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INSIGHT

Courts Paving Path to Move Claims Against CEOs to Arbitration

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Defense counsel often deal with situations where senior managers are defendants in litigation, despite them having minimal—if any—connection to the alleged wrongful conduct. In some cases, only senior managers are named as defendants rather than the company.

When facing this scenario, defense counsel should consider whether these managers have standing to move the claims against them into arbitration.

One potential barrier is that the parties to the contract containing a mandatory arbitration clause are often only the plaintiff and the company. Senior managers would be considered “nonsignatories” in that situation, which presents additional hurdles to enforcing the arbitration clause.

But recent court decisions, including one involving Tesla CEO Elon Musk, reaffirm two ways that a nonsignatory employee may move claims into arbitration. One is to argue that the employee is a third-party beneficiary of the arbitration clause. Another is to argue that the employee acted as an agent of the company and thus has standing as if the employee were the company.

The question of whether a defendant who is a nonsignatory can compel a signatory plaintiff to arbitrate claims is one of [arbitrability](#) (that is, concerning scope of that agreement) and thus governed by [ordinary principles](#) of state law. Any third-party beneficiary argument will depend on how the applicable state law defines third-party beneficiary status.

Generally, the clearest indication that a third party is an intended beneficiary is that the arbitration clause defines third-party beneficiaries by name or categories. For example, if the “company” is defined as including “agents,” “employees,” and “affiliates,” then senior managers may fall within the definition of “company” and be deemed a third-party beneficiary to the arbitration agreement, depending on the governing state law.

This is what happened in September, when the federal district court in [Reinhardt v. Guidehouse Inc.](#) held that a former senior employee was a third-party beneficiary of an arbitration agreement and had standing to seek the claims against her went to arbitration. In *Reinhardt*, the arbitration agreement covered claims against certain categories of persons—including any of the firm’s partners, employees, or agents—and the plaintiff had asserted employment discrimination claims against the former employee.

Similarly, the federal district court in [Watkins v. Musk](#) a few months earlier granted Musk’s motion to compel arbitration. It held that although Musk was a nonsignatory to vehicle purchase contracts from Tesla Inc. that contained mandatory arbitration clauses, he could compel arbitration because he was a third-party beneficiary of the contract.

The plaintiffs in that case had sued Musk (but not against the company) in a punitive class action for alleged misrepresentations by Tesla and Musk about the driving ranges of the company’s vehicles. The company, which was a signatory to the purchase contracts, was defined to include its “affiliates,” and Musk as CEO qualified as an affiliate within that term’s ordinary meaning.

The second theory supporting the argument that nonsignatory employees can compel arbitration of claims brought against them is to argue they were “agents” of the company at all relevant times. The [rationale](#) for this theory is that “a corporate entity or other business can only operate through its employees and an arbitration agreement would be a meaningless arrangement if its terms did not extend to them.”

To strengthen this argument, defense counsel could point to allegations in the complaint that don’t [meaningfully differentiate](#) between the company and the defendant employees—reinforcing that the company is the real target.

For example, in September, the federal district court in *GPS International Technologies, Inc. v. Verizon Communications, Inc.* held that a Verizon employee had standing to seek arbitration under the theory that she acted as an agent of the company, even though she was a nonsignatory to the contract that included the mandatory arbitration clause. This was because the complaint alleged she was working on Verizon’s behalf, and the plaintiff’s claims “all arise out of or relate to her employment with Verizon.”

The court in *Watkins v. Musk* also held that the claims were based on acts Musk took within the scope of his employment, despite being brought against him in his individual capacity. As such, he could enforce the arbitration clause acting as an agent of the company.

Defense counsel should consider moving to compel all claims against all defendants to arbitration wherever possible.

For instance, if the company and its employees are named defendants, the company usually files the motion as a signatory to the contract containing the mandatory arbitration clause.

The defendant employee (who is a nonsignatory) then can join that motion under applicable state law principles. But if the company isn’t a defendant in the lawsuit, then the nonsignatory employee defendant would file the motion to compel arbitration without the company joining.

Getting claims against employees into arbitration is important because doing so:

- Provides a greater likelihood of confidentiality in discovery
- Largely avoids the potential for punitive damages if the agreement prohibits recovery of such damages, as courts are [obligated](#) to enforce terms of such agreements
- Prevents legal fights in parallel court and arbitration proceedings, which comes with its own inefficiencies

The recent court decisions discussed above remind us that third-party beneficiary and agency arguments are two possible ways to move claims against senior managers into private arbitration and out of court.

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