

**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF GEORGIA
NEWNAN DIVISION**

| | | |
|--------------------------------|---|--|
| In re: |) | Chapter 11 |
| |) | |
| DAN RIVER INC., et al., |) | Case Nos. 04-_____ through 04-_____ |
| |) | Jointly Administered |
| Debtors. |) | |
| _____ |) | Judge Drake |

**MOTION OF DEBTORS FOR ORDER PURSUANT TO 11 U.S.C.
§§105(a) AND 363(b) AUTHORIZING PAYMENT OF PREPETITION
CLAIMS OF CERTAIN CRITICAL VENDORS AND SERVICE PROVIDERS**

Dan River Inc. (“Dan River”), The Bibb Company LLC (“Bibb”), Dan River International Ltd. (“Dan River International”), and Dan River Factory Stores, Inc. (“Dan River Stores”) (collectively, the “Debtors” or the “Company”) file this Motion, respectfully showing the Court as follows:

Jurisdiction

1. This Court has jurisdiction to consider this Motion pursuant to 28 U.S.C. § 1334. Consideration of this Motion is a core proceeding pursuant to 28 U.S.C. § 157(b). Venue of this proceeding is proper before this Court pursuant to 28 U.S.C. §§ 1408 and 1409.

Background

2. On the date hereof (the “Petition Date”), each of the Debtors filed a voluntary petition for relief under Chapter 11 of Title 11 of the United States Code (the “Bankruptcy Code”). The Debtors are authorized to operate their businesses as debtors-in-possession pursuant to Sections 1107 and 1108 of the Bankruptcy Code.

A. Company Background.

3. Dan River was founded in 1882 and is a leading designer, manufacturer and marketer of products for the home fashions and apparel fabrics markets. Dan River operates three business segments: home fashions, apparel fabrics, and engineered products.

4. During fiscal 2003, Dan River's home fashions division produced approximately 72 percent of the Company's revenues, generating \$342 million in net sales. Dan River's home fashions products include bedroom furnishings such as comforters, sheets, pillowcases, shams, bed skirts, decorative pillows and draperies. Dan River is an innovator in merchandising home fashions products and introduced the "Bed-in-a-Bag" complete bed ensemble that consists of a comforter with matching sheets, pillowcases, shams, and a dust ruffle. The home fashions products are marketed under the "Dan River" name as well as under private labels of the Company's major retail customers and under licenses from, among others, "Colours by Alexander Julian" and "Lilly Pulitzer." Dan River also markets home fashions products for the juvenile market under a number of licensed names and trademarks, including "Barbie," "Looney Tunes," "Spiderman," and "Scooby Doo" among others.

5. During fiscal 2003, Dan River's apparel fabrics division produced approximately 21 percent of Dan River's total revenues, generating \$102 million in net sales. Dan River's apparel fabrics products include a broad range of high quality woven cotton and cotton-blend fabrics that are marketed primarily to clothing manufacturers.

6. During fiscal 2003, the engineered products division was Dan River's smallest division, and produced 7 percent of Dan River's gross revenue, generating \$34 million in net sales. Dan River's engineered products include coated yarns and woven fabrics that are

manufactured to customer specifications for use in such products as high pressure hoses for the automotive industry, conveyer belts and other industrial applications.

7. The remaining debtors, Bibb, Dan River International, and Dan River Stores are wholly-owned subsidiaries of Dan River. Bibb was acquired by Dan River in 1998, and substantially all of its assets were subsequently transferred to Dan River. In 2001, Bibb was converted to a single member Delaware limited liability company, wholly owned by Dan River. The only remaining assets of Bibb are its environmentally impaired Abbeville facility, and small parcels of raw land with nominal value. Dan River International is a holding company for the Company's international operations.¹ Dan River Stores was formed in 1992. In 2001, Dan River Stores transferred substantially all of its assets to Dan River. The only remaining material assets of Dan River Stores are intercompany receivables and inconsequential leases.

B. The Debtors' Long-Term Debt Structure.

8. On April 15, 2003, the Debtors completed the refinancing of substantially all of their outstanding long-term debt. The refinancing included the sale, at 95.035 percent of par, of 12-3/4 percent senior notes due 2009 in the aggregate principal amount of \$157 million.

9. In addition, the Debtors entered into a new senior secured credit agreement (the "Credit Agreement") dated April 15, 2003 with Deutsche Bank Trust Company Americas, as Agent, Fleet Capital Corporation, as Syndication Agent, Wachovia Bank, National Association,

¹ The Company's international operations include the following Mexican entities: Dan River de Mexico, S. de R.L. de C.V. ("DRMEX"), Maquilas Pinnacle, S. de R.L. de C.V. and Adsercorp, S. de R.L. de C.V. (collectively, the "Mexico Companies"). The Mexico Companies are the equivalent of limited liability companies. However, Mexico does not allow single member limited liability companies. Therefore, Dan River owns a one peso interest in DRMEX. The remaining Mexico Companies own a one peso interest in each other. Dan River International owns all remaining interests in the Mexico Companies. Dan River B.V. is a Netherlands corporation that was formed in 2000 as a wholly-owned subsidiary of Dan River International to hold Dan River International's interests in the Mexico Companies. However, those interests were never transferred to Dan River B.V., and Dan River B.V. has nominal assets. Neither Dan River B.V. nor any of the Mexico Companies are debtors in these proceedings.

as Documentation Agent, and the several lenders from time to time party thereto (collectively, the “Lenders”).

10. The Credit Agreement provides for a five-year \$40 million term loan and a \$160 million revolving credit facility. Availability under the revolving credit facility is based upon a borrowing base determined by reference to eligible accounts receivable and inventory. As of the Petition Date, the principal and interest outstanding under the term loan was \$35.85 million, and the principal and interest outstanding under the revolving credit facility was approximately \$75.8 million. In addition, letters of credit in the approximate amount of \$5.05 million were outstanding under the terms of the Credit Agreement, for a total current amount outstanding under the Credit Agreement of approximately \$116.7 million. The Debtors’ obligations under the Credit Agreement are secured by substantially all of the Debtors’ assets.

C. Events Leading to the Debtors’ Chapter 11 Cases.

11. In fiscal 2003, the Debtors experienced a significant drop in revenues beginning in the second quarter. Retail sales of the Debtors’ products began to weaken in the second quarter due to a lackluster retail environment in general and inventory adjustments by some of its customers, including its largest customer, Kmart. For fiscal 2003, total revenues were down 22.1 percent compared to the previous year.

12. During the second, third and fourth quarters of fiscal 2003, in response to the drop in sales, the Debtors initiated plans to eliminate approximately \$18 million in annual expenses through the closure and consolidation of manufacturing facilities and a reduction of workforce. Four manufacturing facilities were closed, which eliminated over 850 positions for a total estimated annual savings of \$13.6 million. Approximately 80 managerial and administrative positions were eliminated which reduced annual expenses by over \$4 million. The benefits of

these cost-cutting efforts were not expected to be realized until fiscal 2004, too late to mitigate a continued reduction in gross profit caused by the poor economic environment. The Debtors' gross profit for fiscal 2003 was approximately \$61 million less than their gross profit for the previous year.

13. The Debtors are not the only domestic textile company which has encountered financial problems. Numerous other domestic textile companies such as Burlington Industries, Cone Mills, WestPoint Stevens, Pillowtex, and others have already filed for bankruptcy protection.

14. As a result of the Debtors' financial performance, they failed to meet the maximum leverage ratio covenant contained in the Credit Agreement for the third quarter of 2003. The Debtors and the Lenders entered into an amendment of the Credit Agreement that waived the covenant violation and imposed new requirements for minimum levels of excess availability and monthly operating EBITDA. An additional amendment and waiver to the Credit Agreement was executed in December 2003, waiving certain anticipated defaults resulting from the Debtors' financial performance and imposing additional requirements on the Debtors. Another amendment was executed in January 2004 modifying certain terms of the Credit Agreement. Among other things, the Credit Agreement, as amended, requires the Debtors to deliver to the Agent on March 31, 2004 satisfactory evidence that the Debtors will be in compliance with the financial covenants in the Credit Agreement for the fiscal quarter ending April 3, 2004.

15. The Debtors' sales and profitability have not sufficiently improved to be in compliance with all of the Credit Agreement's financial covenants. As a result, commencing April 1, 2004, the Debtors will be in default under the Credit Agreement. Accordingly, the

Company will no longer have access to the funds necessary to meet its operating expenses and will be faced with a loss of enterprise value if it cannot restructure its debt and obtain additional financing. Therefore, the Debtors have concluded, after consultation with their advisors, that their interests and the interests of their creditors and employees will be best served by a reorganization under Chapter 11 of the Bankruptcy Code.

Relief Requested

16. The Debtors request entry of an order authorizing them to pay, in their sole discretion, the prepetition claims of certain Critical Vendors (as such term is defined below).

17. The Court has the authority to grant the relief requested pursuant to Sections 105(a) and 363(b) of the Bankruptcy Code. Section 363(b)(1) of the Bankruptcy Code provides “[t]he trustee, after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate.” 11 U.S.C. § 363(b)(1). Moreover, Section 105(a) of the Bankruptcy Code allows the Court to authorize payments on account of certain prepetition claims when necessary. Section 105(a) of the Bankruptcy Code provides, in relevant part, that “[t]he court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title.” 11 U.S.C. § 105(a). These Bankruptcy Code provisions have led courts to approve similar motions in connection with the administration of debtors’ estates, both within and without this district. *See, e.g., In re Centennial HealthCare Corporation*, Case No. 02-74974 (Bankr. N.D. Ga. December 12, 2002) (Massey, J.); *In re The New Power Company*, Case No. 02-10835 (Bankr. N.D. Ga. June 17, 2002) (Drake, J.); *In re Wolf Camera, Inc.*, Case No. 10-83470 (Bankr. N.D. Ga. June 22, 2001) (Mullins, J.).² *See, also, e.g., In re Mirant Corp.*,

² For the Court’s convenience, copies of unpublished authorities cited herein are submitted to the Court in a separate binder.

296 B.R. 427, 429-30 (Bankr. N.D. Tex. 2003); *In re WorldCom, Inc.*, 2002 WL 1732647 (S.D.N.Y. July 22, 2003); *In re Coserv, L.L.C.*, 273 B.R. 487, 498-99 (Bankr. N.D. Tex. 1999).

**Authorization To Honor Or Pay Critical Vendor Claims Is In The
Best Interests of the Debtors, Their Estates, and All Parties In Interest**

18. In connection with the operation of their businesses, the Debtors utilize certain specialty vendors to supply essential goods and services for the operation of their businesses (collectively, the “Critical Vendors”). The Debtors’ ability to continue their operations is dependent upon the continued business of these Critical Vendors. Thus, support from their Critical Vendors on an ongoing basis is vital to the Debtors’ reorganization process. At this precarious stage in the Debtors’ business operations, an interruption in the goods and services provided by the Critical Vendors will have a severe effect upon the Debtors’ efforts to rehabilitate and reorganize. The goods and services provided by the Critical Vendors must flow to the Debtors unabated during the Debtors’ Chapter 11 cases if substantial harm and loss of enterprise value are to be avoided.

19. Specifically, many of the Critical Vendors provide certain essential raw materials and supplies required to manufacture the Debtors’ products. Because (a) the Debtors do not have any viable alternatives to obtain substitute goods from other suppliers, and (b) the Debtors believe the Critical Vendors may either go out of business or refuse to do business with the Debtors if their claims are not paid, the Debtors have determined that they must have the authority, in their discretion, to satisfy the prepetition claims of these Critical Vendors (collectively, the “Critical Vendor Claims”) to ensure that these essential goods will continue to be available without interruption.

20. In most instances, no other manufacturer or supplier can timely supply the required goods in any form. In those instances where substitute goods or services may exist,

these alternate suppliers cannot provide goods that meet the Debtors' requirements for quality and quantity, or cannot ensure availability on a cost-efficient and timely basis in the appropriate geographic areas. Because the Debtors' competitive advantage over low-cost foreign competitors depends in large part upon their reliability in supplying retailers with the Debtors' products, interruptions in distribution will have a disproportionate impact upon the Debtors' ability to survive and reorganize. For these reasons, the Debtors cannot rely on these alternate sources.

21. The use of materials of inferior or inconsistent quality would also undermine the Debtors' ability to maintain the high quality standards of their products necessary to meet their customers' longstanding expectations and preserve the value of the Debtors' products and trademarks in the marketplace. Likewise, the use of high quality goods from alternate suppliers that lack the capability to produce the necessary products in sufficient quantities or to distribute those products in a timely fashion to the Debtors' various facilities would not permit the Debtors to operate and maintain their manufacturing operations and production schedule without significant interruption.

22. Moreover, many of these Critical Vendors rely heavily on the Debtors' business for their own financial success. The Debtors fear that if they are unable to pay their outstanding prepetition amounts, certain Critical Vendors will have to cease operations, thereby leaving the Debtors with no other source of supply for those products.

23. It is also important to note that a significant portion of these Critical Vendor Claims relate to purchases of goods on credit in the days immediately preceding the Petition Date. As such, the Debtors believe that most of these claims may be subject to treatment and payment as reclamation claims pursuant to Section 2-702 of the Uniform Commercial Code and

Section 546(c) of the Bankruptcy Code. Because such reclamation claims ultimately would be paid or otherwise satisfied as administrative expenses from assets of the Debtors' estates, the payment of such claims pursuant to this Motion would not deplete the Debtors' assets generally available to other creditors. In addition, by paying these types of Critical Vendor Claims, the Debtors can avoid the administrative costs typically associated with reconciling and litigating such reclamation claims.

24. The process of identifying Critical Vendors was undertaken by the Debtors' senior management in conjunction with the Debtors' legal and financial advisors using very strict criteria to screen which vendor payments would be deemed critical to avoid business interruption. Consistent with case law on the subject of critical vendors, including *In re Mirant Corporation*, supra, and *In re WorldCom, Inc.*, supra, the following criteria were developed and used:

- (a) The Debtors first identified vendors that supply goods or services critical to the Debtors' business operations without a long-term contract.
- (b) The Debtors then considered other known suppliers that may have similar goods and services.
- (c) Where an alternative source of supply was identified at reasonably similar prices and terms, the Debtors considered the start-up and delayed delivery time associated with using replacement vendors to determine the extent of supply chain and service interruption that would likely occur.
- (d) Next, the Debtors considered instances where Critical Vendors were so heavily dependent upon the Debtors' business that nonpayment of the vendor's debts could result in the disruption or loss of the Critical Vendor's business.
- (e) Where there was no problem of discontinued service with a specific vendor, or where there was an alternative source of supply identified, those vendors were not considered to be Critical Vendors.

25. The methodology the Debtors used to identify the Critical Vendors is, as indicated, consistent with, and in some cases, stricter than that employed in other cases in this

jurisdiction where similar motions have been approved. It is also consistent with recent case law from the Seventh Circuit cautioning against the overzealous use of Bankruptcy Code Sections 363 and 105 to permit payments to prepetition vendors who might continue to do business with the Debtors despite nonpayment of the prepetition debts. *See Matter of Kmart Corporation*, 359 F.3d 866 (7th Cir. 2004).³

26. The Debtors estimate that, as of the Petition Date, Certain Critical Vendors held claims in the approximate aggregate amount of \$7 million. The total amount requested for payment to critical vendors is *de minimis* when compared to the net sales generated by the Debtors, which were over \$475 million last year.

27. Authority to pay the Critical Vendor Claims will not create an imbalance of the Debtors' cash flows because the majority of these obligations have customary payment terms and will not be payable immediately. Cash maintained by the Debtors, together with the cash generated in the ordinary course of the Debtors' businesses, will provide more than sufficient liquidity for payment of the Critical Vendor Claims in the ordinary course of business. Furthermore, contemporaneously herewith, the Debtors have filed a motion seeking approval of a debtor-in-possession credit facility which would provide for the use of proceeds to satisfy certain Critical Vendor Claims.

28. The Debtors believe they must continue to receive the goods and services provided by the Critical Vendors to achieve a successful reorganization. In some cases, the Debtors believe that some Critical Vendors may, among other things: (i) refuse to provide services; (ii) refuse to provide services on reasonable credit terms absent payment of prepetition claims; or (iii) suffer significant financial hardship if their prepetition claims are not paid in

³ Unlike Kmart Corporation, the Debtors, while large corporations, do not wield the irresistible influence over most of their critical vendors that Kmart held.

whole or in part, resulting in the loss of their products and services. Within the last two quarters preceding the Petition Date, numerous Critical Vendors have altered their credit terms as a condition to doing business with the Debtors, substantially increasing the Debtors' cost of credit and reducing the Debtors' borrowing base. There is no reason to believe that the Critical Vendors are so heavily reliant upon the Debtors that they will continue to do business absent payment of prepetition debts. (Moreover, a number of the Critical Vendors that are heavily dependent upon the Debtors' patronage are on such tight cash flows that they may not survive the Debtors' refusal to pay their prepetition claims, resulting in the loss of certain critical goods and services.)

29. To implement the terms of the authority requested by the Motion, the Debtors propose that the Court enter an order authorizing the Debtors to take one or a combination of the following actions to satisfy the Critical Vendor Claims:

- (a) The Debtors will be authorized, in their discretion and the exercise of their business judgment, but not required, to make payment to any or all of the Critical Vendors in amounts not to exceed, in aggregate, the amounts set forth in the budget supplied in connection with the Court's Interim Order authorizing the Debtors to obtain post-petition financing, as such order may be amended or finalized, and in no event to exceed an aggregate amount of \$7 million, on the conditions that (i) by accepting payment, the Critical Vendor agrees to maintain or reinstate customary trade terms during the pendency of these cases, and (ii) the Debtors mail a copy of the order to each Critical Vendor to which any payment permitted hereunder is made.
- (b) A Critical Vendor's acceptance of payment is deemed to be acceptance of the terms of the order, and if the Critical Vendor thereafter does not provide the Debtors with customary trade terms during the pendency of these cases, then any payments of prepetition claims made after the Petition Date may be deemed to be unauthorized postpetition transfers and therefore recoverable by the Debtors.
- (c) The Debtors shall be authorized to obtain written verification of trade terms to be supplied by the Critical Vendors before issuing payment hereunder.
- (d) The Debtors also propose that the Court order authorize the applicable bank and other financial institutions that process, honor and pay any and all checks on

account of Critical Vendor Claims to rely on the representations of the Debtors as to which all checks are issued and authorized to be paid in accordance with this motion and without any duty of further inquiry and without liability for following the Debtors' instructions.

30. Based on the foregoing, the Debtors submit the relief requested is necessary and appropriate, is in the best interests of their estates and creditors, and should be granted in all respects.

Notice

31. Notice of this Motion has been provided to the Office of the United States Trustee, counsel for the Debtors' pre-petition secured lenders, the indenture trustee for Debtors' senior note holders, counsel to the Agent for the Debtors' proposed debtor-in-possession lenders, and the Debtors' thirty largest unsecured creditors on a consolidated basis. In light of the nature of the relief requested, the Debtors submit that no further notice is necessary.

Conclusion

WHEREFORE the Debtors respectfully request entry of an order granting the relief requested herein, and granting the Debtors such other and further relief as may be just.

Dated: Atlanta, Georgia
March 31, 2004

Respectfully submitted,

KING & SPALDING LLP

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PROPOSED ATTORNEYS FOR THE DEBTORS

**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF GEORGIA
NEWNAN DIVISION**

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| In re: |) | Chapter 11 |
| |) | |
| DAN RIVER INC., <i>et al.</i> |) | Case Nos. 04-__ through 04-__ |
| |) | Jointly Administered |
| |) | |
| Debtors. |) | Judge Drake |
| |) | |

**ORDER GRANTING MOTION OF DEBTORS FOR ORDER PURSUANT TO 11 U.S.C.
§§105(a) AND 363(b) AUTHORIZING PAYMENT OF PREPETITION
CLAIMS OF CERTAIN CRITICAL VENDORS AND SERVICE PROVIDERS**

This matter is before the Court on the motion of Dan River Inc., The Bibb Company, LLC, Dan River International Ltd., and Dan River Factory Stores, Inc. (collectively, the “Debtors”) for authority to pay the prepetition claims of certain vendors whose goods or services are both critical to the Debtors’ reorganization and would be difficult to replace without inordinate disruption to the Debtors’ businesses (the “Motion”).

The Court has considered the Motion, the Declaration of Barry F. Shea in Support of First-Day Applications and Motions, and the matters reflected in the record of the hearing held on the Motion. It appears that the Court has jurisdiction over this proceeding; that this is a core proceeding; that notice of the Motion has been given to the Office of the United States Trustee, counsel for the Debtors’ pre-petition secured lenders, the indenture trustee for the Debtors’ senior note holders, counsel to the Agent for the Debtors’ proposed debtor-in-possession lenders, and the Debtors’ thirty largest unsecured creditors on a consolidated basis; that no further notice is necessary; that the relief sought in the motion is in the best interests of the Debtors, their estates, and their creditors; and that good and sufficient cause exists for such relief. The Court also finds that the methodology used by the Debtors to identify the Critical Vendors limited the

class of Critical Vendors (as defined in the Motion) to those vendors who not only provide unique and essential goods and services to the Debtors, but who also pose a strong risk of discontinuing business with the Debtors, or are not certain of surviving the shock of the loss of payments of their prepetition claims against the Debtors. The Court also finds that the Critical Vendors will not reasonably be likely to continue doing business with the Debtors in response to proposals for alternative security or financing arrangements.

Accordingly, it is hereby ORDERED as follows:

1. The Motion is GRANTED.
2. Except as otherwise required by any post-petition financing order or the Debtors' post-petition financing agreement approved by this Court, the Debtors are authorized, but not required, to honor or pay those critical prepetition obligations described in the Motion to suppliers of goods and services to the Debtors (collectively, the "Critical Vendors"), in an aggregate amount of no more than \$7 million, under the following conditions: (a) the Debtors will mail a copy of this Order to each Critical Vendor that is paid under the terms of this Order; (b) the Critical Vendor accepting payment shall be deemed to have agreed to maintain or reinstate customary trade terms during the pendency of these Chapter 11 cases; (c) the Critical Vendor accepting payment shall be deemed to have accepted the terms of this Order, and if the Critical Vendor does not thereafter provide the Debtors with customary trade terms during the pendency of these Chapter 11 cases, any payments of prepetition claims made after the Petition Date shall be deemed to be an unauthorized postpetition transfer and shall be recoverable by the Debtors; and (d) the Debtors shall be authorized but not required to obtain written verification of the terms to be supplied by the Critical Vendors paid under this Order.

3. The banks and other financial institutions that process, honor and pay any and all checks on account of Critical Vendor Claims may rely on the representation of the Debtors as to which checks are issued and authorized to be paid in accordance with this Order without any duty of further inquiry and without liability for following the Debtors' instructions.

4. To the extent the ten-day stay of Bankruptcy Rule 6004(g) may be construed to apply to the subject matter of this Order, such stay is hereby waived.

5. The Court shall retain jurisdiction to hear and determine all matters arising from the implementation of this Order.

SO ORDERED.

At Atlanta, Georgia this ____ day of _____, 2004.

W. HOMER DRAKE, JR.
UNITED STATES BANKRUPTCY JUDGE

Prepared and Presented by:

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