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. 04-10990 through 04-10993**
	)	**Jointly Administered**
	)	
Debtors.	)	**Judge Drake**
	)	

DEBTORS' RESPONSE TO SUPPLEMENTAL OBJECTION OF THE OFFICIAL COMMITTEE OF UNSECURED CREDITORS TO THE DEBTORS' MOTION FOR ENTRY OF FINAL ORDER (I) AUTHORIZING (A) SECURED POST-PETITION FINANCING ON A SUPER PRIORITY BASIS PURSUANT TO 11 U.S.C. § 364, (B) USE OF CASH COLLATERAL PURSUANT TO 11 U.S.C. § 363, AND (C) GRANT OF ADEQUATE PROTECTION PURSUANT TO 11 U.S.C. §§ 363 AND 364

Dan River, Inc. and its affiliated debtors (collectively, the "Debtors") file this Response To Supplemental Objection Of The Official Committee Of Unsecured Creditors To The Debtors' Motion For Entry Of Final Order (I) Authorizing (A) Secured Post-Petition Financing On A Super Priority Basis Pursuant To 11 U.S.C. § 364, (B) Use Of Cash Collateral Pursuant To 11 U.S.C. § 363, And (C) Grant of Adequate Protection Pursuant To 11 U.S.C. §§ 363 And 364 (the "Supplemental Objection"), respectfully showing the Court as follows:

INTRODUCTION

1. The Committee's Supplemental Objection merely restates the objections raised by the Committee in its original objection, argued at the final hearing and highlighted in the Committee's letter to the Court tendering its form of proposed order. The only new proposition put forth by the Committee is its proposition that the Court should be inclined to view the Committee's objections more favorably because the Committee has ostensibly secured alternative financing which can be implemented in the event that the Court declines to enter the

form of order proposed by the Debtors and Lenders. Like its other objections, the Committee's new proposition is without merit.

2. On April 1, 2004, this Court entered an interim order (the "Interim Order") that authorized the Debtors to obtain emergency post-petition financing and use cash collateral on an emergency basis. As security for the financing provided by the Lenders[1] and the cash collateral used by the Debtors, the Interim Order granted the Agent, for the benefit of the Lenders, a perfected first priority priming lien on all of the Debtors' assets. The Interim Order expressly prohibits any further liens that are prior to or pari passu with the liens granted to the Lenders pursuant to the Interim Order. In reliance on those provisions, the Lenders have loaned the Debtors almost $70,000,000 over the last two months.

3. The Committee now seeks to have this Court disregard the provisions in its Interim Order and consider instead a $30 million loan from an alternative source which loan would be secured by liens that would prime the liens granted to the Lenders by the Interim Order. The Committee's proposal should be rejected for two reasons. First, the proposal completely ignores the effect of the Interim Order by seeking to prime liens that the Interim Order expressly provides cannot be primed. Second, the Debtors have already presented evidence that they considered the possibility of obtaining post-petition financing that would prime the Lenders' pre-petition liens and rejected that alternative, in an exercise of their business judgment, because of the resulting disruptions to their ongoing business activities and to the progress of these cases. For both of these reasons, it is not necessary for the Court to consider the Committee's latest proposal, and the Supplemental Objection should be overruled.

[1] All capitalized terms that are not otherwise defined herein shall have the meaning ascribed to them in the Interim Order.

BACKGROUND

4. The Debtors filed voluntary petitions for relief under Chapter 11 of the Bankruptcy Code on March 31, 2004 (the "Petition Date"). On the Petition Date, the Debtors also filed a motion (the "DIP Motion") pursuant to which the Debtors sought authority to obtain up to $145 million in debtor-in-possession financing, to be secured by superpriority claims and priming liens over substantially all of the Debtors' existing and after-acquired property. Pending the final hearing on the DIP Motion (the "Final Hearing") and entry of a final order on the DIP Motion (the "Final Order"), the Debtors sought the entry of the Interim Order that would authorize emergency post-petition loans up to an aggregate amount of $40,000,000 and emergency use of cash collateral upon the terms and conditions set forth in the Interim Order.

5. The Interim Order was entered by the Court on April 1, 2004. As security for the financing provided by the Lenders and the cash collateral used by the Debtors, the Interim Order granted the Agent, for the benefit of the Lenders, a perfected first priority priming lien on all of the Debtors' assets. (Interim Order, ¶ 6). The Interim Order prohibited any further liens that would be prior to or pari passu with the liens granted pursuant to the Interim Order. Id. The Interim Order also authorized the Secured Parties to reduce the amount owed under the Pre-Petition Revolver by the proceeds of the Pre-Petition Collateral and the DIP Collateral. Id. at ¶ 16. Finally, the Interim Order contained a safe harbor provision pursuant to Section 364(e) of the Bankruptcy Code which provided that in the event the Interim Order was reversed, modified or vacated, the Secured Parties would nevertheless be entitled to the protections afforded by the Interim Order for the period prior to any such reversal or modification of the Interim Order. Id. at ¶ 23. Since the entry of the Interim Order, the Lenders have extended financing to the Debtors and have consented to the use of cash collateral by the Debtors pursuant to the Interim Order.

6. The Final Hearing on the DIP Motion was conducted on April 27, 2004.[2] During the Final Hearing, Robert Del Genio, the Debtors' financial advisor, testified that the Debtors had considered alternatives to the financing proposed in the DIP Motion. Among other things, Mr. Del Genio testified that the Debtors considered a smaller facility that would prime the existing Lenders. (T. at 50:18 – 51:20). Mr. Del Genio explained that this option was rejected to avoid the expense and destabilizing effect of trying to obtain a hostile priming lien. (T. at 51:5 – 51:11).

7. Specifically, Mr. Del Genio testified:

> I think collectively the advisors and the company felt that [trying to obtain a hostile priming lien] would be a destabilizing event . . . and we thought it would be an expensive process.

Id.

Mr. Del Genio's testimony was confirmed by Mr. Barry Shea, the Chief Financial Officer of the Debtors. (T. at 76:9; 77:7-17).

8. The Debtors have subsequently been involved in negotiations with the Lenders regarding an amendment to the DIP Loan Agreement. A copy of the proposed amendment to the DIP Loan Agreement is attached to this Response as Exhibit A.

DISCUSSION

9. Despite the fact that the Debtors have previously exercised their business judgment by deciding not to pursue a hostile priming lien, the Committee would now like the Court to force the Debtors to abandon the financing arrangements entered into with the Lenders and, instead, borrow $30 million from another lender. This alternative financing would be

[2] Although the Final Order has not yet been entered, the Interim Order has been extended on two occasions.

secured by priming liens on the assets of the Debtors and those priming liens would be senior to the liens previously granted by the Court to the Lenders under the Interim Order.

10. As an initial matter, the Committee's proposal would completely undermine the effects of the Interim Order. As noted above, the Interim Order prohibits any further liens that would be prior to or pari passu with the liens granted pursuant to the Interim Order. There is no basis for the Committee to ignore the prohibition on priming liens provided by the Interim Order. Indeed, if the Committee's position is accepted, it would mean that a secured creditor can never rely on the terms of an interim financing order because the relief provided by such an order can be nullified at any point. Such a result is contrary to the provisions of the Bankruptcy Code and the Federal Rules of Bankruptcy Procedure.

11. For instance, Federal Rule of Bankruptcy Procedure 4001(c) provides that a court can authorize a debtor to obtain credit on an interim basis where necessary to avoid immediate and irreparable harm pending a final hearing. In addition, Section 364(e) of the Bankruptcy Code provides that the reversal or modification of an authorization to obtain credit or to grant a lien does not affect the validity of the debt or the lien to an entity that extended the credit in good faith. Taken together, these provisions recognize that it is often critical for a debtor to obtain immediate authorization of post-petition financing upon the filing of a bankruptcy case and that a creditor is unlikely to extend such credit unless the creditor is able to receive the protections of an interim order.

12. If a court could later ignore the terms of an interim financing order, then there would be no reason for a court to enter an interim order in the first place because a creditor would never be able to rely on the protections afforded by an interim order. In that situation, creditors would be unwilling to extend credit to debtors pending a final hearing on any post-

petition financing motion, and the basic purpose of Section 364 and Rule 4001(c) would be thwarted.

13. For these reasons, the Committee should not be allowed to circumvent the terms of the Interim Order. Because the Interim Order prohibits any liens that prime the liens granted by the Interim Order, and because the Committee's proposal is premised on such prohibited priming liens, the Committee's proposal should be rejected.

14. Moreover, the Committee's proposal for an alternative priming facility cannot withstand scrutiny under Section 364(d)(1)(A) which requires a demonstration that no alternative financing is available. The evidence is clear that the Lenders are willing to extend financing to the Debtors. The terms on which the Lenders are willing to finance are all permissible under the Bankruptcy Code. The Debtors have exercised their business judgment in entering into a financing arrangement with the Lenders. Accordingly, there is no basis for concluding that an alternative hostile priming facility is the only financing available to the Debtors or that it complies with Section 364(d)(1)(A).

15. Finally, as evidenced by the testimony of Robert Del Genio at the Final Hearing, the Debtors have already considered and rejected the possibility of obtaining post-petition financing that would prime the pre-petition liens of the Lenders.

16. Bankruptcy courts routinely defer to a debtor's business judgment on most business decisions, including the decision to borrow money. See Group of Institutional Investors v. Chicago Mil. St. P. & Pac. Ry., 318 U.S. 523, 550 (1943); In re Simasko Prod. Co., 47 B.R. 444, 449 (D. Colo. 1985) ("Business judgments should be left to the board room and not to this Court."); In re Lifeguard Indus., Inc. 37 B.R. 3, 17 (Bankr. S.D. Ohio 1983) (same). "More exacting scrutiny would slow the administration of the debtor's estate and increase its costs,

interfere with the Bankruptcy Code's provision for private control of administration of the estate, and threaten the court's ability to control a case impartially." Richmond Leasing Co. v. Capital Bank, N.A., 762 F.2d 1303, 1311 (5th Cir. 1985).

17. In general, a bankruptcy court should defer to a debtor-in-possession's business judgment regarding the need for and the proposed use of funds, unless such decision is arbitrary and capricious. In re Curlew Valley Assoc., 14 B.R. 506, 511-13 (Bankr. D. Utah 1981). Courts generally will not second-guess a debtor-in-possession's business decisions when those decisions involve "a business judgment made in good faith, upon a reasonable basis, and within the scope of [its] authority under the Code." Id. at 513-14 (footnotes omitted).

18. In this case, the Debtors have already presented testimony that they exercised sound business judgment in determining that they should not pursue a hostile priming lien. As Mr. Del Genio testified, the Debtors decided that a hostile priming lien should not be pursued because of the costs and disruptive nature of the litigation that would be required. (T. at 50:18 – 51:20). The Committee has not, and cannot, argue that the business judgment rule is inapplicable. Moreover, the Committee has presented no evidence that the Debtors failed to exercise properly their business judgment with respect to their financing decisions. Because the Debtors have already exercised their business judgment and decided that a hostile priming lien would not have been and is not worth the costs and disruptions involved in obtaining such a lien, the Committee's objection on the basis that there is alternative financing must fail.

CONCLUSION

WHEREFORE, the Debtors respectfully submit that it is not necessary for the Court to consider the Committee's latest proposal for post-petition financing and that the Supplemental Objection should be overruled.

This 26th day of May, 2004.

Respectfully submitted,

KING & SPALDING LLP

/s/ Sarah Robinson Borders

James A. Pardo, Jr.
Georgia Bar No. 561206
Sarah Robinson Borders
Georgia Bar No. 610649
Felton E. Parrish
Georgia Bar No. 564910
191 Peachtree Street
Atlanta, Georgia 30303-1763
(404) 572-4600
Fax: (404) 572-5149

ATTORNEYS FOR THE DEBTORS