, infrastructure management, and soliciting investments.[12]

In 2017, Shoplogix was acquired by another entity, and Mr. Celestini was dismissed the same day.[13] Mr. Celestini contested the termination payment in the 2005 contract, claiming that the substratum of the 2005 contract had eroded to the point where the last employment contract that he had signed no longer reflected this. As such, he demanded common law damages for wrongful dismissal, which substantially exceeded what he would be entitled to under the 2005 contract due to his age, seniority, length of service, and other factors.[14]

C. THE MOTION

On a motion for summary judgment, the motion judge found that the 2008 ICA substantially changed Mr. Celestini's position at Shoplogix. The role which he played from 2008 onward "far exceeded any predictable or incremental changes to his role that reasonably would have been expected when he started as CTO in 2005".[15] The substantial increase in pay was a key factor in demonstrating that Mr. Celestini was doing substantially more after the ICA was signed.

[9] *Ibid* at para 12.
[10] *Ibid* at para 14.
[11] *Ibid* at para 15.
[12] *Ibid* at para 16.
[13] *Ibid* at para 17.
[14] *Ibid* at para 3.
[15] *Ibid* at para 20.

The 2005 agreement was found to notably lack any provision stating that it would continue to apply even if Mr. Celestini's responsibilities changed. As such, Shoplogix's reliance on a provision stating that he had to perform duties "reasonably assigned to him" was ineffective.[16]

The motion judge ruled in favour of Mr. Celestini. He agreed that the substratum of the 2005 agreement had changed substantially, and therefore the notice provisions in that contract were no longer enforceable. It was determined that 18 months' notice was reasonable due to the factors of Mr. Celestini's employment, and he was awarded with an additional 6 months' pay, bonuses, car allowance entitlements, and life insurance benefits, all of which totaled $421,043.05.[17]

Shoplogix appealed, claiming that the motion judge incorrectly applied the doctrine of changed substratum, and that the 2005 contract was still valid at the time of Mr. Celestini's dismissal.[18] Mr. Celestini cross-appealed, arguing that the motion judge erred in deducting the bonus payment which he received upon termination.[19]

D. THE APPEAL

Shoplogix argued that the motion judge made two inaccurate applications of the substratum doctrine. It argued that the doctrine could not be applied to an executive, and further, that it could not be applied to an executive whose title did not change, as this executive was still employed in the same position specified in their original contract.[20] Secondly, it argued that the changes to Mr. Celestini's positions were gradual and incremental enough to not invalidate the 2005 agreement.[21]

The first argument was rejected because it relied on a misunderstanding of the substratum doctrine.[22] The court recognized that the doctrine can be applied to executive level employees, and that there was no legal basis to support this suggestion.[23]

[16] *Ibid* at para 21.
[17] *Ibid* at para 4.
[18] *Ibid* at para 5.
[19] *Ibid* at para 6.
[20] *Ibid* at para 27.
[21] *Ibid* at para 28.
[22] *Ibid* at para 29.
[23] *Ibid* at para 39.

Shoplogix's position on the lack of a change in title was based off of a quote from *Rasanen v. Lisle-Metrix Ltd.*[24], wherein the court stated, "It is interesting to note that in virtually every case where a Canadian court has concluded that the substratum of the employment contract had disappeared, this resulted from a significant promotion of the employee, and not a demotion."[25] The court in *Celestini* found that the facts in *Rasanen* were not analogous. In that case, the plaintiff employee was arguing for changed substratum to be applied following a reduction of duties in the workplace, which was rejected. Mr. Celestini was given expanded duties and responsibilities; the question of his title was only "one contextual factor" in determining the degree to which his role at the company had changed.[26]

The second argument was rejected because it was "inconsistent with the motion judge's conclusions of mixed fact and law which are entitled to deference."[27] The court went on to say that, "It is not the role of this court to retry the case."[28]

Shoplogix's final argument was that "the motion judge erred in failing to find that the ICA ousted Mr. Celestini's bonus entitlement over the reasonable notice period", and that upon the termination of Mr. Celestini, they had addressed the issue by limiting it to the amount unpaid to the date termination.[29] The motion judge determined the ICA bonus he would have earned during the notice period was included in the owed damages as well.

The appellate court affirmed the motion judge's decision.[30] It found that the two-part test used by the Supreme Court in determining bonuses at termination in *Matthews v. Ocean Nutrition Canada Ltd.*[31] was properly applied.[32] This two-part test asks two questions:

> (1) would the employee have been entitled to the bonus or benefit as part of their compensation during the reasonable notice period?; and

[24] *Rasanen v. Lisle-Metrix Ltd.* (2002), 2002 CanLII 49611 (ON SC), 17 C.C.E.L. (3d) 134 (Ont. S.C.).
[25] *Ibid* at para 40.
[26] *Celestini*, *supra* note 1 at para 40.
[27] *Ibid* at para 29.
[28] *Ibid* at para 44.
[29] *Ibid* at para 47.
[30] *Ibid* at para 50.
[31] *Matthews v. Ocean Nutrition Canada Ltd.*, 2020 SCC 26, 449 D.L.R. (4th) 583 [*Matthews*].
[32] *Celestini*, *supra* note 1 at para 51.

> (2) if so, do the terms of the employment contract or bonus plan unambiguously take away or limit that common law right?[33]

The motion judge was correct in determining that Mr. Celestini was entitled to the bonus during the reasonable notice period, and that there was no reasonable basis to infer that the terms of the ICA limited this common law right. The only limitation in the agreement was dismissal for cause, which was not the case in Mr. Celestini's termination.[34]

Related to the calculation of the bonus, Shoplogix submitted that the motion judge was incorrect to average Mr. Celestini's bonuses from the three prior years to determine what he was owed on dismissal.[35] The appellate court stated that barring a substantial error by the lower court, decisions regarding bonuses are to be given significant deference,[36] and that there is no specific rule regarding the calculation of bonuses for damage awards.[37] Further, Shoplogix did not provide convincing evidence to support the calculation of the bonus which they offered Mr. Celestini upon termination.[38]

On cross-appeal, Mr. Celestini argued that the motion judge was incorrect to deduct his $50,554.44 bonus payment, paid upon dismissal, from the damage award, claiming that this bonus corresponded with the bonus entitlement period before he was terminated, while the damages that the motion judge calculated were related to the 18 months following his dismissal.[39]

The court agreed in part with Mr. Celestini. The motion judge should have not deducted the entirety of the bonus payment which Shoplogix had made from his damages. Shoplogix had an obligation to pay Mr. Celestini up until his termination, and then a second obligation to pay a bonus for the notice period. Their payment of the first obligation did not reduce what it owed on the second obligation, absent an overpayment.[40]

Shoplogix argued against this, claiming that the deduction of the entire payment from the damages was fair. The court found that they were obliged to pay both up until termination and during the notice period,

[33] *Matthews*, *supra* note 30 at para 52.
[34] *Celestini*, *supra* note 1 at para 55.
[35] *Ibid* at para 57.
[36] *Ibid* at para 58.
[37] *Ibid* at para 59.
[38] *Ibid* at para 60.
[39] *Ibid* at para 62.
[40] *Ibid* at para 63.

as per the ICA which, unlike the 2005 employment agreement, was still in force.[41] However, Shoplogix argued in the alternative that a smaller deduction was justified, because the payment made at the time of dismissal was calculated as per the 2005 contract, not using the three-year averaging imposed by the motion judge. If the motion judge had used the provision in the ICA to calculate this instead, it would entitle Mr. Celestini to $13,365.83 less than he had been awarded. This overpayment, Shoplogix argued, should have been reduced from the damages owed.[42] This argument was accepted by the court.[43]

In total, the cross-appeal increased the damages owed to Mr. Celestini by $37,188.61, factoring in the reduction from damages for overpayment.[44]

In conclusion, the court dismissed the appeal, stating that the appellants did not identify any errors which justified the granting of an appeal.[45]

E. CONCLUSION

This decision is instructive for employers, including charities and not-for-profits, concerning the need to keep employment contracts up to date, especially in situations where an employee has been promoted or where their original duties have changed substantially. To avoid the potential application of the "changed substratum" doctrine, it may be advisable to enter into a revised employment contract, which clearly provides additional consideration to the employee in exchange for the signing of a revised contract.

[41] *Ibid* at para 68.
[42] *Ibid* at para 69.
[43] *Ibid* at para 70.
[44] *Ibid* at para 73.
[45] *Ibid* at para 7.