

**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
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**MOTION OF THE DEBTORS FOR ORDER,
PURSUANT TO 11 U.S.C. §§ 105(a) AND 363, AUTHORIZING
THE DEBTORS TO PAY PREPETITION SALES AND USE
TAXES AND AUTHORIZING FINANCIAL INSTITUTIONS TO HONOR
AND PROCESS CHECKS AND TRANSFERS RELATED TO SUCH RELIEF**

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, pursuant to Sections 363 and 105(a) of the Bankruptcy Code, (a) authorizing them to pay certain prepetition sales and use tax obligations owed to the Taxing Authorities (as defined below), and (b) authorizing the Debtors' banks and financial institutions to honor and process checks and transfers related to such relief.

The Debtors Should Be Authorized to Pay Prepetition Sales and Use Taxes

17. In connection with the normal operation of their businesses in the ordinary course, the Debtors collect sales and use taxes (collectively, the "Sales and Use Taxes") from their customers (and pay such taxes on behalf of certain vendors through direct pay certificates) on behalf of various state and local taxing authorities (the "Taxing Authorities") for payment to such Taxing Authorities.

18. On a periodic basis, typically monthly, the Debtors pay to the Taxing Authorities all previously collected Sales and Use Taxes via funds drawn by checks or by means of electronic fund transfers.

19. The Debtors estimate that Sales and Use Taxes collected but not paid to the Tax Authorities as of the Petition Date aggregate less than \$60,000 based on the average monthly sales tax liability. In addition, prior to the Petition Date, certain Taxing Authorities were sent

checks (the “Checks”) in respect of such obligations that may not have cleared the Debtors’ banks or other financial institutions (together, the “Banks”) as of the Petition Date.

20. The Debtors seek authority to pay all prepetition Sales and Use Tax obligations owed to the Taxing Authorities. Also, to the extent the checks have not cleared the Banks as of the Petition Date, the Debtors seek an order authorizing the Banks to honor the Checks, and to rely on the Debtors’ representations as to which Checks may and may not be cleared, without any liability to any third party. In addition, to the extent the Taxing Authorities have otherwise not received payment for prepetition Sales and Use Taxes due to them, the Debtors seek authorization to issue replacement checks, or to provide for other means of payment to the Taxing Authorities, to the extent necessary to pay all outstanding Sales and Use Tax obligations due as of the Petition Date.

21. Pursuant to Section 105(a) of the Bankruptcy Code, the “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). The Debtors submit that the relief requested herein is necessary and appropriate to carry out the provisions of the Bankruptcy Code.

22. Sales and Use Taxes are afforded priority status under Section 507(a)(8) of the Bankruptcy Code and, therefore, must be paid in full before any general unsecured obligations of a Debtor may be satisfied. Accordingly, the proposed relief will not prejudice the rights of general unsecured creditors or other parties in interest.

23. To the extent that the Debtors have collected Sales and Use Taxes from their customers, such funds are held in trust by the Debtors for the benefit of the Taxing Authorities and do not constitute property of the Debtors’ estates. *See, e.g., Begier v. Internal Revenue Service*, 496 U.S. 53 (1990); *In re Shank*, 792 F.2d 829, 830 (9th Cir. 1986) (sales taxes required

by state law to be collected by sellers from their customers are “trust fund” taxes); *DeChiaro v. New York State Tax Commission* 760 F.2d 432, 433-34 (2d Cir. 1985) (same); *In re American Int’l Airways. Inc.*, 70 B.R. 102, 103 (Bankr. E.D. Pa. 1987) (excise and withholding taxes); *In re Tap. Inc.*, 52 B.R. 271, 272 (Bankr. D. Mass. 1985) (withholding taxes). Accordingly, the Bankruptcy Code does not prohibit a debtor from paying such taxes.

24. Moreover, many state statutes hold responsible officers and directors of collecting entities personally liable for sales and use taxes owed by those entities. To the extent that any Sales and Use Taxes remain unpaid by the Debtors, the Debtors’ officers and directors may be subject to lawsuits or criminal prosecution during these Chapter 11 cases. Any such lawsuit or criminal prosecution (and the ensuing potential liability) would distract the Debtors and their officers and directors from formulating and confirming a Chapter 11 plan, to the detriment of all parties in interest in these Chapter 11 cases.

25. Similar relief to that requested herein has been granted by other bankruptcy courts within and without this district. *See, e.g., In re Wolf Camera, Inc.*, Case No. 01-83470 (Bankr. N.D. Ga. July 22, 2001) (Mullins, J.); *In re Worldcom*, Case No. 02-40188 (Bankr. S.D.N.Y. 2002); *In re Enron Corp.*, Case No. 01-16034 (Bankr. S.D.N.Y. 2001).¹ The Debtors submit that the present circumstances warrant similar relief in their Chapter 11 cases.

**Payment of Checks Issued and Other Transfers
Made in Respect of Payment of Prepetition Sales and Use Taxes**

26. The Debtors further request that all applicable banks be authorized, when requested by the Debtors in their sole discretion, to receive, process, honor, and pay any and all checks drawn on the Debtors’ accounts, without any duty of inquiry or liability to any party for following such instructions, to pay the prepetition Sales and Use Taxes, whether those checks

were presented prior to or after the Petition Date, and to make other transfers provided that sufficient funds are available in the applicable accounts to make such payments. The Debtors ask that the Banks be entitled to rely upon the Debtors' Representations as to the Checks and transfers. Accordingly, the Debtors believe that checks and transfers other than those relating to authorized payments will not be honored inadvertently.

27. Nothing in this Motion should be construed as impairing the Debtors' right to contest the amount of any Sales and Use Taxes that may be due to any Taxing Authority, and the Debtors expressly reserve all of their rights with respect thereto.

Notice

28. 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.

¹ For the Court's convenience, copies of the unpublished authorities cited herein are submitted for the Court's consideration in a separate binder.

Dated: Atlanta, Georgia
March 31, 2004

Respectfully submitted,

KING & SPALDING LLP

/s/ James A. Pardo, Jr._____

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**IN THE UNITED STATES BANKRUPTCY COURT
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In re:)	Chapter 11
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DAN RIVER INC., et al.,)	Case Nos. 04-__ through 04-__
)	Jointly Administered
Debtors.)	
)	Judge Drake
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**ORDER GRANTING MOTION OF THE DEBTORS FOR ORDER PURSUANT TO 11
U.S.C. §§ 105(a) AND 363(b) AUTHORIZING PAYMENT OF PREPETITION SALES
AND USE TAXES AND AUTHORIZING FINANCIAL INSTITUTIONS TO HONOR
AND PROCESS CHECKS AND TRANSFERS RELATED TO SUCH CLAIMS**

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 certain prepetition sales and use taxes (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’ prepetition 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.

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 prepetition Sales and Use Taxes, as those taxes are defined and more particularly described in the Motion. In no event shall payments on account of Sales and Use Taxes exceed the amounts set forth in any budget supplied in connection with the Court's interim order authorizing the Debtors to obtain debtor-in-possession financing, as such order may be amended or finalized. The Debtors' banks are authorized to process, honor and pay any and all checks issued to pay Sales and Use Taxes, without duty of inquiry or liability for following the Debtors' instructions in relation to payments authorized by this Order.

3. Payment of any Sales and Use Taxes shall not preclude the Debtors from contesting the validity or amount due to those creditors.

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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