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Delaware Court of Chancery Allows Amendment of LLC Agreement to Permit Disparate Consideration Where Amendment Provisions Were Followed

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In *Faiz Khan and Ralph Finger v. Warburg Pincus, LLC et al.*, the Delaware Court of Chancery held that the implied covenant of good faith and fair dealing was not applicable to a private equity sponsor's amendment of a limited liability company (LLC) agreement to permit the payment of differential consideration in a transaction where the LLC agreement at issue specifically disclaimed fiduciary duties and a clear amendment provision was followed.

Facts

CityMD, initially owned by its physicians, became majority-owned by an entity controlled by Warburg Pincus (the WP investors) in 2017. In 2019, CityMD merged with Summit Medical Group, forming WP CityMD Topco LLC (the company). The company's LLC agreement included certain minority protections, such as tag-along rights allowing minority unitholders to participate in transactions on equal terms with the WP investors, a waiver of fiduciary duties for the WP investors, allowing them to act in their own interests, and an amendment provision that required amendments to be approved by a majority vote of any class of holders whose rights would be adversely affected by the amendment.

In 2022, Warburg Pincus negotiated a merger with VillageMD, proposing different consideration for the WP investors, who would receive entirely cash consideration for their interests, and the minority holders, who would receive a mix of cash and rollover equity in VillageMD for their interests. To facilitate the merger under this structure, an amendment to the LLC agreement eliminating the minority's tag-along rights would be required. The amendment was approved by the requisite class vote after minority unitholders received an information statement detailing the transaction, including the disparate consideration that would be received by the WP investors and minority holders.

Following the closing of the merger, the plaintiffs, who were minority investors in the company, sued, claiming coercion and unfair treatment.

Analysis

Among other things, the plaintiffs argued that the company and WP investors breached the implied covenant of good faith and fair dealing by "coercing" them into approving the LLC agreement amendment that terminated their tag-along rights and allowed for disparate consideration. As part of its analysis, the court highlighted that the

implied covenant is a limited and extraordinary legal remedy that only applies to fill a gap when a contract is silent on certain conduct or matters at issue but does not apply when the contract specifically addresses the conduct at issue. According to the court, here, the LLC agreement specifically addressed the requirements needed to amend the LLC agreement, including the minority's tag-along rights, leaving no gaps for the implied covenant to fill with respect to the amendment. The court also found that the LLC agreement specifically waived any fiduciary duties owed by the WP investors, which allowed the WP investors to act in their own best interests. Again, since the LLC agreement specifically addresses the WP investors' conduct at issue, according to the court, there was no gap for the implied covenant to fill.

Takeaways

This case serves as a reminder that Delaware law respects the contractual terms agreed upon by parties, especially in the context of LLCs, which are creatures of contract and allow the complete elimination of fiduciary duties. The decision also underscores the importance of carefully negotiating and understanding contractual rights, and the need for specific and, if feasible, targeted minority blocking rights over future potential transactions.

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