

# Daily Journal

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## Mediating executive termination disputes

**Executive terminations carry unique risks for both companies and individuals, but a skilled mediator can help parties navigate tax strategies, restrictive covenants and creative solutions to reach confidential resolutions that protect business interests while securing favorable outcomes for departing executives.**

By Mark Zemelman

**T**he involuntary termination of a corporate executive, particularly where the executive believes that the termination is wrongful, involves risks for the company and the individual that differ from typical non-voluntary employee separations. The company's risk is that the executive may possess intimate knowledge of the company's business strategy, competitive weaknesses and sensitive information that it would like to keep from competitors, regulators and the public. The executive's risk is that a formal termination or public dispute could impair his or her ability to obtain subsequent employment.

Both parties thus have an interest in a quick and confidential resolution. Their respective goals, however, may make this difficult. The executive typically wants a substantial amount of money, structured in a tax-advantageous manner, with no strings. The company may want "strings" to assure that its confidential information is not revealed, its best people are not poached, and its reputation is not injured.

A mediator with experience in such situations can help the parties reach a win-win resolution through consideration of a range of creative options. The following hypothetical provides an illustration of this.

### A hypothetical executive termination

In 2020, Janet Jones was hired as a senior vice president by Acme



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Electric, a regulated public utility, to create a non-regulated consulting function to advise companies regarding energy strategy. In 2025, Acme's lawyers realized that it could not provide non-regulated services, and Acme decided to spin this function out as a separate subsidiary, terminating Janet's role in the process. The company has offered Janet a package involving a "cliff" payment structure: Six months of additional regular pay, plus her earned long-term incentive pay, will be issued to her within 60 days after termination.

Janet believes she is the scapegoat for a legal error and she con-

siders the severance package to be inadequate. She has hired a plaintiff's lawyer to represent her; the company has responded by hiring a litigation firm. The parties have chosen a mediator well-versed in both employment law and the tax implications of various executive termination scenarios.

### The mediation process

For a mediation of this type, the starting point for the mediator will be, as early as possible, to (1) talk with the respective attorneys to understand the emotional and business factors that will need to be con-

sidered; (2) review the documents that are central to the mediation, including the executive's employment agreement, trade secret/confidentiality agreements, the offered severance agreement, and relevant company policies; (3) determine whether the mediation should be structured as a set of meetings, rather than a single mediation, and the order of issues to be addressed; and (4) determine whether, in addition to the parties' representatives, other experts might be helpful.

In standard employment cases, tax considerations are often left to the end of the negotiation. When

the termination involves a highly paid executive, however, the opposite applies because it will take time for the company's HR personnel and the executive's accountant to evaluate the range of alternatives. Moreover, the process of evaluating tax implications typically is cooperative; early evaluation can help set a constructive tone for resolution of the other issues.

### **Settlement: Tax strategies**

In the best-case scenario, the company's severance policy has already been designed to provide severance packages with tax-favorable designs. This is not, however, the case with Janet. In her case, with guidance from tax, investment and benefits experts, Acme and Janet may consider the following non-comprehensive list of tax strategies:

**Structured settlement.** A structured settlement enables the company to make a one-time settlement payment that is booked in the present year while offering the executive the tax benefit of receiving settlement payments over a period of years. With a structured settlement, Acme would assign the obligation to make future periodic settlement payments, typically to a highly rated life insurance company. Structured settlements can be customized to meet the executive's goals, e.g., paid through a fixed or indexed annuity. If the parties wish to pursue this option, they can retain a firm that specializes in developing structured settlements.

**Salary continuation agreement.** For tax purposes, a severance paid in installments post-termination generally is treated as wages in the year paid. For executives, post-termination payments of 12 months to two years are not uncommon, and longer periods are possible with careful structuring. The parties will want to assure that a salary continuation agreement is not deemed a "deferred compensation" arrangement under Section 409A of the Internal Revenue Code.

**Nonqualified deferred compensation plan.** If Janet already participates in the company's deferred compensation plan, she may be able to elect to defer all or part of the payment to a future tax year. Any

modification of a nonqualified deferred compensation plan must be reviewed for compliance with Section 409A.

**Health benefits.** Continuation of health benefits generally is not taxable to the executive. Subsidization of a COBRA plan may also be excluded from Janet's taxable income.

**Equity-related payouts.** Depending on the company's stock plans and Janet's participation in them, the year in which payment is recognized can be shifted through mechanisms such as accelerated vesting, equity buyouts, incentive stock options (ISOs), non-qualified stock options (NQSOs) and restricted stock units (RSUs). For example, it may be possible for Acme to move the exercise date of Janet's vested stock options and/or move the date on which her RSUs are to be paid to later dates. Again, expert assistance is essential in order to avoid legal barriers or adverse tax consequences; for example, converting a cash severance to equity after termination generally is not permitted.

**Charitable trusts.** Let's say that Janet expects substantial future income and the various tax strategies discussed above are not meaningful to her. The settlement could provide that Acme will put funds into a charitable trust or donor-advised fund directed by Janet.

### **Other settlement terms and restrictions**

The parties' respective counsel will come prepared to argue about Janet's contention that she was treated unfairly. Resolution of this issue may be much easier if the company is able to achieve its non-monetary objectives in exchange for paying more money to Janet. A mediator who is experienced with executive terminations may be able to identify terms that will facilitate such resolution.

The company may, for example, want the following provisions in the settlement agreement if the executive is not already bound by prior agreements: (1) a non-compete clause to prevent Janet from using her energy expertise to help an Acme competitor; (2) a non-solicitation clause to preclude her from helping another company poach

Acme's top performers; (3) a non-disparagement clause preventing Janet from criticizing Acme or its executives; (4) a confidentiality clause precluding her from using Acme's confidential information or trade secrets; and, (5) given the regulatory issue that led to the spinoff, a provision that prohibits Janet from disclosing the issue or encouraging others to sue Acme and requires her to cooperate with the company in the event of an investigation or litigation.

The challenge is that, even if Janet is willing to agree to some or all of these restrictions for more money, certain restrictions will be void on public policy grounds in some states and will only pass muster in other states if they are drawn narrowly. For example, a non-compete clause is likely to be void in California, even for an executive like Janet, but a tightly drawn non-compete (limited in time, geography and activity) may be lawful in some other states if there is a legitimate business interest and substantial consideration for the clause.

Non-solicitation agreements can run afoul of antitrust, unfair competition and labor laws if they are viewed as limiting other employees from obtaining better work. Precluding Janet from informing government agencies of regulatory violations would run afoul of public policy, and the law is clear that a settlement agreement cannot prohibit Janet from filing a False Claims Act case with respect to claims that Acme has submitted to the government. A limitation on encouraging others to sue also may be deemed invalid. Because of the complexity of the law regarding such "strings," the mediator may want to encourage the parties to have appropriate legal experts design the desired provisions.

### **Creative solutions**

An expert mediator will understand the legal implications of the parties' choices and, when appropriate, will help them achieve their objectives through creative solutions. In California, for example, even though non-compete clauses generally are prohibited, Acme may be able to achieve its objective

through a carefully tailored confidentiality and trade secret provision, a customer non-solicitation provision tied to trade secrets, a narrow employee non-solicitation clause, and a mutual non-disparagement provision.

With proper guidance, Acme may also be able to create a strong incentive for Janet not to violate settlement restrictions by tying her right to certain severance payments to her compliance with the agreement. If Janet is willing to do this, she will want the agreement to provide that the company cannot unilaterally declare a breach, i.e., a dispute resolution process must be invoked. The company could even consider a positive incentive for Janet not to injure Acme's new subsidiary by granting her a non-qualified stock option in the new subsidiary; for Janet, this may be a tax-favorable means of addressing a portion of the monetary settlement.

### **Conclusion**

This article should demonstrate the plethora of options available to facilitate settlement of executive termination disputes. A high level of expertise is needed to assure that the final agreement is appropriate from both a legal and tax perspective. A skilled mediator will understand how to use these options responsibly and creatively in order to help the parties reach an agreement that achieves their respective objectives.

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