

**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE**

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In re:

MERVYN'S HOLDINGS, LLC, *et al.*

Debtors.

Case No.: 08-11586 (KG)

Chapter 11

Jointly Administered

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THE OFFICIAL COMMITTEE OF
UNSECURED CREDITORS OF MERVYN'S
HOLDINGS, LLC, *et al.*,

Adv. Pro. No. 09-_____ (KG)

Plaintiff,

v.

SCSF MERVYN'S (OFFSHORE), INC. and
SCSF MERVYN'S (US), LLC,

Defendants.

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COMPLAINT

The Official Committee of Unsecured Creditors (the "Committee" or "Plaintiff") of Mervyn's Holdings, LLC ("Mervyn's Holdings"), Mervyn's LLC ("Mervyn's") and Mervyn's Brands, LLC ("Brands" and collectively with Holdings and Mervyn's, the "Debtors"), by and through its lead counsel, Cooley Godward Kronish LLP, and local counsel, Ashby & Geddes, P.A., for its complaint against defendants SCSF Mervyn's (Offshore), Inc. and SCSF Mervyn's (US), LLC (together, the "SCSF Entities") respectfully alleges as follows:



NATURE OF ACTION

1. This is an adversary proceeding filed to (a) obtain a judgment declaring that the Delaware Financing Statements (defined herein) filed by or on the behalf of the SCSF Entities have no legal force or effect, (b) avoid as preferential transfers the SCSF Entities' purported liens upon and security interests in the assets of Mervyn's and Brands, and (c) recharacterize the claims of the SCSF Entities as equity interests.

PRELIMINARY STATEMENT

2. In November 2007, the SCSF Entities, Mervyn's and Brands entered into various agreements pursuant to which, *inter alia*, the SCSF Entities transferred approximately \$30,000,000 to Mervyn's and purportedly received liens upon and security interests in certain assets of Mervyn's and Brands to secure the repayment thereof.

3. While the SCSF Entities attempted to perfect liens upon and security interests in certain assets of Mervyn's and Brands, in November 2007 the SCSF Entities filed UCC financing statements in the State of Delaware – the wrong jurisdiction. Approximately four months later, in March 2008, the SCSF Entities attempted to correct this defective perfection by filing UCC financing statements in California and Minnesota, the states of incorporation of Mervyn's and Brands, respectively.

4. As set forth herein, the transfer made by the SCSF Entities is, at best, an unsecured obligation of Mervyn's and Brands because (i) the UCC financing statements filed by the SCSF Entities in Delaware did not perfect liens and security interests and are without legal force and effect, and (ii) the purported liens and security interests purportedly perfected by the subsequent UCC filings are avoidable as preferential transfers pursuant to, *inter alia*, sections 544(a) and 547(b) of title 11 of the United States Code (the "Bankruptcy Code").

5. In addition to the fatal perfection problems, the \$30 million transferred by the SCSF Entities was not debt, but rather a capital contribution from insiders holding significant membership interests in Mervyn's Holdings (an affiliate of both Mervyn's and Brands) made at a time when the Debtors were insolvent. Accordingly, the SCSF Entities' claims against Mervyn's and Brands should be recharacterized as equity interests.

BACKGROUND

A. The Debtors' Chapter 11 Cases

6. On July 29, 2008 (the "Petition Date"), the Debtors filed voluntary petitions for relief under chapter 11 of the Bankruptcy Code in the United States Bankruptcy Court for the District of Delaware. Pursuant to sections 1107 and 1108 of the Bankruptcy Code, the Debtors continue to operate their businesses and their properties as debtors-in-possession. No trustee or examiner has been appointed in these cases.

7. On August 7, 2008, the Committee was appointed by the Office of the United States Trustee for the District of Delaware, consisting of the following seven members: (i) Li & Fung USA; (ii) Levi Strauss & Co.; (iii) R.R. Donnelly & Sons Company; (iv) VF Corporation; (v) The Macerich Company; (vi) DDR MDT MV Holdings II LLC; and (vii) The CIT Group/Commercial Services, Inc.

8. On August 26, 2008, the Court entered that *Final Order (A) Authorizing Debtors to Obtain Post-Petition Financing and Grant Security Interests and Superpriority Administrative Expense Status Pursuant to 11 U.S.C. §§ 105 and 364(c); (B) Modifying the Automatic Stay Pursuant to 11 U.S.C. § 362; (C) Authorizing Debtors to Enter Into Agreements With Wachovia Capital Finance Corporation (Western), in its Capacity as Administrative and Collateral Agent for Itself and Certain Other Lenders; and (D) Authorizing Debtors to Use Collateral Subject to*

Liens and Security Interests Including Cash Collateral and Granting Adequate Protection in Respect Thereof (the “Final DIP Order”), pursuant to which, *inter alia*, the SCSF Entities were granted, as adequate protection against any diminution in value of their purported interests in all Collateral (as defined in the Final DIP Order): (i) a replacement lien (the “SCSF Replacement Lien”); (ii) a superpriority administrative expense claim (the “SCSF Superpriority Claim”); and (iii) payment or reimbursement by the Debtors of certain legal and other professional fees paid or incurred by the SCSF Entities in connection with the Debtors’ chapter 11 cases, subject to a cap of \$50,000 in the aggregate per month (the “Adequate Protection Payments”).

9. The Final DIP Order provides the Committee with automatic standing to file an action, claim or defense that seeks to object to, challenge, contest or otherwise invalidate, avoid or reduce, whether by setoff, recoupment, counterclaim, deduction, disgorgement or claim of any kind, the extent, validity, enforceability and priority of the SCSF Entities’ claim (a “Subordinated Noteholder Objection”) and to seek discovery under Bankruptcy Rule 2004 in connection therewith. The Final DIP Order provides that any such Subordinated Noteholder Objection must be filed by the Committee within 180 calendar days from the date of entry of the order approving the retention of Committee counsel, unless such period is extended with the written consent of the SCSF Entities. The Committee’s deadline to file a Subordinated Noteholder Objection was extended through April 21, 2009 upon the written consent of counsel to the SCSF Entities provided on October 31, 2008.

10. The Final DIP Order authorizes the Court to grant appropriate relief with respect to the purported indebtedness of the SCSF Entities and the purported liens and claims securing such indebtedness in the event that a Subordinated Noteholder Objection is timely filed and successfully pursued.

11. On October 17, 2008, the Debtors filed that *Motion of the Debtors and Debtors in Possession for Order Authorizing and Approving (A) Auction and Bid Procedures, (B) Bid Protections to Stalking Horse Bidder, if Applicable, (C) Store Closing Sales Free and Clear of Liens, (D) Agency Agreement, and (E) Related Relief, With Respect to the Debtors' Remaining Stores*, pursuant to which the Debtors sought authority to, among other things, (a) close all their remaining retail stores and other locations; (b) conduct store closing sales, and (c) enter into an agency agreement providing for the liquidation of merchandise inventory and other assets with the successful bidder at auction.

12. On October 22, 2008, the Committee filed that (I) *Objection of the Official Committee of Unsecured Creditors to Motion of the Debtors and Debtors In Possession for Orders Authorizing and Approving (A) Auction and Bid Procedures, (B) Bid Protections to Stalking Horse Bidder, if Applicable, (C) Store Closing Sales Free and Clear of Liens, (D) Agency Agreement, and (E) Related Relief, With Respect to the Debtors' Remaining Stores*, and (II) *Cross-Motion for an Order Pursuant to 11 U.S.C. § 1112(b) and 11 U.S.C. § 105(a) Converting the Debtors' Chapter 11 Cases to Cases Under Chapter 7 of the Bankruptcy Code*, (as supplemented on October 27, 2008, the "Objection and Cross-Motion").

13. The Debtors, the Committee, the SCSF Entities, and the Debtors' senior prepetition and postpetition lenders agreed to resolve the Objection and Cross-Motion as set forth and approved on the record at the hearing held before the Court on October 30, 2008, with certain additional terms described on the record at the hearing held before the Court on November 25, 2008.

14. The terms of the resolution of the Objection and Cross-Motion were memorialized in that *Stipulation and Order Resolving and Settling (I) Objection of the Official*

Committee of Unsecured Creditors to Motion of the Debtors and Debtors In Possession for Orders Authorizing and Approving (A) Auction and Bid Procedures, (B) Bid Protections to Stalking Horse Bidder, if Applicable, (C) Store Closing Sales Free and Clear of Liens, (D) Agency Agreement, and (E) Related Relief, With Respect to the Debtors' Remaining Stores, and (II) Cross-Motion for an Order Pursuant to 11 U.S.C. § 1112(b) and 11 U.S.C. § 105(a) Converting the Debtors' Chapter 11 Cases to Cases Under Chapter 7 of the Bankruptcy Code, entered by the Court on December 30, 2008 (as amended and modified by Order entered March 26, 2009, the "Settlement Order").

15. The Settlement Order provides the Committee with standing, authority, control, and the exclusive right and sole discretion to investigate, prosecute and/or seek authorization to compromise on behalf of the Debtors' estates, among other things, the 2004 Transaction Litigation (as defined below), causes of action under chapter 5 of the Bankruptcy Code and any other claims of causes of action concerning the SCSF Entities and their affiliates.

16. The Settlement Order requires the Debtors to hold in an escrow account maintained by Richards, Layton & Finger, P.A. (the "SCSF Escrow Account") an amount equal to the full present value of the SCSF Entities' purported indebtedness until the earlier to occur of (i) expiration of the deadline for the Committee to bring a Subordinated Noteholder Objection or (ii) entry of an order resolving a Subordinated Noteholder Objection or approving a compromise between the Committee and the SCSF Entities with respect thereto.

B. The 2004 Litigation

17. On September 2, 2008, Mervyn's commenced an adversary proceeding in this Court (Adv. Pro. No. 08-51402) (the "2004 Litigation") against various defendants, including the SCSF Entities, by filing a complaint (as amended on December 22, 2008, the "2004 Complaint") seeking,

among other things, avoidance of certain transactions in connection with Mervyn's Holdings acquisition of Mervyn's in 2004 and recovery of certain transfers consummated in connection therewith (the "2004 Transaction"). As more fully alleged in the 2004 Complaint, valuable real estate assets of Mervyn's – including owned store locations and below-market leases – were stripped out of Mervyn's and used to finance its leveraged buyout by a consortium of private equity players that include the SCSF Entities. Hundreds of millions of dollars of loans were taken against those real estate assets to finance the 2004 Transaction, with none of the proceeds going to Mervyn's.

C. Committee Standing and Authority

18. The Committee has standing and authority to file and prosecute the first and second causes of action set forth herein pursuant to section 1103 of the Bankruptcy Code, section 4.1 of the Final DIP Order and the Settlement Order.

19. The Committee has standing and authority to file and prosecute the third cause of action set forth herein pursuant to section 1103 of the Bankruptcy Code and the Settlement Order.

D. Jurisdiction and Venue

20. This Court has jurisdiction over this matter pursuant to 28 U.S.C. §§ 157 and 1334.

21. This adversary proceeding arises under and relates to the chapter 11 case of *In re Mervyn's Holdings, LLC, et al.* (Lead Case No. 08-11586), which is pending in this Court, and is a core proceeding pursuant to 28 U.S.C. § 157(b).

22. Venue in this district is proper pursuant to 28 U.S.C. §§ 1408 and 1409.

E. Parties

23. Plaintiff is the Official Committee of Unsecured Creditors of the Debtors.
24. Defendant SCSF Mervyn's (US), LLC is a Delaware limited liability company.
25. Defendant SCSF Mervyn's (Offshore), Inc. is a Delaware corporation.
26. The SCSF Entities were insiders of Mervyn's and Brands within the meaning of section 101(31)(B) of the Bankruptcy Code at the time the Purported Liens and Security Interests were perfected.
27. The SCSF Entities own membership interests in Mervyn's Holdings.
28. The SCSF Entities designated one or more officers and directors of the Debtors.
29. The SCSF Entities were in control of the Debtors within the meaning of section 101(31)(B)(iii) of the Bankruptcy Code at the time the Purported Liens and Security Interests were perfected.
30. Sun Capital Securities Fund, LP owns all of the equity in SCSF Mervyn's (US), LLC.
31. Sun Capital Securities Offshore Fund, Ltd. owns all of the equity in SCSF Mervyn's (Offshore), Inc.
32. Sun Capital Partners, Inc. ("Sun Capital") is the direct or indirect owner of SCSF Mervyn's (US), LLC, SCSF Mervyn's (Offshore), Inc., Sun Capital Securities Offshore Fund, Ltd. and Sun Capital Securities Fund, LP.
33. Sun Capital, directly or through its affiliates, designated one or more officers and directors of the Debtors.

34. Sun Capital, directly or through its affiliates, was in control of the Debtors within the meaning of section 101(31)(B)(iii) of the Bankruptcy Code at the time the Purported Liens and Security Interests were perfected.

35. Mervyn's Holdings was formed by affiliates of Sun Capital, Cerberus Capital Management, L.P., Lubert-Adler and Klaff Partners, L.P. in connection with Mervyn's Holdings' acquisition of Mervyn's through the 2004 Transaction.

36. Brands is a wholly-owned subsidiary of Mervyn's and owns all or substantially all of Mervyn's intellectual property.

37. Mervyn's is incorporated in the State of California.

38. Brands is incorporated in the State of Minnesota.

39. Mervyn's Holdings is incorporated in the State of Delaware.

F. The \$30,000,000 Transfer

40. On or about November 27, 2007, Mervyn's, Brands, as Guarantor, and the SCSF Entities, as Purchasers, entered into a Note Purchase Agreement (the "Note Purchase Agreement").

41. On or about November 27, 2007, Mervyn's, Brands and the SCSF Entities entered into a Security Agreement (the "Junior Security Agreement").

42. On or about November 27, 2007, the SCSF Entities transferred \$30,000,000 to Mervyn's (the "\$30,000,000 Transfer"), purportedly as a loan, pursuant to the Note Purchase Agreement.

43. In connection with the \$30,000,000 Transfer, Mervyn's delivered a Subordinated Promissory Note, dated as of November 27, 2007, to the SCSF Entities (the "Subordinated Promissory Note").

44. Both the Subordinated Promissory Note and the Junior Security Agreement, by their terms, are governed by laws of the State of New York.

45. As security for the Debtors' repayment obligations under the Subordinated Promissory Note, Mervyn's and Brands granted to the SCSF Entities purported liens upon and security interests in (the "Purported Liens and Security Interests") substantially all of the assets of Mervyn's and Brands (the "Collateral").

G. The SCSF Entities' Defective Perfection

46. On or about November 28, 2007, the SCSF Entities attempted to perfect the Purported Liens and Security Interests in the Collateral by filing UCC financing statements in the State of Delaware (the "Delaware Financing Statements"). However, at that time, Mervyn's and Brands were incorporated in the States of California and Minnesota, respectively.

47. Accordingly, filing the Delaware Financing Statements was of no legal force and effect and did not serve to perfect the Purported Liens and Security Interests.

H. The SCSF Entities' Second Attempt at Perfection

48. Nearly four months later, on or about March 20, 2008 and March 24, 2008, the SCSF Entities attempted to correct their defective filings by filing UCC financing statements in the States of California, for Mervyn's, and Minnesota, for Brands (the "March Financing Statements").

**AS AND FOR A FIRST CAUSE OF ACTION
(Declaratory Relief Pursuant to 11 U.S.C. §§ 105(b) and 544(a)(1),
N.Y. U.C.C. §§ 9-301(a) and 9-307(e), Cal. Code § 9501(a)(2)
and Minn. Stat. Ann. § 336.9-501(a)(2))**

49. Plaintiff repeats and realleges each of the allegations set forth in paragraphs 1 through 43 above.

50. The issue of whether or not the filing of the Delaware Financing Statements is effective to perfect the Purported Liens and Security Interests is a justiciable controversy of practical significance to the Debtors' estates.

51. Because the Delaware Financing Statements were not filed in the respective states of incorporation of Mervyn's and Brands, the Delaware Financing Statements have no legal force and effect.

52. The Purported Liens and Security Interests were not perfected through the filing of the Delaware Financing Statements.

53. Accordingly, this Court should declare and adjudge that (i) the Delaware Financing Statements are of no legal force and effect and (ii) the Purported Liens and Security Interests were not perfected through the filing of the Delaware Financing Statements.

AS AND FOR A SECOND CAUSE OF ACTION
(Avoidance and Recovery of Preferential Transfers
Under 11 U.S.C. §§ 544, 547(b) and 550(a))

54. Plaintiff repeats and realleges each of the allegations set forth in paragraphs 1 through 48 above.

55. The March Financing Statements were filed within one year of the Petition Date.

56. The Purported Liens and Security Interests were not perfected until the dates the March Financing Statements were filed.

57. The perfection of the Purported Liens and Security Interests in March 2008 was a transfer of an interest in property of Mervyn's and Brands within the meaning of section 101(54) of the Bankruptcy Code.

58. The perfection of the Purported Liens and Security Interests in March 2008 was made to or for the benefit of the SCSF Entities.

59. The SCSF Entities were creditors of Mervyn's and Brands within the meaning of section 101(10)(A) of the Bankruptcy Code at the time the Purported Liens and Security Interests were perfected.

60. The perfection of the Purported Liens and Security Interests in March 2008 was made for or on account of an antecedent debt owed to the SCSF Entities by Mervyn's and Brands before the Purported Liens and Security Interests were perfected.

61. The perfection of the Purported Liens and Security Interests in March 2008 was made while Mervyn's and Brands were insolvent within the meaning of section 101(32)(A) of the Bankruptcy Code.

62. The perfection of the Purported Liens and Security Interests would enable the SCSF Entities to receive more than they would receive if: (i) the Mervyn's and Brands chapter 11 cases were cases under chapter 7 of the Bankruptcy Code; (ii) the Purported Liens and Security Interests had not been perfected by the filing of the March Financing Statements; and (iii) the SCSF Entities received payment of the debt owed by Mervyn's and Brands to the extent provided by the provisions of the Bankruptcy Code.

63. Pursuant to section 547(b) of the Bankruptcy Code, the perfection of the Purported Liens and Security Interests should be avoided.

64. Pursuant to section 544(a) of the Bankruptcy Code, Mervyn's and Brands have the status of judgment lien creditors.

65. Pursuant to the Uniform Commercial Code in effect in the States of California and Minnesota, the rights of a creditor holding an unperfected security interest are defeated by a judgment lien creditor.

66. Accordingly, any and all claims of the SCSF Entities arising from or related to the \$30,000,000 Transfer should be deemed unsecured obligations of Mervyn's and Brands.

67. Because any and all claims of the SCSF Entities arising from or related to the \$30,000,000 Transfer should be deemed unsecured obligations of Mervyn's and Brands, the SCSF Replacement Lien should be avoided pursuant to the authority of this Court as provided in the Final DIP Order.

68. Because any and all claims of the SCSF Entities arising from or related to the \$30,000,000 Transfer should be deemed unsecured obligations of Mervyn's and Brands, SCSF Superpriority Claim should be disallowed and expunged pursuant to the authority of this Court as provided in the Final DIP Order.

69. By reason of the foregoing and pursuant to section 550 of the Bankruptcy Code, Mervyn's and Brands are entitled to recover, and the SCSF Entities should be required to disgorge, any and all transfers made to or for the benefit of the SCSF Entities on account of the \$30,000,000 Transfer and/or the Purported Liens and Security Interests, including, without limitation, any Adequate Protection Payments.

**AS AND FOR A THIRD CAUSE OF ACTION
(Recharacterization of the \$30,000,000 Transfer)**

70. Plaintiff repeats and realleges each of the allegations set forth in paragraphs 1 through 65 above.

71. The \$30,000,000 Transfer was made:

- a. by the SCSF Entities, insiders of Mervyn's and Brands;
- b. at a time and in an amount unobtainable by Mervyn's from independent sources on ordinary commercial loan terms;
- c. with no reasonable expectation of repayment by Mervyn's and/or Brands;

d. as Mervyn's was approaching bankruptcy.

72. The \$30,000,000 Transfer was intended to be, and was in fact, an equity contribution made by the SCSF Entities.

73. Accordingly, principles of equity require that the \$30,000,000 Transfer be recharacterized as equity capital and that any and all claims of the SCSF Entities arising from or related to the \$30,000,000 Transfer be recharacterized as equity interests in Mervyn's and Brands.

WHEREFORE, Plaintiff respectfully requests that this Court enter an order:

(i) declaring and adjudging that (a) the Delaware Financing Statements are of no legal force and effect, and (b) the Purported Liens and Security Interests were not validly perfected through the filing of the Delaware Financing Statements;

(ii) avoiding the perfection of the Purported Liens and Security Interests as a preferential transfer;

(iii) deeming any and all claims of the SCSF Entities arising from or related to the \$30,000,000 Transfer to be unsecured obligations of Mervyn's and Brands;

(iv) disallowing and expunging the SCSF Superpriority Claim;

(v) releasing the SCSF Replacement Lien;

(vi) amending the Settlement Order to authorize and direct the release of all funds held in the SCSF Escrow Account to the Debtors and their estates;

(vii) directing the disgorgement of any and all transfers made to or for the benefit of the SCSF Entities on account of \$30,000,000 Transfer and/or the Purported Liens and Security Interests, including, without limitation, any Adequate Protection Payments;

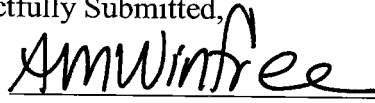
(viii) recharacterizing any and all claims of the SCSF Entities arising from or related to the \$30,000,000 Transfer as equity interests in Mervyn's and Brands; and

(ix) granting such other and further relief as the Court deems just and proper.

Dated: Wilmington, Delaware
April 7, 2009

Respectfully Submitted,

By:



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