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KNOW YOUR RIGHTS WHEN YOU ARE THREATENED WITH PERSONAL LIABILITY FOR BUSINESS ACTIVITIES

Although both “indemnification” and “advances,” as found in the Minnesota Business Corporations Act (the “MBCA”) (Minnesota Statutes Chapter 302A), serve as means to reimburse company officials who personally incur business liability, they are distinct concepts and accomplish different goals.

“Advances” constitute prompt, interim relief from a corporation to enable an individual to afford legal counsel and to relieve that person of the ongoing financial burden associated with defending him or herself in various proceedings related to the business, including litigation. “Indemnification” refers to coverage by the corporation of losses which that person may ultimately suffer or realize in connection with such proceedings.

A Minnesota corporation, through its bylaws or other governing documents, may elect to enact its own policies governing indemnification and advances in a manner that goes beyond that found in the applicable statute. A corporation must specifically address *both* indemnification and advances in order to customize both remedies apart from the statute.

1. Mandatory Indemnification Under Minn. Stat. § 302A.521

Minnesota law, specifically the MBCA, as well as its nonprofit analogue, the MNCA, provide for *mandatory* indemnification and reimbursement of the expenses a person incurs in connection with his or her official capacity within a corporation. Mandatory, statutory indemnification is only available to those persons who are “made or threatened to be made a party to a proceeding by reason of the former or present *official capacity*.” “Official capacity,” means generally a person’s role as a director, officer, board or committee member, or employee of the corporation...”

In order to obtain the benefit of mandatory corporate indemnification, one must further meet certain statutory standards. Specifically, an otherwise eligible person can only seek indemnification if he or she:

- a) has not already been indemnified by another organization or employee benefit plan;
- b) acted in good faith;
- c) received no improper personal benefit and has addressed any conflicts of interest regarding the matter as required under Minnesota Statutes section 302A.255;
- d) in the case of a criminal proceeding, had no reasonable cause to believe the conduct was unlawful; and
- e) believed that the conduct was in the best interests of the corporation.

2. The Entitlement to Advancement Under Minn. Stat. § 302A.521

The MBCA also contemplates mandatory advances for qualifying persons. Minn. Stat. § 302A.521, subd. 3 provides that “if a person is made or threatened to be made a party to a proceeding, the person is entitled, upon written request to the corporation, to payment or reimbursement by the corporation of reasonable expenses, including attorneys’ fees and disbursements, incurred by the person in advance of the final disposition of the proceeding.

To avail oneself of the benefit of advancement, one must:

- make a written request to the corporation asking for reimbursement by the corporation of reasonable expenses incurred which written request must include a statement that the person believes in good faith that he or she meets the indemnification standards described above; and
- make a commitment to repay any advances if the corporation ultimately determines that the indemnification criteria of subdivision 2 have not been met. Such a commitment is ongoing in nature but requires no security and no statement (or evidence) of an ability to repay such advances, if repayment should ever become necessary.

Upon receipt of this written request, the corporation would make a determination whether to provide advancement according to Minn. Stat. § 302A.521, subd. 3 (described below), based on the facts then known to the corporation. If facts should come to light thereafter and the corporation later determines that the person does not meet the criteria, he or she would be required to repay any and all advances.

3. Minn. Stat. § 302A.521 Specifies the Manner in Which a Corporation Is to Determine Eligibility for Corporate Mandatory Advances or Indemnification

The Corporation itself must make the determination of whether an eligible person is entitled to indemnification or advancement. Minn. Stat. § 302A.521 provides the mechanism by which a corporation is to render such decision, and allows for potential court intervention, if necessary.

Finally, if the Corporation determines to indemnify or provide advances, it may be required to disclose the amount(s) to shareholders.

As a corporate director, board or committee member, officer, or employee, it is important to understand your rights to indemnification and advancement if and when you are ever threatened with personal liability for business related activities. Understanding the mechanics of these provisions under state law will help you be prepared before you find yourself under the stress of threatened liability, allowing you to invoke these procedures and help you avoid serious personal financial distress.