

STAR GAS PARTNERS LP  
Form DEF 14A  
January 24, 2006  
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**SCHEDULE 14A INFORMATION**

**Proxy Statement Pursuant to Section 14(a) of  
the Securities Exchange Act of 1934**

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Filed by the Registrant

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  - Definitive Proxy Statement
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**STAR GAS PARTNERS, L.P.**

(Name of Registrant as Specified in its Charter)

Not applicable

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**STAR GAS PARTNERS, L.P.**

2187 Atlantic Street

Stamford, CT 06902

To our Unitholders:

You are cordially invited to attend a special meeting of the unitholders of Star Gas Partners, L.P. ( "Star Gas Partners" ) to be held at the offices of Phillips Nizer LLP, 666 Fifth Avenue, New York, New York 10103, on March 17, 2006, at 11:00 a.m. local time. The board of directors of Star Gas LLC ( "Star Gas" ), our general partner, has called the special meeting.

The board of directors of Star Gas has approved a strategic recapitalization of Star Gas Partners that, if approved by our unitholders and completed, would result in a reduction in the outstanding amount of our 10.25% senior notes due 2013 ( "senior notes" ) of up to \$100 million (assuming full noteholder participation in the senior notes tender offer described in more detail in these materials) and the issuance of approximately 42,171,308 new common units.

At the special meeting you will be asked to consider and approve the issuance and sale to Kestrel Energy Partners, LLC ( "Kestrel" ) or its affiliates of a minimum of 7,500,000 common units and a maximum of 25,000,000 common units at a purchase price of \$2.00 per unit, pursuant to the terms and conditions of a unit purchase agreement dated as of December 5, 2005 (the "unit purchase agreement" ), by and among Star Gas Partners, Star Gas, Kestrel, Kestrel Heat, LLC ( "Kestrel Heat" ) and KM2, LLC ( "M2" ). A copy of the unit purchase agreement is attached to the enclosed proxy statement as Annex A.

As part of the proposed recapitalization, you will also be asked to approve the election of Kestrel Heat, as successor general partner to Star Gas, and the adoption of amendments to Star Gas Partners' amended and restated agreement of limited partnership that reflect the election of Kestrel Heat as successor general partner and revise the terms of our partnership securities in several respects, as further described in the proxy statement, including the conversion of each outstanding senior subordinated unit and junior subordinated unit into one common unit.

The board of directors of Star Gas has determined that the proposed recapitalization is in the best interests of Star Gas Partners and our unitholders and recommends that unitholders vote FOR each of the recapitalization proposals.

Representation of your units at the meeting is very important. Your vote is important, no matter how many or how few units you hold. We urge you, whether or not you plan to attend the meeting, to promptly date, sign and return the enclosed proxy in the envelope furnished for that purpose. If you attend the meeting, you may, if you wish, revoke your proxy and vote in person.

The Board of Directors of

Star Gas LLC, the general partner of

Star Gas Partners, L.P.

**Please see the sections entitled *Important Considerations*, *The Recapitalization Reasons for the Recapitalization that the Board Considered; Recommendations of the Board* and *Interest of Certain Persons in the Recapitalization* for a discussion of potential advantages and disadvantages and other factors which you should consider in connection with the recapitalization proposal.**

If you need assistance in voting your Star Gas Partners units, please call the firm assisting us in the solicitation of proxies for the special meeting:

Georgeson Shareholder

Call toll free: (800) 960-7546

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**STAR GAS PARTNERS, L.P.**

2187 Atlantic Street

Stamford, CT 06902

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**NOTICE OF SPECIAL MEETING OF UNITHOLDERS**

**TO BE HELD ON MARCH 17, 2006**

To our Unitholders:

We, the board of directors of Star Gas, the general partner of Star Gas Partners, give notice that a special meeting of our unitholders will be held at the offices of Phillips Nizer LLP, 666 Fifth Avenue, New York, New York 10103, on March 17, 2006, at 11:00 a.m. local time. At the meeting, our unitholders will act on the following matters:

*Proposal 1.* Approval of the issuance of:

7,500,000 new common units at a purchase price of \$2.00 per unit to Kestrel Heat and M2, wholly owned subsidiaries of Kestrel, on the terms and subject to the conditions set forth in the unit purchase agreement dated as of December 5, 2005 in the form attached to this proxy statement as Annex A;

17,500,000 new common units in an offering of non-transferable rights to our common unitholders at an exercise price of \$2.00 per unit, with a standby commitment from M2 to purchase all units that are not subscribed for in the rights offering;

13,433,962 (subject to adjustment based on rounding) new common units upon the conversion by certain holders of Star Gas Partners 10.25% senior notes due 2013 of approximately \$26.9 million in principal amount of senior notes at a conversion price of \$2.00 per unit; and

3,737,346 new common units upon the conversion of each outstanding senior subordinated unit and each outstanding junior subordinated unit into one common unit in accordance with the terms and conditions of the second amended and restated agreement of limited partnership submitted to unitholders for approval in Proposal 3.

*Proposal 2.* Approval of the election of Kestrel Heat as successor general partner upon the withdrawal of Star Gas; and

*Proposal 3.* The adoption of a second amended and restated agreement of limited partnership of Star Gas Partners, substantially in the form attached to the proxy statement as Annex B, that will, among other matters, reflect the election of Kestrel Heat as successor general partner upon

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the withdrawal of Star Gas and revise the terms and distribution rights of our partnership securities as further described in this proxy statement, including the conversion of each outstanding senior subordinated unit and junior subordinated unit into one common unit, as indicated in Proposal 1 above.

The form of proxy provides unitholders with the opportunity to vote on each of the three proposals to effect the recapitalization separately. However, none of the proposals will be implemented unless all three proposals are approved by unitholders. Under our partnership agreement, proposal 1 requires the approval of a majority of the outstanding common units and proposals 2 and 3 require the approval of a unit majority which means (i) a majority of common units entitled to vote and outstanding as of the record date, and (ii) a majority of senior subordinated units and junior subordinated units, voting together as one class, entitled to vote and outstanding as of the record date, in each case excluding units owned by Star Gas or its affiliates, including its executive officers, directors and members. Under the NYSE rules, proposal 1 requires the approval of a majority of the votes cast by the holders of the common units and senior subordinated units, provided that the total votes cast on the proposal represent at least 50% of all units entitled to vote, and proposals 2 and 3 do not require unitholder approval.

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We are sending this proxy statement to our unitholders on or about January 26, 2006. We have set the close of business on January 24, 2006 as the record date for determining which unitholders are entitled to receive notice of and to vote at the special meeting or any postponements or adjournments thereof. A list of unitholders entitled to vote is on file at our principal offices, 2187 Atlantic Street, Stamford, CT 06902, and will be available for inspection by any unitholder during the meeting.

If you cannot attend the special meeting, you may vote over the telephone or the Internet as instructed on the enclosed proxy card or by mailing the proxy card in the enclosed postage-prepaid envelope. Any unitholder attending the meeting may vote in person even though he or she already has returned a proxy card or voted by telephone or through the Internet.

The Board of Directors of

Star Gas LLC, the general partner of

Star Gas Partners, L.P.

YOU SHOULD RELY ONLY ON THE INFORMATION CONTAINED IN THIS PROXY STATEMENT OR DOCUMENTS INCORPORATED BY REFERENCE IN THIS PROXY STATEMENT. WE HAVE NOT AUTHORIZED ANYONE TO PROVIDE YOU WITH DIFFERENT INFORMATION. THIS PROXY STATEMENT IS DATED JANUARY 24, 2006. YOU SHOULD ASSUME THAT THE INFORMATION CONTAINED IN THIS PROXY STATEMENT IS ACCURATE AS OF THAT DATE ONLY. OUR BUSINESS, FINANCIAL CONDITION, RESULTS OF OPERATIONS AND PROSPECTS MAY HAVE CHANGED SINCE THAT DATE.

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**STAR GAS PARTNERS, L.P.**

2187 Atlantic Street

Stamford, CT 06902

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**PROXY STATEMENT**

**SPECIAL MEETING OF UNITHOLDERS**

January 24, 2006

This proxy statement contains information related to the special meeting of unitholders of Star Gas Partners and any postponements or adjournments thereof. The special meeting will be held on March 17, 2006 beginning at 11:00 a.m. local time at the offices of Phillips Nizer LLP, 666 Fifth Avenue, New York, New York 10103.

At the meeting, our unitholders will act on the following matters:

*Proposal 1.* Approval of the issuance of:

7,500,000 new common units at a purchase price of \$2.00 per unit to Kestrel Heat and M2, wholly owned subsidiaries of Kestrel, on the terms and subject to the conditions set forth in the unit purchase agreement dated as of December 5, 2005 in the form attached to this proxy statement as Annex A;

17,500,000 new common units in an offering of non-transferable rights to our common unitholders at an exercise price of \$2.00 per unit, with a standby commitment from M2 to purchase all units that are not subscribed for in the rights offering;

13,433,962 (subject to adjustment based on rounding) new common units upon the conversion by certain holders of Star Gas Partners 10.25% senior notes due 2013 of approximately \$26.9 million in principal amount of senior notes at a conversion price of \$2.00 per unit; and

3,737,346 new common units upon the conversion of each outstanding senior subordinated unit and each outstanding junior subordinated unit into one common unit in accordance with the terms and conditions of the second amended and restated agreement of limited partnership submitted to unitholders for approval in Proposal 3.

*Proposal 2.* Approval of the election of Kestrel Heat as successor general partner upon the withdrawal of Star Gas; and



*Proposal 3.* The adoption of a second amended and restated agreement of limited partnership of Star Gas Partners, substantially in the form attached to the proxy statement as Annex B, that will, among other matters, reflect the election of Kestrel Heat as successor general partner upon the withdrawal of Star Gas and revise the terms and distribution rights of our partnership securities as further described in this proxy statement, including the conversion of each outstanding senior subordinated unit and junior subordinated unit into one common unit, as indicated in Proposal 1 above.

This proxy statement is first being mailed to Star Gas Partners unitholders on or about January 26, 2006.

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Annex A	Unit Purchase Agreement
Annex B	Form of Second Amended and Restated Agreement of Limited Partnership, a clean copy of which is attached hereto as Annex B-1, and a copy marked to show changes compared to the existing Amended and Restated Agreement of Limited Partnership is attached hereto as Annex B-2.
Annex C	Annual Report on Form 10-K for the fiscal year ended September 30, 2005
Annex D	Opinion of Jefferies & Company, Inc.

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**FORWARD-LOOKING STATEMENTS**

Many of the statements contained in this proxy statement, including, without limitation, statements regarding our business strategy, plans and objectives of our management for future operations are forward-looking within the meaning of the federal securities laws. These statements use forward-looking words, such as anticipate, continue, expect, may, will, estimate, believe or other similar words. These statements, including those contained in The Recapitalization - 2006 Forecast of Star Gas Partners, discuss future expectations or contain projections. Although we believe that the expectations reflected in the forward-looking statements are reasonable, actual results may differ from those suggested by the forward-looking statements for various reasons, including:

the approval of the recapitalization;

the effect of weather conditions on our financial performance;

the price and supply of home heating oil;

the consumption patterns of our customers;

our ability to obtain satisfactory gross profit margins;

our ability to obtain new customers and retain existing customers;

our ability to effect strategic acquisitions or redeploy underperforming assets;

the ultimate disposition of excess proceeds from the sale of the propane segment should the recapitalization not be consummated;

the impact of litigation;

the ongoing impact of the business process redesign project at the heating oil segment and our ability to address issues related to that project;

natural gas conversions;

future union relations and the outcome of current and future union negotiations;

the impact of current and future environmental, health and safety regulations;

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customer creditworthiness; and

marketing plans.

The above factors, as well as the factors set forth below under Item 1A Risk Factors of our Annual Report on Form 10-K for the fiscal year ended September 30, 2005, which is attached to this proxy statement as Annex C, could cause our actual results to differ materially from those contained in any forward-looking statement. We disclaim any obligation to update the above list or to announce publicly the result of any revisions to any of the forward-looking statements to reflect future events or developments.

Throughout this proxy statement, we refer to ourselves, Star Gas Partners, L.P., as we or us or Star Gas Partners. We sometimes refer to the board of directors of our general partner, Star Gas, as our board of directors, our board, the board, Star Gas board or Star Gas Partners board.

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**S U M M A R Y**

*This summary highlights selected information from this proxy statement and does not contain all of the information that is important to you. To fully understand the transaction, and for a more complete description of legal terms, you should read carefully this entire document and the documents to which we have referred you. A glossary of terms used in this proxy statement begins on page 86. You should pay special attention to the **Important Considerations** section beginning on page 21 of this proxy statement in determining how to vote on the proposals.*

**About Star Gas Partners**

*Star Gas Partners.* We are the largest retail distributor of home heating oil in the United States, based on volume as reported by the National Oilheat Research Alliance Organization, March 2003. Our home heating oil operations serve approximately 480,000 customers in the Northeast and Mid-Atlantic regions. For the fiscal year ended September 30, 2005, our home heating oil segment sold 487 million gallons of home heating oil. We were also formerly engaged as a retail distributor of propane until December 17, 2004, when we sold our propane segment.

For the fiscal year ended September 30, 2005, approximately 75% of total sales from our heating oil operations were from sales of home heating oil, approximately 15% were from the installation and repair of heating and air conditioning equipment and approximately 10% were from the sale of other petroleum products, including diesel fuel and gasoline, primarily to commercial customers for fleet fuel service. During this period, our home heating oil operations generated total sales of approximately \$1.3 billion.

Our executive offices are located at 2187 Atlantic Street, Stamford, Connecticut 06902. The telephone number is (203) 328-7310.

**The Recapitalization (see pages 26 to 44)**

The board of directors of Star Gas has approved a strategic recapitalization of Star Gas Partners that, if approved by unitholders and completed, would result in a reduction in the outstanding amount of our senior notes of up to \$100 million (assuming full noteholder participation in the senior notes tender offer described below under **Noteholder Agreements**) and the issuance of approximately 42,171,308 new common units.

The recapitalization includes a commitment by Kestrel and its affiliates to purchase \$15 million of new equity capital and provide a standby commitment in a \$35 million rights offering to our common unitholders, each at a price of \$2.00 per common unit. We would utilize the \$50 million in new equity financing, together with additional funds from operations, to repurchase at least \$60 million in face amount of our senior notes and, at our option, up to approximately \$73.1 million of senior notes (less any principal, interest and premium payments required to be reserved for non-tendering noteholders in the senior notes tender offer). In addition, certain noteholders have agreed to convert approximately \$26.9 million in face amount of such senior notes into 13,433,962 (subject to adjustment based on rounding) new common units at a conversion price of \$2.00 per unit in connection with the closing of the recapitalization.

*Unit Purchase Agreement.* We have entered into a unit purchase agreement with Kestrel and its affiliates, which provides for, among other things: the receipt by us of \$50 million in new equity financing through the issuance to Kestrel's affiliates of 7,500,000 common units at \$2.00

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per unit for an aggregate of \$15 million and the issuance of an additional 17,500,000 common units in the rights offering to our common unitholders at an exercise price of \$2.00 per unit for an aggregate of \$35 million. The rights will be non-transferable, and an affiliate of Kestrel has agreed to buy any common units not subscribed for in the rights offering. Under the terms of the unit purchase agreement, and subject to unitholder approval, Kestrel Heat will become our new general partner and Star Gas, our current general partner, will receive no consideration for its withdrawal as general partner.

*Noteholder Agreements.* We have entered into agreements with an unaffiliated group of investors who hold approximately 94% of the principal amount of our senior notes (sometimes referred to in this proxy

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statement as the consenting noteholders ) that provide that these noteholders will tender their senior notes to us at par for:

a pro rata portion of \$60 million or, at our option, up to approximately \$73.1 million in cash (less any principal, interest and premium payments required to be reserved for non-tendering noteholders in the senior notes tender offer);

13,433,962 (subject to adjustment based on rounding) new common units at a conversion price of \$2.00 per unit (which new units would be acquired by certain noteholders exchanging approximately \$26.9 million in face amount of senior notes); and

new notes representing the remaining face amount of the tendered notes.

The closing of the tender offer for the senior notes is conditioned upon the simultaneous closing of the transactions under the Kestrel unit purchase agreement.

The closing of the recapitalization will be deemed a change of control under the indenture for our senior notes. Consequently, we will be required to make an offer to repurchase any senior notes that are not otherwise tendered in the senior notes tender offer at a purchase price equal to 101% of their face value. As of the date of this proxy statement, the holders of an aggregate of approximately \$15.3 million in senior notes have not yet agreed to tender their notes in the tender offer. The principal amount of any senior notes, plus any interest and premium payments that we are required to make in respect of senior notes tendered for repurchase in the change of control repurchase offer, will reduce on a dollar-for-dollar basis the amount of senior notes that we shall repurchase for cash in connection with the closing of the recapitalization.

Subject to and until the closing of the recapitalization, these noteholders have agreed not to accelerate indebtedness due under the senior notes or initiate any litigation or proceeding with respect to the senior notes. The consenting noteholders have further agreed:

to waive certain potential defaults under the indenture;

not to tender their senior notes in the change of control offer which will be required to be made by us following the closing of the transactions under the unit purchase agreement with Kestrel; and

to consent to certain amendments to the existing indenture.

The agreements with the consenting noteholders further provide for the termination of their provisions in the event that the Kestrel unit purchase agreement is no longer in effect. The understandings and agreements contemplated by these transactions will terminate if the recapitalization does not close prior to April 30, 2006.

*Amendments to Partnership Agreement.* The unit purchase agreement provides for the adoption of a second amended and restated agreement of limited partnership that will, among other things, provide for the following:

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*Conversion of Senior Subordinated Units and Junior Subordinated Units into Common Units.* The proposed amendments will provide for the mandatory conversion of each outstanding senior subordinated unit and each junior subordinated unit into one common unit, as a result of which the subordination period (as defined in our partnership agreement) will end.

*Reduction of the Minimum Quarterly Distribution.* The proposed amendments will reduce the minimum quarterly distribution on the common units from \$0.575 per unit per quarter, or \$2.30 per unit per year, to \$0.0 per unit through September 30, 2008, or, if we elect to commence making distributions sooner, the quarter in which any distribution of available cash is made, and to \$0.0675 per unit per quarter, or \$0.27 per unit per year, thereafter. The amendment will also eliminate all previously accrued cumulative distribution arrearages on our common units, which aggregated \$92.5 million at



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November 30, 2005. We believe that this amendment will more closely align the minimum quarterly distribution with the levels of available cash that we may be expected to generate in the future.

*Reduction of Incentive Distribution Levels.* The proposed amendments will reduce the target distribution levels for the incentive distribution rights so that, commencing with the quarter beginning October 1, 2008, or, if we elect to commence making distributions sooner, the quarter in which any distribution of available cash is made, the new general partner units in the aggregate will be entitled to receive 10% of the cash distributions in a quarter once each common unit and general partner unit has received \$.0675 for that quarter, plus any arrearages on the common units from prior quarters, and 20% of the cash distributions in a quarter once each common unit and general partner unit has received \$.1125 for that quarter, plus any arrearages on the common units from prior quarters. Under the partnership agreement as currently in effect, the senior subordinated units, junior subordinated units and general partner units are not entitled to receive incentive distributions until \$.604 has been distributed on each common unit for a quarter, plus any arrearages on the common units for prior quarters.

*Suspension of Mandatory Distribution of Available Cash.* We suspended distributions on our senior subordinated units, junior subordinated units and general partner units on July 29, 2004 and on our common units on October 18, 2004. The proposed amendments will provide that we are not required to distribute available cash through the quarter ending September 30, 2008. We currently do not intend to make distributions of available cash during this period, even if we have available cash to distribute.

### **Reasons for the Recapitalization; Potential Advantages and Disadvantages of the**

#### **Recapitalization (see pages 31 to 34)**

##### *Reasons for the Recapitalization*

As discussed under *The Recapitalization-Background*, during fiscal 2004, we experienced difficult operating and financial conditions as a result of our inability to pass on the full impact of record wholesale heating oil prices to customers and the effects of unusually high net customer attrition principally related to our heating oil segment's operational restructuring. Prior to the 2004 winter heating season, our heating oil segment attempted to develop a competitive advantage in customer service, and as part of that effort, centralized its heating equipment service dispatch and engaged a centralized call center to fulfill its telephone requirements for the majority of its home heating oil customers. We experienced difficulties in advancing this initiative during the fiscal year ended September 30, 2004, which adversely impacted our customer base, product sales and costs. These conditions led to the suspension of distributions on our senior subordinated units, junior subordinated units and general partner units on July 29, 2004 and to the suspension of distributions on the common units on October 18, 2004. We continued to experience difficult operating and financial conditions in fiscal 2005. As indicated below, we believe that the recapitalization would permit us to address the problems resulting from these difficult operating and financial conditions in a manner that would be beneficial to our unitholders.

##### *Certain Potential Advantages of the Proposed Recapitalization to Common Unitholders:*

*Reduce Liquidity Concerns.* The use of the \$50 million in new equity financing (including from the rights offering), together with additional funds from operations, to repurchase up to approximately \$73.1 million in face amount of our senior notes (assuming full noteholder participation in the senior notes tender offer), and the conversion of an additional \$26.9 million in face amount of senior notes into equity in connection with the closing of the recapitalization would substantially strengthen our balance sheet and thereby reduce our concerns about liquidity and a shortage of capital. We believe this would provide us with the financial flexibility to better manage this period of high oil prices and to continue our program to improve operating results. As of the date of this proxy statement, the holders of an aggregate of approximately \$15.3 million in senior notes have not yet agreed to tender their notes in the tender offer. The principal amount of any senior notes, plus any interest and



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premium payments that we are required to make in respect of senior notes tendered for repurchase in the change of control repurchase offer, will reduce on a dollar-for-dollar basis the amount of senior notes that we shall repurchase for cash in connection with the closing of the recapitalization.

*Facilitate Future Acquisitions.* The repayment or conversion into equity of senior notes pursuant to the senior notes tender offer would significantly reduce our indebtedness, which should help to facilitate our access to the capital markets to obtain equity capital and debt financing for acquisitions. If we are unable to access additional capital to grow our business, we may be adversely affected in our ability to maintain or increase our customer base, which could further erode our ability to generate available cash. Reducing our indebtedness should enhance our ability to make acquisitions.

*Simplify Capital Structure.* The elimination of the cumulative common unit arrearages and the conversion of the senior subordinated units and junior subordinated units into common units would simplify our capital structure, which should help to facilitate our access to the capital markets. We believe that it would be difficult to issue new common or subordinated units while our existing common units are subject to significant arrearages for past distributions, which could adversely affect our ability to obtain debt financing for acquisitions since an important element of obtaining debt financing is our ability to access equity markets to repay debt. If we are limited in our ability to access capital to grow the business, we may be adversely affected in our ability to maintain or increase our customer base. Such reduction of activity could further erode our ability to generate available cash.

*Experience of Kestrel Representatives.* Subject to the closing of the transactions contemplated by the unit purchase agreement, Star Gas will withdraw as general partner and Kestrel Heat will become our new general partner. Kestrel will be entitled to elect the board of directors of the general partner. We expect to benefit from the ability of the Kestrel representatives who have substantial experience in the energy markets. Paul A. Vermynen, Jr., the President of Kestrel, served as an executive officer of Meenan Oil Co., L.P., a heating oil company, for 18 years before it was sold to Star Gas Partners in 2001. See Information Regarding Kestrel Heat.

*Agreements with Senior Noteholders.* The agreements with the holders of 94% of our senior notes would largely eliminate the costs and significant risks associated with the potential for litigation and alleged defaults under the indenture for our senior notes involving, among other matters, our use of proceeds from the sale of our propane segment. If this matter were not resolved and we were unsuccessful in defending our position in any future claim that might be brought by noteholders, this would constitute an event of default if declared by either of the holders of 25% in principal amount of the senior notes or by the trustee and in such event all amounts due under the senior notes would become immediately due and payable. An acceleration of our senior notes would have a material adverse effect on our ability to continue as a going concern. The report of our independent registered public accounting firm on our consolidated financial statements as of September 30, 2005 and 2004, and for the three years ended September 30, 2005, includes an explanatory paragraph with respect to the impact of this matter on our ability to continue as a going concern if this matter is resolved adversely to us.

*Certain potential disadvantages of the proposed recapitalization to common unitholders:*

*Elimination of Previously Accrued Cumulative Distribution Arrearages.* Arrearages on the common units that have accrued through the date of the closing of the recapitalization proposal would be eliminated. As of November 14, 2005, cumulative distribution arrearages on all outstanding common units aggregated \$92.5 million, or \$2.875 per common unit.

*Reduction and Postponement of Minimum Quarterly Distributions.* The approval of the proposals would result in a reduction of the minimum quarterly distribution from the current \$0.575 per common unit to \$0.0675 per common unit. Also there would be no mandatory distributions on

the common units until at least fiscal 2009.

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However, regardless of whether the minimum quarterly distribution is reduced, our board of directors of our general partner has concluded that (absent the proposed recapitalization) we are not generating enough available cash to pay any quarterly distributions and/or arrearages at the present time or in the foreseeable future.

*Increased Distributions to General Partner.* If the proposals are approved, the general partner would be entitled to receive a substantially higher percentage of cash distributed above \$0.0675 per unit than under the existing partnership agreement as a result of the revisions to the incentive distribution payments to allocate all incentive distributions to the holders of the general partner units. The reduction of the minimum quarterly distribution would mean that the general partner would be able to receive incentive distributions sooner. See Amendments to the Partnership Agreement Comparison of the Star Gas Partnership Agreement Before and After the Recapitalization.

*Depressed Purchase Price.* The price per common unit that we would receive from Kestrel Heat and M2 and in connection with the rights offering is close to the bottom of the trading range for our common units since we became a public partnership, but such price represents a 34% premium to the closing sales price of the common units on the last trading day prior to the public announcement of the recapitalization transaction.

*Substantial Dilution.* The number of common units outstanding would increase from 32,165,528 to approximately 74,336,836, representing a significant dilution to existing unitholders. However, common unitholders who participate in the rights offering would be able to reduce the dilution in their unit holdings. Prior to the recapitalization, the common units represented approximately 88.8% of the total number of units outstanding. Following the recapitalization, if all common unitholders exercise their rights in the rights offering, our existing common unitholders would own common units representing approximately 66.5% of the total number of units outstanding. However, if none of the common unitholders exercise their rights in the rights offering and M2 is issued the 17,500,000 common units offered to the common unitholders pursuant to its standby commitment, our existing common unitholders would own common units representing approximately 43.1% of the total number of units outstanding.

*Termination of Subordination Period.* The termination of the subordination period would eliminate the priority of payment to the common unitholders in preference to the senior subordinated units and junior subordinated units. In addition, the termination of the subordination period would eliminate the requirement that the general partner receive unitholder approval for issuance of more than a specified number of additional common units during the subordination period. However, the rules of the NYSE generally would require prior unitholder approval before we could issue common units in excess of 20% of the then currently issued and outstanding common units in a single or series of related transactions other than a public offering for cash.

*Restriction on Use of NOLs.* We believe that the issuance of units in our recapitalization will likely result in an ownership change of our corporate subsidiary, Star/Petro, Inc. ( Star/Petro ) under the Internal Revenue Code of 1986, as amended ( Tax Code ). As a result of this ownership change, Star/Petro will be materially restricted in its ability to use its net operating loss carryforwards to reduce its future taxable income. As of September 30, 2005, Star/Petro had federal net operating loss carryforwards of approximately \$181.7 million. The net operating loss carryforwards (prior to an ownership change ) will begin to expire in 2025 and are generally available to reduce future taxable income that would otherwise be subject to federal income taxes. We believe that the restriction may entirely eliminate Star/Petro's ability to use its net operating loss carryforwards. The restriction on Star/Petro's ability to use net operating loss carryforwards to reduce its federal tax liability will reduce the amount of cash Star/Petro has available to make distributions to us. Consequently, the restriction will reduce the amount of cash we have available to distribute to our unitholders.

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*Potential Advantages and Disadvantages to Senior Subordinated Unitholders and Junior Subordinated Unitholders:*

In addition to the certain potential advantages to the common unitholders, the following are certain potential advantages of the proposed recapitalization to senior subordinated unitholders and junior subordinated unitholders:

*Increased Likelihood of Distributions.* The conversion of each outstanding senior subordinated unit and junior subordinated unit into one common unit will eliminate the priority common units had on distributions ahead of the senior subordinated units and junior subordinated units and will significantly increase the likelihood that we will resume distributions to the holders of these units.

In addition to the certain potential disadvantages to the common unitholders, the following are certain potential disadvantages of the proposed recapitalization to senior subordinated and junior subordinated unitholders:

*No Incentive Distributions.* The right of the senior subordinated units and junior subordinated units to receive incentive distributions would be eliminated. However, given that as of September 30, 2005 we had approximately \$92.5 million in accrued distribution arrearages on the common units that must be paid prior to the payment of any incentive distributions, it is unlikely that any incentive distributions would be received by the holders of senior subordinated units in the foreseeable future.

*No Separate Class Vote.* The senior subordinated and junior subordinated units would lose their right to vote separately as a class during the subordination period on all matters on which unitholders are entitled to vote. However, the separate class vote was originally intended to protect the rights of the subordinated unitholders when they constituted a junior class of securities to the common units, which would no longer be the case once the subordinated units are converted in common units.

*Dilution.* Subordinated units would not be allowed to participate in the rights offering being made to the holders of common units, and therefore would be diluted to a greater extent than the holders of common units who participate in the rights offering.

**Important Considerations (see pages 21 to 25)**

We refer you to **Important Considerations** beginning on page 21, which discusses certain important matters that you should carefully consider in evaluating the recapitalization proposals.

**Recommendations of the Board of Directors**

(see page 34)

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After considering the advice of its independent legal counsel and financial advisor, the board of directors believes that the transaction is fair to, and in the best interests of, the Star Gas Partners unitholders. The board of directors of Star Gas unanimously recommends that Star Gas Partners unitholders vote FOR each of the recapitalization proposals.

Each of Star Gas Partners executive officers and directors who owns units has indicated that he intends to vote in favor of each of the proposals. These officers and directors own in the aggregate 35,125 common units, 290,037 senior subordinated units and 53,426 junior subordinated units. The votes of affiliates of Star Gas, including its executive officers, directors and members, will be excluded for the purposes of the votes required to approve proposals 2 and 3.

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**Opinion of Jefferies & Company, Inc.**

(see pages 35 to 42)

On December 2, 2005, Jefferies & Company, Inc., or Jefferies, rendered to Star Gas board of directors its opinion as investment bankers to the effect that, as of that date and based upon and subject to the various considerations and assumptions set forth therein, the Recapitalization Transaction (as defined in such opinion), taken as a whole, was fair, from a financial point of view, to the existing holders of common units on that date. The full text of the Jefferies opinion, which sets forth the assumptions made, matters considered and limitations on the scope of review undertaken by Jefferies in rendering its opinion, is attached to this proxy statement as Annex D. See The Recapitalization Opinion of Jefferies & Company, Inc. or such Annex D for a description of the Recapitalization Transaction as used in the Jefferies opinion. Star Gas and its board of directors encourage the holders of common units to read the Jefferies opinion carefully and in its entirety. The summary of the Jefferies opinion in this proxy statement is qualified in its entirety by reference to the full text of the Jefferies opinion. **The Jefferies opinion was provided to Star Gas board of directors in connection with its consideration of the proposed recapitalization, taken as a whole, and does not address the underlying business decision of Star Gas Partners to engage in the proposed recapitalization or the terms of the unit purchase agreement and the documents referred to therein. The Jefferies opinion addresses only the fairness, from a financial point of view and as of the date of the Jefferies opinion, of the Recapitalization Transaction, taken as a whole, to existing holders of common units as of the date of its opinion, and does not address any individual element of the Recapitalization Transaction. The Jefferies opinion does not constitute a recommendation as to how any holder of units should vote on the Recapitalization, or as to whether any holder of common units should exercise rights to acquire additional common units in the rights offering.**

**Interests of Certain Persons in the Recapitalization (see page 44)**

In connection with the proposed recapitalization, our current general partner, Star Gas, will withdraw as general partner by contributing its general partner units and its .01% equity interest in Star/Petro to Star Gas Partners for no consideration.

Kestrel has proposed that following the closing of the recapitalization, Mr. William P. Nicoletti, the chairman of the board of Star Gas, Mr. Joseph P. Cavanaugh, the chief executive officer and a director of Star Gas, and Mr. Daniel P. Donovan, the president of Star Gas, would become directors of Kestrel Heat. Mr. Paul Biddelman, Mr. Stephen Russell and Mr. Irik P. Sevin, the other three directors of Star Gas, will not become directors of Kestrel Heat. In addition, if the recapitalization is consummated, Mr. Cavanaugh, Mr. Donovan and Mr. Richard F. Ambury, the chief financial officer of Star Gas, would continue to be employed by us under the terms of their current employment arrangements. If Kestrel Heat is elected successor general partner, the proposed directors and executive officers of Kestrel Heat will have interests in the proposed recapitalization as described in Information Regarding Kestrel Heat below.

The unit purchase agreement provides in general that Kestrel will cause Star Gas Partners to maintain, for a period of six years after the completion of the transaction, the current indemnification agreements and provisions for Star Gas officers and directors and the current policies of directors and officers liability insurance maintained by Star Gas Partners, or policies of at least the same coverage and amounts containing terms and conditions that are no less advantageous, with respect to claims arising from facts or events that occurred on or before the date of the completion of the transaction.

The membership interests in Star Gas are owned by Irik P. Sevin, Audrey L. Sevin and Hanseatic Americas, Inc. Mr. Sevin is a director of Star Gas. Star Gas and its members own an aggregate of 314,305 senior subordinated units and 345,364 junior subordinated units that will be converted into common units in connection





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with the proposed recapitalization. Mr. Paul Biddelman, who is a director of Star Gas, is an executive officer of Hanseatic Corporation, the sole managing member of Hanseatic Americas, LDC, which is the indirect parent of Hanseatic Americas, Inc. Mr. Biddelman and a colleague of his each beneficially own an approximately 10% equity interest in Hanseatic Americas, Inc., and persons unaffiliated with Mr. Biddelman beneficially own an approximately 80% equity interest in Hanseatic Americas, Inc.

In addition, the executive officers and directors of Star Gas (excluding Mr. Sevin) own an aggregate of 18,561 senior subordinated units that will be converted into common units in connection with the proposed recapitalization.

Kestrel has acknowledged that Star Gas Partners is required to reimburse Star Gas for amounts that are payable by Star Gas to Mr. Sevin under his agreement dated March 7, 2005 and Kestrel has agreed to cause Star Gas Partners to continue to make such reimbursement without offsets, defenses or counterclaims, except that Star Gas Partners shall have such defenses as may become available to Star Gas pursuant to such agreement. See Information Regarding Kestrel Heat Interests of the Proposed Executive Officers and Directors in the Recapitalization.

## **Market Prices and Related Matters**

Our common units and senior subordinated units are listed and traded on the New York Stock Exchange under the symbol SGU and SGH, respectively.

During the fiscal year ended September 30, 2005, the high and low sales prices of our common units were \$22.23 and \$1.94, respectively, and the high and low sales prices of our senior subordinated units were \$14.05 and \$1.15, respectively.

On December 2, 2005, the last trading day prior to our public announcement of the recapitalization transaction, the closing sales price of the common units and senior subordinated units was \$1.32 and \$1.89, respectively. On January 23, 2006, the last trading day prior to the date of this proxy statement, the closing sales price of the common units and senior subordinated units was \$2.39 and \$2.20, respectively. Unitholders are urged to obtain a current quotation for the common units and senior subordinated units.

For additional information concerning the market prices of our common units and senior subordinated units and information concerning distributions, see Item 5 Market for the Registrant's Units and Related Matters from our Annual Report on Form 10-K for the fiscal year ended September 30, 2005, which is attached hereto as Annex C.

## **The Meeting; Required Vote**

The special meeting of unitholders to vote on the recapitalization proposals will be held on March 17, 2006, at 11:00 a.m., local time, at the offices of Phillips Nizer LLP, 666 Fifth Avenue, New York, New York 10103 (the Meeting). The recapitalization cannot be effected without approval of each of the recapitalization proposals. Under our partnership agreement, proposal 1 requires the approval of a majority of the outstanding common units and proposals 2 and 3 require the approval of a unit majority, which means (i) a majority of common units entitled to vote and outstanding as of the record date, and (ii) a majority of senior subordinated units and junior subordinated units, voting together as one

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class, entitled to vote and outstanding as of the record date, in each case excluding units owned by Star Gas or its affiliates, including its executive officers and directors and members. Under the NYSE rules, proposal 1 requires the approval of a majority of the votes cast by the holders of the common units and senior subordinated units, voting as a single class, provided that the total votes cast on the proposal represent at least 50% of all units entitled to vote, and proposals 2 and 3 do not require unitholder approval. None of the proposals will be implemented unless all three recapitalization proposals are approved by unitholders.

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**Material U.S. Federal Income Tax Consequences (see pages 45 to 47)**

In general, the recapitalization is not expected to result in taxable income or loss to the unitholders. See Material U.S. Federal Income Tax Consequences.

**Description of Common Units and other Partnership**

**Interests Following the Recapitalization (see pages 71 to 75)**

<i>Units to be Outstanding After the Recapitalization</i>	Approximately 74,336,836 common units, representing a combined 99.6% limited partner interest, and 325,729 general partner units, representing a combined 0.4% general partner interest.
<i>Requirement to Distribute Available Cash</i>	Within 45 days following the end of each quarter commencing with the quarter beginning October 1, 2008, or, if we elect to commence making distributions sooner, the quarter in which any distribution of available cash is made, Star Gas Partners is required to distribute 100% of its available cash with respect to such quarter to partners as of the record date selected by the general partner in its reasonable discretion. Star Gas Partners has no obligation to distribute available cash through the quarter ending September 30, 2008 and currently has no intention of making any such distributions.
<i>Definition of Available Cash</i>	Available cash for any quarter will continue to consist of all cash on hand at the end of that quarter, as adjusted for reserves. The general partner has broad discretion in establishing reserves.
<i>Minimum Quarterly Distribution</i>	\$0.0 through the quarter ending September 30, 2008 or, if we elect to commence making distributions sooner, the quarter in which any distribution of available cash is made, and \$0.0675 per unit per quarter, or \$0.27 per unit per year, thereafter.
<i>First Target Distribution Level</i>	\$0.1125 per unit per quarter or \$0.45 per unit per year.
<i>Distribution of Available Cash from Operating Surplus</i>	Available cash from operating surplus with respect to any quarter will be distributed in the following manner:  First, 100% to the common units, pro rata, until we distribute to each common unit the minimum quarterly distribution of \$0.0675;  Second, 100% to the common units, pro rata, until we distribute to each common unit any arrearages in payment of the minimum quarterly distribution on the common units for prior quarters;

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Third, 100% to the general partner units, pro rata, until we distribute to each general partner unit the minimum quarterly distribution of \$0.0675;

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Fourth, 90% to the common units, pro rata, and 10% to the general partner units, pro rata, until we distribute to each common unit the first target distribution of \$0.1125; and

Thereafter, 80% to the common units, pro rata, and 20% to the general partner units, pro rata.

*Subordination Period*

Because all senior subordinated units and junior subordinated units will convert into common units as part of the recapitalization, the subordination period will end. All outstanding limited partner units will be common units.

*Voting*

Approval of a majority of the outstanding common units, including common units owned by the general partner and its affiliates, is required for the following:

certain amendments to our partnership agreement;

the merger of our partnership or the sale of all or substantially all of our assets; and

the dissolution of our partnership.

**Table of Contents****Financial Information****Unit Ownership**

The following table shows the approximate number of units outstanding before and after the proposed recapitalization.

	<b>Before Recapitalization</b>		<b>After Recapitalization</b>	
	<b>Number</b>	<b>Percentage</b>	<b>Number</b>	<b>Percentage</b>
<b>Common Units</b>				
Existing common units	32,165,528	88.8%	32,165,528	43.1%
Issued to Kestrel entities**			7,500,000	10.1%
Issued in rights offering			17,500,000	23.4%
Issued to senior noteholders			13,433,962	18.0%
Issued to subordinated unitholders			3,737,346	5.0%
<b>Subtotal</b>	<b>32,165,528</b>	<b>88.8%</b>	<b>74,336,836</b>	<b>99.6%</b>
<b>Subordinated Units</b>				
Senior subordinated units	3,391,982	9.4%		
Junior subordinated units	345,364	0.9%		
<b>Subtotal</b>	<b>3,737,346</b>	<b>10.3%</b>		
<b>General Partner Units</b>	<b>325,729</b>	<b>0.9%</b>	<b>325,729</b>	<b>0.4%</b>
<b>Total</b>	<b>36,228,603</b>	<b>100%</b>	<b>74,662,565</b>	<b>100%</b>

\* As of the date of this proxy statement.

\*\* Assumes no additional units are acquired in the rights offering by M2 pursuant to its standby commitment.

**Capitalization**

The following table sets forth our historical capitalization as of September 30, 2005 on an actual basis and as adjusted to give pro forma effect to the following elements of the recapitalization (see Unaudited Condensed Pro Forma Financial Information):

the issuance of 7,500,000 common units to Kestrel Heat and M2 for a purchase price of \$2.00 per unit and the issuance to Kestrel Heat of 325,729 general partner units;

the issuance of 17,500,000 common units in the rights offering at an exercise price of \$2.00 per unit;

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the use of the net proceeds from the issuance of common units to Kestrel and M2 and the rights offering, together with additional cash from operations, to repurchase approximately \$73.1 million of senior notes (assuming full noteholder participation in the senior notes tender offer); as of the date of this proxy statement, the holders of an aggregate of approximately \$15.3 million in senior notes have not yet agreed to tender their notes in the tender offer; the principal amount of any senior notes, plus any interest and premium payments that we are required to make in respect of senior notes tendered for repurchase in the change of control repurchase offer, will reduce on a dollar-for-dollar basis the amount of senior notes that we shall repurchase for cash in connection with the closing of the recapitalization;

the conversion of approximately \$26.9 million of senior notes into 13,433,962 (subject to adjustment for rounding) newly issued common units;

the conversion of each senior subordinated unit and each junior subordinated unit into one common unit;

the write-off of net deferred charges and debt premium of \$1.4 million; and

the estimated expenses of the recapitalization of \$6.5 million.



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	As of	
	September 30, 2005	
	(in thousands)	
	Actual	Pro Forma
Cash and cash equivalents	\$ 99,148	\$ 68,235(a)
Debt		
<b>Star Gas:</b>		
10.25% Senior Notes due 2013	\$ 267,322	\$ 166,446
<b>Heating Oil Segment:</b>		
Revolving Credit Facility (b)	6,562	6,562
Acquisition Notes Payable	225	225
Subordinated Debentures	666	666
<b>Total debt</b>	<b>\$ 274,775</b>	<b>\$ 173,899</b>
Less: Revolving Credit Facility	(6,562)	(6,562)
Current Portion of Acquisition Notes and Subordinated Debentures	(796)	(796)
<b>Total long-term debt</b>	<b>\$ 267,417</b>	<b>\$ 166,541</b>
Total partner's capital	145,108	214,039
<b>Total capitalization</b>	<b>\$ 412,525</b>	<b>\$ 380,580</b>

- (a) Reflects the repayment of approximately \$73.1 million in face amount of our senior notes (assuming full noteholder participation in the senior notes tender offer). Pursuant to the tender offer for the senior notes, Star Gas Partners must exchange for cash at least \$60 million of senior notes but not more than \$73.1 million. Star Gas Partners intends to offer to repurchase approximately \$73.1 million of senior notes, subject to cash availability at the time of closing. If Star Gas Partners tenders for \$60.0 million of senior notes, cash will decrease by \$17.6 million and long-term debt will decrease by \$87.7 million. As of the date of this proxy statement, the holders of approximately \$15.3 million in face amount of senior notes had not yet agreed to exchange their notes in the tender offer. If all of these noteholders do not participate in the tender offer and do not tender their notes in connection with the subsequent change of control repurchase offer, the amount of senior notes that we would repurchase for cash in connection with the recapitalization would be at least approximately \$44.4 million but not more than approximately \$57.5 million.
- (b) The heating oil segment's revolving credit facility currently includes a \$260 million revolving loan facility (which increases to \$310 million during the peak heating season from December 1 through March 31), subject to borrowing base requirements and coverage ratios, of which up to \$75 million may be used to issue letters of credit. This facility contains various restrictive and affirmative covenants. The most restrictive of these covenants relate to the incurrence of additional indebtedness, and restrictions on dividends, certain investments, guarantees, loans, sales of assets and other transactions.

**Table of Contents****Summary Consolidated Historical Financial and Operating Data**

The following table sets forth our summary consolidated financial information that has been derived from our audited consolidated statements of operations and cash flows for each of the years ended September 30, 2003, 2004 and 2005 and our consolidated balance sheets as of September 30, 2004 and 2005 included in our Annual Report on Form 10-K attached as Annex C to this proxy statement. You should read this financial information in conjunction with Selected Historical Financial and Operating Data and Management's Discussion and Analysis of Financial Condition and Results of Operations and our historical consolidated financial statements and notes set forth in our Annual Report on Form 10-K for the fiscal year ended September 30, 2005 attached as Annex C to this proxy statement. The information set forth below is not necessarily indicative of our future results or financial position.

(in thousands, except per unit data)	Fiscal Years Ended September 30,		
	2003	2004	2005
<b>Statement of Operations Data:</b>			
Sales	\$ 1,102,968	\$ 1,105,091	\$ 1,259,478
Costs and expenses:			
Cost of sales	793,543	799,055	983,779
Delivery and branch expenses	217,244	232,985	231,581
Depreciation and amortization expenses	35,535	37,313	35,480
General and administrative expenses	39,763	19,937	43,418
Goodwill impairment charge			67,000
Operating income (loss)	16,883	15,801	(101,780)
Interest expense, net	(29,530)	(36,682)	(31,838)
Amortization of debt issuance costs	(2,038)	(3,480)	(2,540)
Gain (loss) on redemption of debt	212		(42,082)
Loss from continuing operations before income taxes	(14,473)	(24,361)	(178,240)
Income tax expense	1,200	1,240	696
Loss from continuing operations	(15,673)	(25,601)	(178,936)
Income (loss) from discontinued operations, net of income taxes	19,786	20,276	(4,552)
Gain (loss) on sales of discontinued operations, net of income taxes		(538)	157,560
Cumulative effects of change in accounting principle for discontinued operations:			
Adoption of SFAS No. 142	(3,901)		
Net income (loss)	\$ 212	\$ (5,863)	\$ (25,928)
Weighted average number of limited partner units:			
Basic	32,659	35,205	35,821
Diluted	32,767	35,205	35,821
<b>Per Unit Data:</b>			
Basic and diluted loss from continuing operations per unit (a)	\$ (0.48)	\$ (0.72)	\$ (4.95)
Basic and diluted net income (loss) per unit (a)	\$ 0.01	\$ (0.16)	\$ (0.72)
Cash distribution declared per common unit	\$ 2.30	\$ 2.30	\$
Cash distribution declared per senior sub. unit	\$ 1.65	\$ 1.73	\$

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(in thousands, except per unit data)	Fiscal Years Ended September 30,		
	2003	2004	2005
<b>Balance Sheet Data (end of period):</b>			
Current assets	\$ 211,109	\$ 234,171	\$ 311,432
Total assets	\$ 975,610	\$ 960,976	\$ 629,261
Long-term debt	\$ 499,341	\$ 503,668	\$ 267,417
Partners' Capital	\$ 189,776	\$ 169,771	\$ 145,108
<b>Summary Cash Flow Data:</b>			
Net cash provided by (used in) operating activities	\$ 15,365	\$ 13,669	\$ (54,915)
Net cash provided by (used in) investing activities	\$ (48,395)	\$ 6,447	\$ 467,431
Net cash provided by (used in) financing activities	\$ 48,049	\$ (19,874)	\$ (306,694)
<b>Other Data:</b>			
EBITDA (b)	\$ 52,630	\$ 53,114	\$ (108,382)
Heating oil segment's retail gallons sold	567,024	551,612	487,300

- (a) Income (loss) from continuing operations per unit is computed by dividing the limited partners' interest in income (loss) from continuing operations by the weighted average number of limited partner units outstanding. Net income (loss) per unit is computed by dividing the limited partners' interest in net income (loss) by the weighted average number of limited partner units outstanding.
- (b) EBITDA from continuing operations should not be considered as an alternative to net income (as an indicator of operating performance) or as an alternative to cash flow (as a measure of liquidity or ability to service debt obligations), but provides additional information for evaluating our ability to make the minimum quarterly distribution. The working capital facility and the senior notes impose certain restrictions on our ability to pay distributions to unitholders.

The definition of EBITDA set forth above may be different from that used by other companies. EBITDA from continuing operations is calculated for the fiscal years ended September 30 as follows:

Statement of Operations Data (in thousands)	Fiscal Years Ended September 30,		
	2003	2004	2005
Loss from continuing operations	\$ (15,673)	\$ (25,601)	\$ (178,936)
Plus:			
Income tax expense	1,200	1,240	696
Amortization of debt issuance cost	2,038	3,480	2,540
Interest expense, net	29,530	36,682	31,838
Depreciation and amortization	35,535	37,313	35,480
EBITDA from continuing operations	\$ 52,630	\$ 53,114	\$ (108,382)
Add/(subtract)			
Income tax expense	(1,200)	(1,240)	(696)
Interest expense, net	(29,530)	(36,682)	(31,838)
Unit compensation expense (income)	9,001	(4,382)	(2,185)
Provision for losses on accounts receivable	6,601	7,646	9,817
Gain on sales of fixed assets, net	(52)	(281)	(43)
Goodwill impairment charge			67,000
(Gain)/loss on redemption of debt	(212)		42,082
Loss on derivative instruments, net	306	1,673	2,144
Change in operating assets and liabilities	(22,179)	(6,179)	(32,814)

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Net cash provided by (used in) operating activities	<u>\$ 15,365</u>	<u>\$ 13,669</u>	<u>\$ (54,915)</u>
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**Table of Contents****Summary Selected Unaudited Pro Forma Condensed Financial Information**

The following summary selected unaudited pro forma condensed consolidated statement of operations for the fiscal year ended September 30, 2005 assumes the recapitalization occurred on October 1, 2004. The selected unaudited pro forma condensed consolidated balance sheet data as of September 30, 2005 assumes the recapitalization occurred on September 30, 2005. You should not rely on the pro forma financial information as being indicative of the historical results that we would have had or the future results that we will experience after the recapitalization. See Unaudited Condensed Pro Forma Financial Information.

The Pro Forma column of the table represents the recapitalization assuming the repayment of approximately \$73.1 million in senior notes (assuming full noteholder participation in the senior notes tender offer) and the conversion of approximately \$26.9 million of senior notes into common units. As of the date of this proxy statement, the holders of an aggregate of approximately \$15.3 million in senior notes have not yet agreed to tender their notes in the tender offer. The principal amount of any senior notes, plus any interest and premium payments that we are required to make in respect of senior notes tendered for repurchase in the change of control repurchase offer, will reduce on a dollar-for-dollar basis the amount of senior notes that we shall repurchase for cash in connection with the closing of the recapitalization.

<b>(in thousands, except per unit data)</b>	<b>Fiscal Year Ended September 30, 2005</b>
	<b>Pro Forma</b>
	<b>(unaudited)</b>
Sales:	
Product	\$ 1,071,270
Installations and service	188,208
<b>Total sales</b>	<b>1,259,478</b>
Cost and expenses:	
Cost of product	786,349
Cost of installations and service	197,430
Delivery and branch expenses	231,581
Depreciation and amortization expenses	35,480
General and administrative expenses	43,418
Goodwill impairment charge	67,000
<b>Operating income (loss)</b>	<b>(101,780)</b>
Interest expense	(26,016)
Interest income	3,429
Amortization of debt issuance costs	(2,230)
Gain (loss) on redemption of debt	(42,082)
<b>Loss from continuing operations before income taxes</b>	<b>(168,679)</b>
Income tax expense	696
<b>Loss from continuing operations</b>	<b>(169,375)</b>
<b>General Partners' interest in (loss from) continuing operations</b>	<b>\$ (740)</b>
<b>Limited Partners' interest in (loss from) continuing operations</b>	<b>\$ (16,295)</b>

Basic and diluted loss from continuing operations per Limited Partner Unit:	\$ (2.27)
Weighted average number of Limited Partner units outstanding: Basic and Diluted	74,255

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	<b>Fiscal Year Ended September 30, 2005</b>
	<b>Pro Forma</b>
	<b>(In thousands)</b>
<b>Balance Sheet Data (end of period)</b>	
Current assets	\$ 280,519
Total assets	596,035
Long-term debt	166,541
Total partners' capital	214,039
<b>Summary Cash Flow Data</b>	
Net cash used in operating activities	\$ (44,902)
Net cash provided by investing activities	467,321
Net cash used in financing activities	(336,326)

**Other Data**

EBITDA (see footnote (b) to the Summary Consolidated Historical Financial and Operating Data table above) is calculated as follows:

	<b>Fiscal Year Ended September 30, 2005</b>
	<b>Pro Forma</b>
	<b>(In thousands)</b>
Pro Forma Loss from continuing operations	\$ (169,375)
Plus:	
Income tax expense	696
Amortization of debt issuance cost	2,230
Interest expense, net	22,587
Depreciation and amortization	35,480
<b>Pro Forma EBITDA from continuing operations</b>	<b>\$ (108,382)</b>

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**QUESTIONS AND ANSWERS ABOUT THE SPECIAL MEETING**

***How will my proxy be voted?***

Unless you give other instructions on your proxy card, the persons named as proxy holders on the proxy card will vote all executed proxy cards in accordance with the recommendations of the board of directors of Star Gas, which is to vote FOR all three proposals to effect the recapitalization. With respect to any other matter that properly comes before the special meeting the proxy holders will vote as recommended by the board of directors of Star Gas, or, if no recommendation is given, in their own discretion. See *The Recapitalization Reasons for the Recapitalization that the Board Considered; Recommendations of the Board.*

***Who sent me this proxy statement?***

The board of directors of Star Gas, the general partner of Star Gas Partners, sent you this proxy statement and the proxy card. The solicitation will be paid for by Star Gas Partners. In addition to this solicitation by mail, proxies may be solicited by Star Gas directors, officers and other employees by telephone, internet, e-mail, telegraph, telefax or telex, in person or otherwise. These people will not receive any additional compensation for assisting in the solicitation. We have retained Georgeson Shareholder, to assist us in the solicitation of proxies, for a fee of \$25,000 plus reimbursement of reasonable out-of-pocket expenses. We will also request brokerage firms, nominees, custodians and fiduciaries to forward proxy materials to the beneficial owners of our units and will reimburse them for their reasonable out-of-pocket expenses.

***What is the recommendation of Star Gas board of directors?***

The board of directors of Star Gas has approved the recapitalization as being in the best interests of Star Gas Partners and our unitholders and recommends that unitholders vote FOR each of the recapitalization proposals. See *Important Considerations, The Recapitalization Reason for the Recapitalization that the Board Considered; Recommendations of the Board and Interest of Certain Persons in the Recapitalization.*

***Did Star Gas board of directors receive an opinion from its financial advisor?***

Yes. On December 2, 2005, Jefferies rendered to Star Gas board of directors its opinion as investment bankers to the effect that, as of that date and based upon and subject to the various considerations and assumptions set forth therein, the Recapitalization Transaction (as defined in such opinion), taken as a whole, was fair, from a financial point of view, to the existing holders of common units on that date. The full text of the Jefferies opinion, which sets forth the assumptions made, matters considered and limitations on the scope of review undertaken by Jefferies in rendering its opinion, is attached to this proxy statement as Annex D. See *The Recapitalization Opinion of Jefferies & Company, Inc.* or such Annex D for a description of the Recapitalization Transaction as used in the Jefferies opinion. Star Gas and its board of directors encourage the holders of common units to read the Jefferies opinion carefully and in its entirety. The summary of the Jefferies opinion in this proxy statement is qualified in its entirety by reference to the full text of the Jefferies opinion.

***Whom can I contact for further information?***



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If you have any questions about the proposals, please call us at (203) 328-7310 or Georgeson Shareholder at (800) 960-7546.

### ***Why did I receive this proxy statement and proxy card?***

You received this proxy statement and proxy card because you owned our common units, senior subordinated units or junior subordinated units as of January 24, 2006. We refer to this date as the record date. This proxy statement contains important information for you to consider when deciding whether to vote for the listed proposals. Please read it carefully.

### ***Who is entitled to vote at the special meeting?***

All unitholders who owned our common units, senior subordinated units or junior subordinated units at the close of business on the record date, January 24, 2006 (excluding for purposes of proposals 2 and 3 units owned

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by the general partner and its affiliates, including its executive officers, directors and members), are entitled to receive notice of the special meeting and to vote the units that they held on the record date at the special meeting, or any postponements or adjournments of the special meeting. Each unitholder is entitled to one vote for each common unit, senior subordinated unit and junior subordinated unit owned on all matters in which it is entitled to vote. On January 24, 2006, 32,165,528 common units, 3,391,982 senior subordinated units and 345,364 junior subordinated units were issued and outstanding.

### ***Who can attend the special meeting?***

All unitholders as of the record date, or their duly appointed proxies, may attend the special meeting. Each unitholder may be asked to present valid picture identification, such as a driver's license or passport. Cameras, recording devices and other electronic devices will not be permitted at the meeting.

Please note that if you own your common units or senior subordinated units in street name, meaning through a broker or other nominee, you will need to bring a copy of a brokerage statement reflecting your unit ownership as of the record date.

### ***What constitutes a quorum?***

Under our partnership agreement, if the following number of units are present in person or by proxy at the special meeting:

- (1) a majority of common units entitled to vote and outstanding as of the record date, and
  
- (2) a majority of senior subordinated units and junior subordinated units, voting together as one class, entitled to vote and outstanding as of the record date,

in each case excluding units owned by Star Gas or its affiliates, including its executive officers, directors and members, who beneficially own in the aggregate 314,305 senior subordinated units and 345,364 junior subordinated units, these majorities will constitute a quorum and will permit us to conduct the proposed business at the special meeting. Your units will be counted as present at the meeting if you:

are present and vote in person at the meeting; or

have properly submitted a proxy card or voted over the telephone or the internet.

Proxies received but marked as abstentions and broker non-votes, if any, will be included in the number of units considered to be present at the special meeting.

***What vote is required to approve the recapitalization proposal?***

The recapitalization cannot be effected without approval of each of the recapitalization proposals. Under our partnership agreement, proposal 1 requires the approval of a majority of the outstanding common units and proposals 2 and 3 require the approval of a unit majority which means (i) a majority of common units entitled to vote and outstanding as of the record date, and (ii) a majority of senior subordinated units and junior subordinated units, voting together as one class, entitled to vote and outstanding as of the record date, in each case excluding units owned by Star Gas or its affiliates, including its executive officers, directors and members. Under the NYSE rules, proposal 1 requires the approval of a majority of the votes cast by the holders of the common units and senior subordinated units voting as a single class, provided that the total votes cast on the proposal represent at least 50% of all units entitled to vote, and proposals 2 and 3 do not require unitholder approval.

A properly executed proxy marked **ABSTAIN** with respect to any matter will not be voted, although it will be counted for purposes of determining whether there is a quorum. Accordingly, an abstention, or the failure to vote at all, will have the effect of a negative vote for the purposes of the votes required under our partnership agreement but not for the purposes of the vote required under the NYSE rules.

If you own your common units or senior subordinated units in **street name** through a broker or nominee, your broker or nominee will not be permitted to exercise voting discretion with respect to the matters to be acted

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upon at the special meeting. Thus, if you do not give your broker or nominee specific instructions, your units will not be voted on those matters and will not be counted in determining the number of common units or senior subordinated units necessary for approval and will have the effect of a negative vote. Any broker non-votes will, however, be counted in determining whether there is a quorum. Voting results are tabulated and certified by our transfer agent, LaSalle Bank National Association.

### ***How do I vote?***

If you properly complete, sign and return the accompanying proxy card it will be voted as you direct. If you owned common units, senior subordinated units or junior subordinated units as of the record date and attend the special meeting, you may deliver your completed proxy card in person. Street name unitholders who wish to vote at the special meeting will need to obtain a legal proxy from the institution that holds their units. Even if you plan to attend the special meeting, your plans may change, so it is a good idea to complete, sign and return your proxy card or vote through the internet or by telephone in advance of the meeting.

### ***Can I vote by telephone or electronically?***

If you are a registered unitholder (that is, you hold your units in certificate form), you may vote by telephone or through the internet by following the instructions included with your proxy card.

If your common units or senior subordinated units are held in street name, please check your proxy card or contact your broker or nominee to determine whether you will be able to vote by telephone or electronically.

The deadline for voting by telephone or through the Internet for registered unitholders is 5:00 p.m. Eastern Standard Time on March 16, 2006.

### ***Can I change my vote after I return my proxy card?***

Yes. Even after you have submitted your proxy, you may change your vote at any time before the proxy is exercised by filing with the Secretary of Star Gas either a notice of revocation or a duly executed proxy bearing a later date. The powers of the proxy holders will be suspended if you are a registered unitholder and attend the special meeting in person and so request. Please note that attendance at the meeting will not by itself revoke a previously granted proxy.

### ***What should I do if I want to make a proposal to be considered at the meeting?***

Your units do not entitle you to make proposals at the special meeting. Under our partnership agreement, only our general partner, Star Gas, can make a proposal at the meeting. Our partnership agreement establishes a procedure for calling meetings whereby limited partners owning 20% or more of the outstanding units of the class for which a meeting is proposed may call a meeting at which they may make proposals.

*Do I have any dissenters' rights?*

No. Dissenters' rights are not available to our unitholders with respect to matters to be voted on at the special meeting.

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**IMPORTANT CONSIDERATIONS**

*In addition to the information set forth below, for other important considerations concerning Star Gas Partners, see the information under Item 1A-Risk Factors, in our Annual Report on Form 10-K for the fiscal year ended September 30, 2005, which is attached hereto as Annex C.*

*Each senior subordinated unit and junior subordinated unit will be converted into one common unit.*

If the recapitalization is consummated, each senior subordinated unit and junior subordinated unit will be converted into one common unit even though under our partnership agreement as currently in effect such a conversion into common units is remote. The purpose of such conversion is to serve as an inducement to the holders of senior subordinated units to vote in favor of the recapitalization, which requires a class vote of the subordinated unitholders to approve two of the proposals, and to simplify our capital structure. In order for the senior subordinated units and junior subordinated units to convert under the existing partnership agreement, Star Gas would have had to distribute the annualized minimum quarterly distribution of \$2.30 on all outstanding units for each of three consecutive non-overlapping four-quarter periods, adjusted operating surplus during each of the three consecutive non-overlapping four-quarter periods would have to exceed the annualized minimum quarterly distribution and there would have to be no cumulative common unit arrearages. On October 18, 2004, we announced that we would not pay a distribution on the common units. We had previously announced the suspension of distributions on the senior subordinated units on July 29, 2004. As of November 30, 2005, the amount of accrued and unpaid arrearages on the common units was \$92.5 million, or \$2.875 per common unit. Assuming that the number of outstanding common units remained at 32,165,528 and that we did not distribute any available cash from operating surplus, these arrearages would increase by \$18.5 million per quarter. If the recapitalization is not consummated, it is unlikely that regular distributions on the common units would be resumed in the foreseeable future and it is considerably less likely that regular distributions would resume in the foreseeable future on the senior subordinated units because of their subordination terms.

*Each common unitholder will experience substantial dilution in his interest in Star Gas Partners.*

As a result of the issuance of units to Kestrel and the issuance of units in the rights offering, the issuance of additional units to the noteholders in conversion of senior notes into common units and the conversion of the senior subordinated units and junior subordinated units into common units, the number of common units will increase from 32,165,528 to approximately 74,336,836, representing a substantial dilution of the common unitholders' existing interest. The recapitalization will also result in a termination of the subordination period during which certain issuances of additional units required a unitholder vote. Consequently, there will be no limit in the partnership agreement on the number of additional limited partner interests, including units senior to the common units, that we may issue at any time without the approval of our unitholders. As a result of this dilution and the possible future issuance of additional equity securities:

each common unitholder's proportionate ownership interest in us will decrease;

the amount of cash available for distribution on each unit will decrease (without taking into account the additional cash that would be available as a result of the reduction in interest expense in connection with the repayment or conversion of up to \$100 million of senior notes, assuming full noteholder participation in the senior notes tender offer);

the common units may be subordinated as to distributions and voting rights given to new senior units we may decide to issue in the future, although we do not have any present intention to issue senior units;

the relative voting strength of each previously outstanding unit will be diminished; and

the market price of the common units may decline.

However, common unitholders who participate in the rights offering would be able to reduce the dilution in their unit holdings.

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Prior to the recapitalization, the common units represented approximately 88.8% of the total number of units outstanding. Following the recapitalization, if all common unitholders exercise their rights in the rights offering, our existing common unitholders would own common units representing approximately 66.5% of the total number of units outstanding. However, if none of the common unitholders exercise their rights in the rights offering and M2 is issued the 17,500,000 common units offered to the common unitholders pursuant to its standby commitment, our existing common unitholders would own common units representing approximately 43.1% of the total number of units outstanding.

*Accrued and unpaid arrearages in the payment of the minimum quarterly distribution on the common units will be eliminated.*

Under our partnership agreement as currently in effect, during the subordination period, no distributions can be made on the subordinated units until all accrued and unpaid arrearages in the payment of the minimum quarterly distribution on the common units have been paid. As of November 30, 2005, the amount of accrued and unpaid arrearages in the payment of the minimum quarterly distribution on the common units was \$92.5 million. Assuming that the number of outstanding common units remained at 32,165,528 and that we did not distribute any available cash from operating surplus, these arrearages would increase by \$18.5 million per quarter. As a result of the recapitalization, all accrued and unpaid arrearages on the common units would be eliminated. Consequently, the preference of the existing common unitholders to cash distributions in that amount would be eliminated.

*We have substantially lowered the minimum quarterly distribution and the first target distribution, which will make it easier for the general partner units to receive incentive distributions.*

Under our partnership agreement as currently in effect, the senior subordinated units, junior subordinated units and general partner units are not entitled to receive incentive distributions in a quarter until the first target distribution of \$0.604 per unit has been distributed on each common unit. Under the proposed amendments to our partnership agreement, commencing with the quarter beginning October 1, 2008, or, if we elect to commence making distributions sooner, the quarter in which any distribution of available cash is made, the new general partner units in the aggregate will be entitled to receive 10% of the cash distributions in a quarter once each common unit and general partner unit has received the minimum quarterly distribution of \$.0675 for that quarter, plus any arrearages on the common units from prior quarters, and 20% of the cash distributions in a quarter once each common unit and general partner unit has received \$.1125 for that quarter, plus any arrearages on the common units from prior quarters. See Amendments to the Partnership Agreement Comparison of the Star Gas Partnership Agreement Before and After the Recapitalization. Thus, the ability of the general partner units to receive incentive distributions has been enhanced in several ways:

The general partner units are entitled to incentive distributions once the minimum quarterly distribution has been paid on the common units and general partner units, as opposed to only after the first target distribution has been paid under the existing partnership agreement.

The minimum quarterly distribution and the first target distribution have been substantially reduced. The minimum quarterly distribution has been reduced from \$0.575 to \$0.0 for each quarter through September 30, 2008, or, if we elect to commence making distributions sooner, the first quarter in which a distribution of available cash is made, and to \$0.0675 per unit thereafter, representing an 88% decrease. The first target distribution has been reduced from \$0.604 to \$.1125 per unit, representing an 81% decrease.

*We are not required to, and currently do not intend to, distribute any available cash through the quarter ending September 30, 2008.*

The partnership agreement amendments provide that we are not obligated to distribute available cash through the quarter ending September 30, 2008. We currently do not intend to make distributions of available cash during this period, even if we have available cash to distribute. Also, if



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we accumulate available cash during this period, it will be easier for us to make distributions on the general partner units after this period than if we had distributed available cash each quarter.

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*If our use of the net proceeds from the sale of the propane segment does not comply with the terms of the indenture for the senior notes, we may be subject to liability to the noteholders, which would have a material adverse effect on our ability to continue as a going concern.*

On December 17, 2004, we completed the sale of our propane segment for a purchase price of \$481.3 million, without assumption of the propane segment's indebtedness for borrowed money at the time of sale. Pursuant to the terms of the indenture relating to our senior notes, we were permitted, within 360 days of the sale, to apply the net proceeds of the sale of the propane segment either to reduce our indebtedness or the indebtedness of a restricted subsidiary, or to make an investment in assets or capital expenditures useful to our or any subsidiary's business. To the extent any net proceeds that were not so applied exceeded \$10 million (referred to in this proxy statement as excess proceeds), the indenture requires us to make an offer to all holders of notes to purchase for cash that number of notes that may be purchased with excess proceeds at a purchase price equal to 100% of the principal amount of notes plus accrued and unpaid interest to the date of purchase.

After repayment of certain debt and transaction expenses, the net proceeds from the propane segment sale were approximately \$156.3 million. As of the closing of the propane sale and application of the proceeds, the amount of net proceeds not applied in excess of \$10 million was \$146.3 million. As of September 30, 2005, the heating oil segment had utilized \$53.1 million of the proceeds to invest in working capital assets, purchase capital assets and repay long-term debt, which reduced the amount available to repurchase notes to \$93.2 million. As of December 2, 2005, the heating oil segment had used all of the remaining excess proceeds.

Our board of directors and management considered, based on informal communications with certain noteholders and their counsel, that certain noteholders might take the position that the use of net proceeds to invest in working capital assets was not a permitted use under the indenture. Based upon the advice of counsel, we disagreed with this position. However, we recognized that if we were unsuccessful in defending our position, this would constitute an event of default if declared by either the holders of 25% in principal amount of the senior notes or by the trustee under the indenture and in such event all amounts due under the senior notes would become immediately due and payable. An acceleration of our senior notes would have a material adverse effect on our ability to continue as a going concern. The report of our independent registered public accounting firm on our consolidated financial statements as of September 30, 2005 and 2004, and for the three years ended September 30, 2005, includes an explanatory paragraph with respect to the impact of this matter on our ability to continue as a going concern if this matter is resolved adversely to us. We have reached an agreement with the holders of 94% in aggregate principal amount of the senior notes to resolve this matter, which is subject to our completing the proposed recapitalization, of which there can be no assurance.

*The issuance of units in the recapitalization will likely result in an ownership change of our corporate subsidiary, Star/Petro, under the Tax Code, and as a result, Star/Petro will be materially restricted in its ability to use its net operating loss carryforwards to reduce its future taxable income.*

We believe that the issuance of units in our recapitalization will likely result in an ownership change of our corporate subsidiary, Star/Petro, under the Tax Code. As a result of this ownership change, Star/Petro will be materially restricted in its ability to use its net operating loss carryforwards to reduce its future taxable income. As of September 30, 2005, Star/Petro had federal net operating loss carryforwards of approximately \$181.7 million. The net operating loss carryforwards (prior to an ownership change) will begin to expire in 2025 and are generally available to reduce future taxable income that would otherwise be subject to federal income taxes. We believe that the restriction may entirely eliminate Star/Petro's ability to use its net operating loss carryforwards. The restriction on Star/Petro's ability to use net operating loss carryforwards to reduce its federal tax liability will reduce the amount of cash Star/Petro has available to make distributions to us. Consequently, the restriction will reduce the amount of cash we have available to distribute to our unitholders.

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*You may be required to pay taxes on income from us even if you do not receive distributions from us.*

A common unitholder is required to report on his U.S. federal income tax return his share of our taxable income without regard to whether the unitholder receives corresponding cash distributions from us. The suspension of mandatory distributions, elimination of distribution arrearages and reduction in the minimum quarterly distribution will increase the risk that a common unitholder will be allocated a portion of our taxable income without any cash being distributed to him or that he will be allocated taxable income in excess of the amount of cash distributed to him.

*Affiliates of the general partner will now be able to vote on all matters.*

Under the existing partnership agreement, during the subordination period the votes of the general partner and its affiliates were excluded in determining a quorum for, and the votes on, any matter requiring the approval of a unit majority, which included certain amendments to our partnership agreement; the merger of our partnership or the sale of all or substantially all our assets; and the dissolution of our partnership. Due to the mandatory conversion of the senior and junior subordinated units into common units, the subordination period will end. Consequently, after the recapitalization, the general partner and its affiliates will be able to vote their units on all matters brought before the unitholders.

*Possible conflicts of interest were present in negotiating and structuring the recapitalization.*

Certain executive officers and directors of Star Gas have interests in the recapitalization that are different from, and may conflict with, the interests of the public unitholders. Kestrel has proposed that following the closing of the recapitalization, Mr. William P. Nicoletti, the chairman of the board of Star Gas, Mr. Joseph Cavanaugh, the chief executive officer and a director of Star Gas and Mr. Daniel Donovan, the president of Star Gas, would become directors of Kestrel Heat. Mr. Paul Biddelman, Mr. Stephen Russell and Mr. Irik P. Sevin, the other three directors of Star Gas, will not become directors of Kestrel Heat. In addition, if the recapitalization is consummated, Mr. Cavanaugh, Mr. Donovan and Mr. Richard Ambury, the chief financial officer, treasurer and secretary of Star Gas, would continue to be employed by us under the terms of their current employment arrangements.

The unit purchase agreement provides in general that Kestrel will cause Star Gas Partners to maintain, for a period of six years after the completion of the transaction, the current indemnification agreements and provisions for Star Gas officers and directors and the current policies of directors and officers liability insurance maintained by Star Gas Partners, or policies of at least the same coverage and amounts containing terms and conditions that are no less advantageous, with respect to claims arising from facts or events that occurred on or before the date of the completion of the transaction.

The membership interests in Star Gas are owned by Mr. Sevin, Ms. Audrey L. Sevin and Hanseatic Americas, Inc. Mr. Sevin is a director of Star Gas. Star Gas and its members own an aggregate of 314,305 senior subordinated units and 345,364 junior subordinated units, all of which will be converted into common units in connection with the proposed recapitalization. Mr. Biddelman, who is a director of Star Gas, is an executive officer of Hanseatic Corporation, the sole managing member of Hanseatic Americas, LDC, which is the indirect parent of Hanseatic Americas, Inc. Mr. Biddelman and a colleague of his each beneficially own an approximately 10% equity interest in Hanseatic Americas, Inc., and persons unaffiliated with Mr. Biddelman beneficially own an approximately 80% equity interest in Hanseatic Americas, Inc.

In addition, the executive officers and directors of Star Gas (excluding Mr. Sevin) own an aggregate of 18,561 senior subordinated units that will be converted into common units in connection with the proposed recapitalization.

Kestrel has acknowledged that Star Gas Partners is required to reimburse Star Gas for amounts that are payable by Star Gas to Mr. Sevin under his agreement dated March 7, 2005 and Kestrel has agreed to cause Star Gas Partners to continue to make such reimbursement without offsets, defenses or counterclaims, except that Star

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Gas Partners shall have such defenses as may become available to Star Gas pursuant to such agreement. See Information Regarding Kestrel Heat Interests of the Proposed Executive Officers and Directors in the Recapitalization.

*Star Gas board of directors considered whether to appoint a special committee.*

In connection with the Star Gas board's review of the Kestrel transaction, the board considered whether it would be advisable to appoint a special committee of directors to review this transaction on behalf of our public unitholders, but determined that the interests of such unitholders could be properly represented without the appointment of a special committee. In reaching this determination, the board took into account that neither Kestrel nor Yorktown is affiliated with our general partner or any of its directors or any of their affiliates and that under the terms of the unit purchase agreement our current general partner will not receive any compensation for its general partner units or its equity interest in Star/Petro. The board also took into account the requirement that proposals 2 and 3 of the recapitalization transaction must be approved by a unit majority, which consists of (1) a majority of common units entitled to vote and outstanding as of the record date, and (2) a majority of senior subordinated units and junior subordinated units, voting together as one class, entitled to vote and outstanding as of the record date, in each case excluding units owned by Star Gas or its affiliates, including its executive officers, directors and members. See The Recapitalization Interests of Certain Persons in the Recapitalization.

*Our noteholders and affiliates of Kestrel may sell common units in the public market, which sales could have an adverse impact on the trading price of our common units.*

After the recapitalization, our senior noteholders will own 13,433,962 (subject to adjustment based on rounding) common units and affiliates of Kestrel will own between 7,500,000 common units and 25,000,000 common units. We have granted the consenting noteholders certain registration rights for these units and our partnership agreement would provide Kestrel and its affiliates with certain registration rights for these units. The sale of these units in the public market could have an adverse impact on the price of the common units.

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### THE RECAPITALIZATION

#### Background

We are the largest retail distributor of home heating oil in the United States, based on volume as reported by the National Oilheat Research Alliance Organization, March 2003. Our home heating oil operations serve approximately 480,000 customers in the Northeast and Mid-Atlantic regions. For the fiscal year ended September 30, 2005, our home heating oil segment sold 487 million gallons of home heating oil. We were also formerly engaged as a retail distributor of propane until December 17, 2004 when we sold our propane segment.

During fiscal 2004, we experienced difficult operating conditions as a result of our inability to pass on the full impact of record wholesale heating oil prices to customers and the effects of unusually high net customer attrition principally related to our heating oil segment's operational restructuring. Prior to the 2004 winter heating season, our heating oil segment attempted to develop a comprehensive advantage in customer service, and as part of that effort, centralized its heating equipment service dispatch and engaged a centralized call center to fulfill its telephone requirements for the majority of its home heating oil customers. We experienced difficulties in advancing this initiative during the fiscal year ended September 30, 2004, which adversely impacted our customer base, product sales and costs.

These conditions led to the suspension of distributions on our senior subordinated units, junior subordinated units and general partner units on July 29, 2004 and to the suspension of distributions on the common units on October 18, 2004.

During fiscal 2005, we continued to experience difficult operating conditions. As of September 30, 2005, the average wholesale price of home heating oil, as measured by the closing price on the New York Mercantile Exchange, increased 48% to \$2.06 per gallon from \$1.39 per gallon, as compared to September 30, 2004. The continuing unprecedented rise and volatility in the price of heating oil has intensified price sensitivity among our customers and price competition among our competitors, which has adversely impacted the heating oil segment's margins and added to the heating oil segment's difficulties in reducing customer attrition.

We experienced net customer attrition of 7.1% in fiscal 2005, compared to net attrition of 6.4% and 1.5% in fiscal 2004 and 2003, respectively. This rate represents the net of its annual customer loss rate after customer gains. For fiscal 2004 and 2005, gross customer losses were 19.5% and 20%, respectively. We believe that net customer attrition for the fiscal 2005 resulted from (i) a combination of the effect of our premium service/premium price strategy when customer price sensitivity increased due to high energy prices and our refusal, to reduce our retail prices to what we believe are unreasonably low levels in spite of competitors aggressive pricing tactics; (ii) the lag effect of customer attrition related to service and delivery problems experienced by customers in prior fiscal years; (iii) continued customer dissatisfaction with the centralization of customer care; and (iv) tightened customer credit standards.

We believe that we have identified the problems associated with the home heating oil segment's centralization efforts and are taking steps to address these issues. However, we expect that high net attrition rates may continue through fiscal 2006 and perhaps beyond. We note that even to the extent the rate of attrition can be reduced, attrition from prior fiscal years will adversely impact net income in the future. The heating oil segment may not be able to achieve net gains of customers and may continue to experience net customer attrition in the future.

Traditionally, we have sought to offset the effects of net customer attrition through our acquisition program. However, under the heating oil segment's current revolving credit facility, the heating oil segment was restricted from making any acquisitions through June 17, 2005 and

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thereafter individual acquisitions may not exceed \$10 million or an aggregate of \$25 million in any fiscal year, subject to meeting certain availability requirements. These restrictions severely limit our ability to make acquisitions. We did not make any acquisitions during fiscal 2005.

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On December 17, 2004, we completed the sale of our propane segment for a purchase price of \$481.3 million, without assumption of the propane segment's indebtedness for borrowed money at the time of sale. Pursuant to the terms of the indenture relating to our senior notes, we were permitted, within 360 days of the sale, to apply the net proceeds of the sale of the propane segment either to reduce our indebtedness or the indebtedness of a restricted subsidiary, or to make an investment in assets or capital expenditures useful to our or any subsidiary's business. To the extent any net proceeds that were not so applied exceed \$10 million (referred to in this proxy statement as excess proceeds), the indenture requires us to make an offer to all holders of notes to purchase for cash that number of notes that may be purchased with excess proceeds at a purchase price equal to 100% of the principal amount of notes plus accrued and unpaid interest to the date of purchase.

After repayment of certain debt and transaction expenses, the net proceeds from the propane segment sale were approximately \$156.3 million. As of the closing of the propane sale and application of the proceeds, the amount of net proceeds not applied in excess of \$10 million was \$146.3 million. As of September 30, 2005, the heating oil segment had utilized \$53.1 million of the proceeds to invest in working capital assets, purchase capital assets and repay long-term debt, which reduced the amount available to repurchase notes to \$93.2 million. As of December 2, 2005, the heating oil segment had used all of the remaining excess proceeds.

Our board of directors and management considered, based on informal communications with certain noteholders and their counsel, that certain noteholders might take the position that the use of net proceeds to invest in working capital assets was not a permitted use under the indenture. Based on the advice of counsel, we disagreed with this position. However, we recognized that if we were unsuccessful in defending our position, this would constitute an event of default if declared by either of the holders of 25% in principal amount of the senior notes or by the trustee and in such event all amounts due under the senior notes would become immediately due and payable. An acceleration of our senior notes would have a material adverse effect on our ability to continue as a going concern. The report of our independent registered public accounting firm on our consolidated financial statements as of September 30, 2005 and 2004, and for the three years ended September 30, 2005, includes an explanatory paragraph with respect to the impact of this matter on our ability to continue as a going concern if this matter is resolved adversely to us. We have reached an agreement with the holders of 94% in aggregate principal amount of the senior notes to resolve this matter, which is subject to our completing the proposed recapitalization, of which there can be no assurance.

## **Kestrel Proposal**

In March 2005, Mr. Nicoletti was contacted by Mr. Bryan Lawrence of Yorktown Energy Partners and Mr. Paul Vermilyen, Jr. of Kestrel, an affiliate of Yorktown Energy Partners VI, L.P. (Yorktown) to inquire whether we would be interested in discussing a transaction in which Kestrel would make an equity investment in Star Gas Partners and an affiliate of Kestrel would become the new general partner of Star Gas Partners.

On April 12, 2005, Mr. Nicoletti and Mr. Cavanaugh meet with Mr. Lawrence and Mr. Vermilyen at Yorktown's offices in New York City to further discuss Kestrel's interest in Star Gas Partners. At a subsequent meeting on April 27, 2005, Kestrel presented a written proposal to Mr. Nicoletti and Mr. Cavanaugh.

Kestrel's initial proposal included the following provisions:

The replacement of our general partner, Star Gas, with an affiliate of Kestrel.

The purchase of 7,500,000 common units by Kestrel at \$2.00 per unit.



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A tender offer to purchase a minimum of \$70 million and a maximum of \$120 million of our senior notes, with the first \$85 million in funds to be provided by Kestrel's \$15 million equity investment and \$70 million in excess proceeds from the sale of the propane segment, with the balance of the funds for purchases over \$85 million to be supplied from up to a \$35 million rights offering to a unitholders, with a standby commitment from Kestrel.

The suspension of all mandatory distributions of available cash through the fiscal quarter ending September 30, 2008.

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The elimination of all cumulative distribution arrearages on all units that have accrued through the closing of the restructuring.

Beginning in fiscal 2009, all common units would receive or accrue a minimum quarterly distribution of \$.075 per unit.

Kestrel would receive an incentive distribution equal to 10% of the cumulative amounts distributed to common units above \$.075 per quarter and 20% of the cumulative amounts distributed to common units above \$.125 per quarter.

There would be no incentive distributions if there are any distribution arrearages.

There would be no change in the terms of the senior subordinated units and the junior subordinated units.

Our board of directors discussed the Kestrel proposal at a board meeting on May 4, 2005 and authorized our chairman to pursue further discussions with Kestrel regarding its proposal. The board took into account that Kestrel's principal investor, Yorktown, has a reputation for successfully completing transactions in the energy field and has had experience in making investments in master limited partnerships. The board also considered that Mr. Vermeylen has substantial experience in the home heating oil business, including having served as an executive officer of our subsidiary, Meenan Oil Co., L.P., for 18 years prior to our acquisition of that company in August 2001.

*Engagement of Financial Advisors.* In May 2005, we engaged Jefferies as our exclusive financial advisor to provide advice and assistance to us in connection with various matters, including with respect to our capital structure, the senior notes and our other indebtedness. We also engaged Alvarez & Marsal LLC to provide advice and assistance to us with respect to our business plan, cash flows, working capital and liquidity requirements.

At the meeting of our board of directors held on July 25, 2005, representatives of Jefferies reviewed with the board the partnership's liquidity requirements and capital structure. The board discussed various potential avenues to provide liquidity, including the following:

Commence self-help initiatives to improve our liquidity, including by seeking to revise our supply arrangements and hedging arrangements to free up working capital and dispose of non-strategic assets.

Commence discussions with our existing bank lenders and with potential alternate traditional and non-traditional lenders to obtain a more flexible credit agreement with greater availability.

Begin conducting due diligence with Kestrel and other interested equity investors.

Pursue a transaction to deleverage, reduce interest expense and position us for future growth with a view towards resuming distributions to unitholders.

Following a discussion, the board authorized management and our financial advisors to proceed to explore each of these possibilities.

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*July-September Meetings.* From the end of July through the beginning of September 2005, our chairman, chief executive officer, chief financial officer and chief operating officer were in communication with representatives of Kestrel and representatives of Kestrel were in communication with the operating management of our heating oil segment. During the same period, our chairman, members of our management and our financial and legal advisors had several meetings and telephone conversations with representatives of the senior noteholders.

At the meeting of our board of directors held on September 7, 2005, representatives of Jefferies and our management provided our board with an update of the status of the various initiatives. Representatives of Alvarez & Marsal also provided us with an update of their analysis of our liquidity requirements for fiscal 2006.

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This analysis indicated that if home heating oil prices were to remain at their present levels or increase, we would need to use substantially all of the net proceeds from the propane segment sale to support our working capital requirements.

During this time we communicated to Kestrel that the recapitalization transaction would require a majority vote of the public holders of our senior subordinated units and that in order to provide an incentive to the public holders of our senior subordinated units to vote in favor of the recapitalization we might need to provide for the conversion of our senior subordinated units into common units. We also noted that such conversion as well as the conversion of the junior subordinated units into common units would reduce administrative expenses in the future, simplify our capital structure and eliminate the continuance of a class of equity securities with separate voting rights,

*Revised Kestrel Proposal.* On September 28, 2005, we received a revised term sheet from Kestrel concerning its investment proposal that responded to the various issues that we had raised concerning the original proposal.

The revised Kestrel proposal reflected the following material changes from the original proposal:

The amount of senior notes to be repurchased was reduced from \$120 million to \$60 million and the source of funds to repay these notes was revised so that \$50 million would come from the issuance of \$15 million of common units to Kestrel at \$2.00 per unit and a rights offering to common unitholders of 17,500,000 common units at \$2.00 per unit, with a standby commitment from Kestrel, with the remaining \$10 million to come from cash from operations.

The minimum quarterly distribution on common units was reduced to \$0.0675 from 0.075 per unit and the first target level distribution was reduced from \$0.125 per unit to \$0.1125 per unit.

The senior subordinated units and junior subordinated units would be converted into common units.

*October 7 Board Meeting.* At the meeting of our board of directors held on October 7, 2005, management and our financial advisors reported that:

They had conducted a thorough search to create additional liquidity to enable us to finance volatility in home heating oil prices and potentially effect a deleveraging transaction.

They had explored a number of potential sources of additional liquidity, including:

an expansion of the heating oil segment's existing credit facility with covenant relief; and

a new working capital facility from traditional or alternative lenders.

Negotiations with the current bank group to provide for additional liquidity were ongoing and had been generally positive to date.

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Negotiations with alternative lenders had also been successful and offered a potential alternative to the current credit facility.

Jefferies also reported on the status of the negotiations with Kestrel as well as the input that Jefferies had received from two other potential equity sources; however, none of those sources offered terms comparable to the Kestrel proposal.

Our management then reported on the status of various self-help initiatives, including proposals for new supply arrangements that would reduce our inventory level requirements and free up working capital and proposals for the disposition of certain non-strategic assets.

The board and its advisors then discussed the anticipated impact on future operating results as well as the cost, timing and likelihood of success of the various financing alternatives. After discussion, our board determined that a transaction in which Kestrel would make an equity investment in us of up to \$50 million,

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combined with an amendment to our existing revolving credit facility to expand this credit facility, appeared to offer the partnership the most favorable opportunity to improve our liquidity and to deleverage.

Our board authorized Jefferies to proceed with the negotiations with Kestrel. Our board also authorized management and our advisors to contact our heating oil segment's bank lenders and representatives of the senior noteholders to discuss the Kestrel proposal with them.

*October-November Negotiations.* During October and November 2005, we negotiated the terms of a definitive unit purchase agreement with Kestrel as well as the terms of agreements concerning our senior notes with representatives of our senior noteholders. The unit purchase agreement and the agreements with the senior noteholders were each conditioned upon the closing of each other. Separately, we negotiated and closed an amendment to the terms of our revolving credit facility to increase our seasonal availability under this facility.

We facilitated (and our chairman, management and financial and legal advisors attended) a meeting on November 9, 2005 between representatives of our senior noteholders and Kestrel to discuss the terms of the proposed transactions. Kestrel had requested that all senior notes be callable immediately at par upon the completion of the proposed transactions. The noteholders indicated they were not prepared to permit the senior notes to be called at par, and requested the opportunity to convert a portion of their senior notes to equity at \$2.00 per unit, the same price being paid by Kestrel. During the subsequent discussions, the noteholders also requested that certain changes be made to the covenants of the indenture which would govern the new notes to be issued. Over a period of several weeks, discussions ensued among representatives of Kestrel, the noteholders and the Partnership, through which: Kestrel agreed that the notes would not be callable at par; the noteholders agreed to a \$40 million conversion of senior notes into equity at \$2.00 per common unit (which amount was ultimately reduced to approximately \$26.9 million); and certain modifications to the financial covenants of the indenture governing the new notes were agreed upon. During the course of the negotiations, we agreed that if Kestrel terminated the agreement, one or more of the noteholders would have certain step-in rights to complete the recapitalization in place of Kestrel.

On November 3, 2005, our heating oil segment entered into an amendment to its revolving credit facility that increased the borrowing limits by \$50 million to \$310 million (subject to certain borrowing base limitations and coverage ratios) for the peak winter months of December through March.

In the course of lengthy negotiations with Kestrel, the original draft of the unit purchase agreement was changed for the benefit of the unitholders in various respects, including:

the break-up fee originally proposed to be \$5 million was reduced to \$4 million and the conditions under which it may be paid were significantly tightened;

each senior subordinated unit and each junior subordinated unit would be converted into a common unit;

the maximum liability of the partnership for breaches was capped at 25% of Kestrel's total purchase price; and

the definition of partnership material adverse change was tightened to reduce the circumstances under which Kestrel could terminate the agreement.

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In connection with the board's review of the Kestrel transaction, the board considered whether it would be advisable to appoint a special committee of directors to review this transaction on behalf of our public unitholders, but determined that the interests of such unitholders could be properly represented without the appointment of a special committee. In reaching this determination, the board took into account that neither Kestrel nor Yorktown is affiliated with our general partner or any of its directors or any of their affiliates and that under the terms of the unit purchase agreement our current general partner will not receive any compensation for its general partner units or its equity interest in Star/Petro. The board also took into account the requirement that proposals 2 and 3 of the recapitalization must be approved by a unit majority, which consists of (1) a majority of

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common units entitled to vote and outstanding as of the record date, and (2) a majority of senior subordinated units and junior subordinated units, voting together as one class, entitled to vote and outstanding as of the record date, in each case excluding units owned by Star Gas or its affiliates, including its executive officers, directors and members. See *Interests of Certain Persons in the Recapitalization*.

The board also considered whether it would be advisable to obtain a separate opinion as to the fairness from a financial point of view of the transaction to the public holders of the senior subordinated units in addition to an opinion with respect to the holders of the common units. In viewing the transaction from the viewpoint of the public senior subordinated unitholders, the board concluded that the conversion of the senior subordinated units into common units would align the interests of the senior subordinated unitholders with the common unitholders following the closing of the transaction. With respect to the terms of conversion of the senior subordinated units into common units, the board concluded that it had the ability to evaluate the fairness of the conversion ratio without a separate opinion. Among other matters, the board considered that arrearages on the common units were \$92.5 million as of November 30, 2005 and that no distributions could be paid on the senior subordinated units until such arrearages were paid in full, which made it unlikely that distributions would be paid on the senior subordinated units in the foreseeable future. The board also considered that there are no circumstances under our current partnership agreement, as currently in effect, in which the holders of the senior subordinated units could expect to receive more than one Class B common unit for each senior subordinated unit upon the termination of the subordination period. The board also took into account the requirement under our partnership agreement that proposals 2 and 3 must be approved by a separate class vote of the senior subordinated units and junior subordinated units, excluding units owned by Star Gas and its affiliates.

At a meeting of our board on November 16, 2005, our financial and legal advisors updated the board as to the status of the negotiations with Kestrel and the representatives of the senior noteholders. Following such meeting, we and our representatives continued the negotiations with Kestrel and its representatives and the representatives of the senior noteholders.

*November-December Board Discussions.* At meetings of our board held on November 30, 2005 and December 2, 2005, the board received presentations concerning, and reviewed the terms of, the proposed recapitalization pursuant to the unit purchase agreement and the noteholder agreements with members of management and our legal and financial advisors. At the December 2 meeting, Jefferies rendered to Star Gas board of directors its opinion as investment bankers to the effect that, as of that date and based upon and subject to the various considerations and assumptions set forth therein, the Recapitalization Transaction (as defined in such opinion), taken as a whole, was fair, from a financial point of view, to the existing holders of common units on that date. Also at the December 2, 2005 meeting, the board unanimously determined that the proposed recapitalization pursuant to the unit purchase agreement and noteholder agreements is fair to, and in the best interests of, the Star Gas Partners public unitholders. See *Interests of Certain Persons in the Recapitalization*.

## **Reasons for the Recapitalization that the Board Considered; Recommendations of the Board**

During the course of its deliberations, the board, with the assistance of management and its legal and financial advisors, considered a number of factors, including, among others, the following potential advantages and disadvantages of the recapitalization to our unitholders.

### *Certain Potential Advantages of the Proposed Recapitalization to Common Unitholders:*

*Reduce Liquidity Concerns.* The use of the \$50 million in new equity financing (including from the rights offering), together with additional funds from operations, to repurchase up to approximately \$73.1 million in face amount of our senior notes (assuming full noteholder participation in the senior notes tender offer), and the conversion of an additional \$26.9 million in face amount of senior notes into equity in connection with the closing of the recapitalization would substantially strengthen our balance sheet and thereby reduce our concerns about



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liquidity and a shortage of capital. We believe this would provide us with the financial flexibility to better manage this period of high oil prices and to continue our program to improve operating results. As of the date of

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this proxy statement, the holders of an aggregate of approximately \$15.3 million in senior notes have not yet agreed to tender their notes in the tender offer. The principal amount of any senior notes, plus any interest and premium payments that we are required to make in respect of senior notes tendered for repurchase in the change of control repurchase offer, will reduce on a dollar-for-dollar basis the amount of senior notes that we shall repurchase for cash in connection with the closing of the recapitalization.

*Facilitate Future Acquisitions.* The repayment or conversion into equity of up to \$100 million in senior notes pursuant to the senior notes tender offer would significantly reduce our indebtedness, which should help to facilitate our access to the capital markets to obtain equity capital and debt financing for acquisitions. If we are unable to access additional capital to grow our business, we may be adversely affected in our ability to maintain or increase our customer base, which could further erode our ability to generate available cash. Reducing our indebtedness should enhance our ability to make acquisitions.

*Simplify Capital Structure.* The elimination of the cumulative common unit arrearages and the conversion of the senior subordinated units and junior subordinated units into common units would simplify our capital structure. We believe that it would be difficult to issue new common or subordinated units while our existing common units are subject to significant arrearages for past distributions, which could adversely affect our ability to obtain debt financing for acquisitions since an important element of obtaining debt financing is our ability to access equity markets to repay debt. If we are limited in our ability to access capital to grow the business, we may be adversely affected in our ability to maintain or increase our customer base. Such reduction of activity could further erode our ability to generate available cash.

*Experience of Kestrel Representatives.* Subject to the closing of the transactions contemplated by the unit purchase agreement, Star Gas will withdraw as general partner, Kestrel Heat, will become our new general partner. Kestrel will be entitled to elect the board of directors of the general partner. We expect to benefit from the ability of the Kestrel representatives who have substantial experience in the energy markets. Mr. Vermynen, Jr., the President of Kestrel, served as an executive officer of Meenan Oil Co., L.P., a heating oil company, for 18 years before it was sold to Star Gas Partners in 2001. See Information Regarding Kestrel Heat.

*Agreements with Senior Noteholders.* The agreements with the holders of 94% of our senior notes would largely eliminate the costs and significant risks associated with the potential for litigation and alleged defaults under the indenture for our senior notes involving, among other matters, our use of proceeds from the sale of our propane segment. If this matter were not resolved and we were unsuccessful in defending our position in any future claim that might be brought by noteholders, this would constitute an event of default if declared by either the holders of 25% in principal amount of the senior notes or by the trustee and in such event all amounts due under the senior notes would become immediately due and payable. An acceleration of our senior notes would have a material adverse effect on our ability to continue as a going concern. The report of our independent registered public accounting firm on our consolidated financial statements as of September 30, 2005 and 2004, and for the three years ended September 30, 2005, includes an explanatory paragraph with respect to the impact of this matter on our ability to continue as a going concern if this matter is resolved adversely to us.

### *Certain Potential Disadvantages of the Proposed Recapitalization to Common Unitholders:*

*Elimination of Previously Accrued Cumulative Distribution Arrearages.* Arrearages on the common units that have accrued through the date of the closing of the recapitalization proposal would be eliminated for no consideration. As of November 14, 2005, cumulative distribution arrearages on all outstanding common units aggregated \$92.5 million, or \$2.875 per common unit.

*Reduction and Postponement of Minimum Quarterly Distributions.* The approval of the proposals would result in a reduction of the minimum quarterly distribution from the current \$0.575 per common unit to \$0.0675 per common unit. Also there would be no mandatory distributions on

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the common units until at least fiscal 2009. However, regardless of whether the minimum quarterly distribution is reduced, our board of directors of our general partner has concluded that (absent the proposed recapitalization) we are not generating enough available cash to pay any quarterly distributions and/or arrearages at the present time or in the foreseeable future.

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*Increased Distributions to General Partner.* If the proposals are approved, the general partner would be entitled to receive a substantially higher percentage of cash distributed above \$0.0675 per unit than under the existing partnership agreement as a result of the revisions to the incentive distribution payments to allocate all incentive distributions to the holders of the general partner units. The reduction of the minimum quarterly distribution would mean that the general partner would be able to receive incentive distributions sooner. See *Amendments to the Partnership Agreement – Comparison of the Star Gas Partnership Agreement Before and After the Recapitalization.*

*Depressed Purchase Price.* The price per common unit that we would receive from Kestrel Heat and M2 and in connection with the rights offering is close to the bottom of the trading range for our common units since we became a public partnership, but such price represents a 34% premium to the closing sales price of the common units on the last trading day prior to the public announcement of the recapitalization transaction.

*Substantial Dilution.* The number of common units outstanding would increase from 32,165,528 to approximately 74,336,836, representing a significant dilution to existing unitholders. However, common unitholders who participate in the rights offering would be able to reduce the dilution in their unit holdings. Prior to the recapitalization, the common units represented approximately 88.8% of the total number of units outstanding. Following the recapitalization, if all common unitholders exercise their rights in the rights offering, our existing common unitholders would own common units representing approximately 66.5% of the total number of units outstanding. However, if none of the common unitholders exercise their rights in the rights offering and M2 is issued the 17,500,000 common units offered to the common unitholders pursuant to its standby commitment, our existing common unitholders would own common units representing approximately 43.1% of the total number of units outstanding.

*Termination of Subordination Period.* The termination of the subordination period would eliminate the priority of payment to the common unitholders in preference to the senior subordinated units and junior subordinated units. In addition, the termination of the subordination period would eliminate the requirement that the general partner receive unitholder approval for issuance of more than a specified number of additional common units during the subordination period. However, the rules of the NYSE generally would require prior unitholder approval before we could issue common units in excess of twenty percent of the then currently issued and outstanding common units in a single or related transactions other than a public offering for cash.

*Restriction on Use of NOLs.* We believe that the issuance of units in our recapitalization will likely result in an ownership change of our corporate subsidiary, Star/Petro, under the Tax Code. As a result of this ownership change, Star/Petro will be materially restricted in its ability to use its net operating loss carryforwards to reduce its future taxable income. As of September 30, 2005, Star/Petro had federal net operating loss carryforwards of approximately \$181.7 million. The net operating loss carryforwards (prior to an ownership change) will begin to expire in 2025 and are generally available to reduce future taxable income that would otherwise be subject to federal income taxes. We believe that the restriction may entirely eliminate Star/Petro's ability to use its net operating loss carryforwards. The restriction on Star/Petro's ability to use net operating loss carryforwards to reduce its federal tax liability will reduce the amount of cash Star/Petro has available to make distributions to us. Consequently, the restriction will reduce the amount of cash we have available to distribute to our unitholders.

### *Potential Advantages and Disadvantages to Senior Subordinated Unitholders and Junior Subordinated Unitholders:*

In addition to the certain potential advantages to the common unitholders, the following are certain potential advantages of the proposed recapitalization to senior subordinated unitholders and junior subordinated unitholders:

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*Increased Likelihood of Distributions.* The conversion of each outstanding senior subordinated unit and junior subordinated unit into one common unit will eliminate the priority common units had on distributions

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ahead of the senior subordinated units and junior subordinated units and will significantly increase the likelihood that we will resume distributions to the holders of these units.

*In Addition to the Certain Potential Disadvantages to the Common Unitholders, the Following are Certain Potential Disadvantages of the Proposed Recapitalization to Senior Subordinated and Junior Subordinated Unitholders:*

*No Incentive Distributions.* The right of the senior subordinated units and junior subordinated units to receive incentive distributions would be eliminated. However, given that as of September 30, 2005 we had approximately \$92.5 million in accrued distribution arrearages on the common units that must be paid prior to the payment of any incentive distributions, it is unlikely that any incentive distributions would be received by the holders of senior subordinated units in the foreseeable future.

*No Separate Class Vote.* The senior subordinated and junior subordinated units would lose their right to vote separately as a class during the subordination period on all matters on which unitholders are entitled to vote. However, the separate class vote was originally intended to protect the rights of the subordinated unitholders when they constituted a junior class of securities to the common units, which would no longer be the case once the subordinated units are converted in common units.

*Dilution.* Subordinated units would not be allowed to participate in the rights offering being made to the holders of common units, and therefore would be diluted to a greater extent than the holders of common units who participate in the rights offering.

*Other Factors Considered by the Board:*

Our board also considered, among other factors:

Proposals 2 and 3 of the recapitalization would be subject to a unitholder vote of both common and senior subordinated units, each voting as a class.

The terms of the unit purchase agreement and the second amended and restated partnership agreement.

The conditions to the completion of the transaction, specifically the fact that approximately 94% of the noteholders had entered into agreements with us to support the recapitalization and that the material adverse change provision in the unit purchase agreement and noteholder agreement was expressly tied to a draft of our Annual Report on Form 10-K, which report highlighted the current attrition rates of customers.

The unit purchase agreement allows us to consider superior proposals, and allows us to negotiate with the parties making any such unsolicited superior proposal, and to enter into a transaction with such parties. The board of directors believed that these provisions of the unit purchase agreement allow the board of directors sufficient flexibility if a superior proposal is presented.

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The termination fee of \$4 million and the maximum expense reimbursement of \$500,000 upon termination of the unit purchase agreement would not be likely to unduly deter a third party from making or inhibit the board of directors in evaluating, negotiating and, if appropriate, approving a superior proposal.

The discussion above of information and factors considered and given weight by the board is not intended to be exhaustive. Except for Jefferies opinion, on which it placed significant weight in view of the wide variety of factors considered in its evaluation, the board did not find it practicable to, and did not, quantify or otherwise attempt to assign relative weights to the specific factors considered in reaching its determination. In addition, individual members of the board may have given different weights to different factors.

**The board of directors of Star Gas unanimously recommends that the Star Gas Partners public unitholders vote FOR the recapitalization proposals. See Interests of Certain Persons in the Recapitalization.**

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### Opinion of Jefferies & Company

Star Gas Partners engaged Jefferies & Company, Inc., or Jefferies, to serve as its financial advisor in connection with the proposed recapitalization and to render an opinion to Star Gas board of directors as to the fairness of the Recapitalization Transaction (as defined below), from a financial point of view, to existing holders of common units. On December 2, 2005, Jefferies rendered to Star Gas board of directors its opinion as investment bankers to the effect that, as of that date and based upon and subject to the various considerations and assumptions set forth therein, the Recapitalization Transaction, taken as a whole, was fair, from a financial point of view, to the existing holders of common units on that date.

The full text of the Jefferies opinion, which sets forth the assumptions made, matters considered and limitations on the scope of review undertaken by Jefferies in rendering its opinion, is attached to this proxy statement as Annex D. Star Gas and its board of directors encourage the holders of common units to read the Jefferies opinion carefully and in its entirety. The summary of the Jefferies opinion in this proxy statement is qualified in its entirety by reference to the full text of the Jefferies opinion. **The Jefferies opinion was provided to Star Gas board of directors in connection with its consideration of the proposed recapitalization, taken as a whole, and does not address the underlying business decision of Star Gas Partners to engage in the proposed recapitalization or the terms of the unit purchase agreement and the documents referred to therein. The Jefferies opinion addresses only the fairness, from a financial point of view and as of the date of the Jefferies opinion, of the Recapitalization Transaction, taken as a whole, to existing holders of common units as of the date of its opinion, and does not address any individual element of the Recapitalization Transaction. The Jefferies opinion does not constitute a recommendation as to how any holder of units should vote on the Recapitalization, or as to whether any holder of common units should exercise rights to acquire additional common units in the rights offering.**

For purposes of the Jefferies opinion, the Recapitalization Transaction was defined to mean the following:

the receipt of \$50 million in new equity financing through the issuance to Kestrel or its affiliates of 7,500,000 common units at a purchase price of \$2.00 per unit for an aggregate of \$15 million and the issuance of an additional 17,500,000 common units in the rights offering to the holders of common units at an exercise price of \$2.00 per unit for an aggregate of \$35 million, with a standby commitment from Kestrel or its affiliates to purchase all units that are not subscribed for in the rights offering;

the conversion of approximately \$26.9 million in face amount of senior notes into approximately 13.4 million newly issued common units at a conversion price of \$2.00 per unit;

the adoption of a second amended and restated agreement of limited partnership of Star Gas Partners, that will include, among others, the following changes to the terms of Star Gas Partner s securities:

suspend all mandatory distributions of available cash by Star Gas Partners through the fiscal quarter ending September 30, 2008;

eliminate, for no consideration, all cumulative distribution arrearages on the common units that have accrued through the closing of the proposed recapitalization;

change the minimum quarterly distribution to the common units to \$0.0675 per unit, or \$0.27 per year, which will commence accruing October 1, 2008;



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mandatory conversion of each outstanding senior subordinated unit and junior subordinated unit into one common unit; and

authorize the new general partner units in replacement of the existing general partner units and reallocate the incentive distribution rights so that, commencing October 1, 2008, the new general partner units will be entitled to receive 10% of the available cash distributed once \$.0675 per quarter, or \$0.27 per year has been distributed to common units and 20% of the available cash distributed in excess of \$.1125 per quarter, or \$0.45 per year, provided that there are no arrearages in minimum quarterly distributions at the time of such distribution.

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the amendment of the indenture of the senior notes to eliminate certain covenants from such indenture on the terms set forth in the lock-up agreements.

In conducting its analysis and arriving at its opinion, Jefferies, among other things:

reviewed a draft dated November 29, 2005 of the unit purchase agreement, a draft dated November 17, 2005 of the second amended and restated agreement of limited partnership, and a draft dated November 29, 2005 of this proxy statement;

reviewed Star Gas Partner s operations and prospects both on a standalone basis and after giving effect to the Recapitalization Transaction;

reviewed certain financial and other information about Star Gas Partners that was publicly available;

reviewed information furnished to Jefferies by Star Gas Partner s senior management, including certain internal financial analyses, budgets, reports and other information;

held discussions with various members of senior management of Star Gas Partners concerning historical and current operations, financial conditions and prospects, including recent financial performance;

reviewed the trading price history of the common units for a period Jefferies deemed appropriate;

reviewed the valuations of publicly traded companies that Jefferies deemed comparable in certain respects to Star Gas Partners;

prepared a discounted cash flow analysis of Star Gas Partners; and

reviewed the potential pro forma impact of the Recapitalization Transaction on Star Gas Partners, including on Star Gas Partner s indebtedness, leverage ratios and distributable cash flow to common units.

In addition, Jefferies conducted such other quantitative reviews, analyses and inquiries relating to Star Gas Partners as Jefferies considered appropriate in rendering its opinion.

In its review and analysis and in rendering its opinion, Jefferies assumed and relied upon, but did not assume any responsibility to independently investigate or verify, the accuracy, completeness and fair presentation of, all financial and other information that was provided to Jefferies by Star Gas Partners or that was publicly available to Jefferies (including, without limitation, the information described above), or that was otherwise reviewed by Jefferies. The Jefferies opinion was expressly conditioned upon such information (whether written or oral) being complete, accurate and fair in all respects material to Jefferies analysis.

With respect to the financial forecasts provided to and examined by Jefferies, Jefferies noted that projecting future results of any company is inherently subject to uncertainty. Star Gas Partners has informed Jefferies, however, and Jefferies assumed, that such financial forecasts were

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reasonably prepared on bases reflecting the best currently available estimates and good faith judgments of the management of Star Gas Partners as to the future performance of Star Gas Partners. Jefferies expressed no opinion as to Star Gas Partner's financial forecasts or the assumptions on which they are made. In addition, in rendering its opinion, Jefferies assumed that Star Gas Partners will perform in accordance with such financial forecasts for all periods specified therein. Although such financial forecasts did not form the principal basis for the Jefferies opinion, but rather constituted one of many items that Jefferies employed, changes to such financial forecasts could affect its opinion.

Accordingly, the analyses performed by Jefferies must be considered as a whole. Considering any portion of such analyses or the factors considered, without considering all analyses and factors, could create a misleading or incomplete view of the process underlying the conclusions expressed in its opinion. Jefferies expressly disclaimed any undertaking or obligation to advise any person of any change in any fact or matter affecting the Jefferies opinion of which Jefferies became aware after the date of its opinion.

In its review, Jefferies did not obtain any independent evaluation or appraisal of the assets or liabilities of, nor did Jefferies conduct a physical inspection of any of the assets of, Star Gas Partners, nor was Jefferies

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furnished with any such evaluations or appraisals or reports of such physical inspections, nor did Jefferies assume any responsibility to obtain any such evaluations, appraisals or inspections. In addition, Jefferies did not evaluate the solvency or fair value of Star Gas Partners under any state or federal laws relating to bankruptcy, insolvency or similar matters. The Jefferies opinion was based on economic, monetary, regulatory, market and other conditions existing and which could be evaluated as of the date of its opinion. Jefferies made no independent investigation of any legal or accounting matters affecting Star Gas Partners, and Jefferies assumed the correctness in all respects material to its analysis of all legal and accounting advice given to Star Gas Partners and Star Gas board of directors, including, without limitation, advice as to the legal, accounting and tax consequences of the terms of, and transactions contemplated by, the unit purchase agreement to Star Gas Partners and its unit holders. In addition, in preparing its opinion, Jefferies did not take into account any tax consequences of the Recapitalization Transaction to Star Gas Partners or any holder of common units.

In rendering its opinion, Jefferies also assumed with the consent of Star Gas board of directors that:

the transactions contemplated by the unit purchase agreement will be consummated on the terms described therein without any waiver of any material terms or conditions;

there was not as of the date of its opinion, and there will not as a result of the consummation of the transactions contemplated by the unit purchase agreement be, any default, or event of default, under any indenture, credit agreement or other material agreement or instrument to which Star Gas Partners or any of its subsidiaries or affiliates is a party; and

all material assets and liabilities (contingent or otherwise, known or unknown) of Star Gas Partners were as set forth in the consolidated financial statements provided to Jefferies by Star Gas Partners, as of the dates of such financial statements.

In addition, Jefferies was not authorized to and did not solicit any expressions of interest from any other parties (other than a limited number of parties that had approached Star Gas Partners on an unsolicited basis) with respect to a potential equity investment in Star Gas Partners or any other alternative transaction.

It is understood that Jefferies opinion was for the use and benefit of the board of directors of Star Gas in its consideration of the Recapitalization Transaction, taken as a whole, and the Jefferies opinion did not address the relative merits of the transactions contemplated by the unit purchase agreement as compared to any alternative transactions that might be available to Star Gas Partners, nor did it address the underlying business decision by Star Gas Partners to engage in the Recapitalization Transaction or the terms of the unit purchase agreement or the documents referred to therein. Jefferies expressed no opinion as to the price at which the common units will trade at any time, and also expressed no opinion as to any individual element of the Recapitalization Transaction.

Jefferies opinion did not constitute a recommendation as to how any holder of units should vote on the Recapitalization Transaction or any matter relating thereto or as to whether any holder of common units should exercise rights to acquire additional common units in the rights offering. Jefferies expressed no opinion as to the price at which the common units will trade at any time.

In preparing its opinion, Jefferies performed a variety of financial and comparative analyses. The preparation of a fairness opinion is a complex process involving various determinations as to the most appropriate and relevant quantitative and qualitative methods of financial analysis and the applications of those methods to the particular circumstances and, therefore, is not necessarily susceptible to partial analysis or summary description. Jefferies believes that its analyses must be considered as a whole. Considering any portion of its analyses or the factors considered by it, without considering all analyses and factors, could create a misleading or incomplete view of the process underlying the conclusion expressed in its opinion. In addition, Jefferies may have given various analyses more or less weight than other analyses, and may have deemed

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various assumptions more or less probable than other assumptions, so that the range of valuation resulting from any particular analysis described below should not be taken to be Jefferies' view of Star Gas Partners' actual value. Accordingly, the conclusions reached by Jefferies are based on all analyses and factors taken as a whole and also on the application of Jefferies' own experience and judgment.

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In performing its analyses, Jefferies made numerous assumptions with respect to industry performance, general business and economic conditions and other matters, many of which are beyond Jefferies and Star Gas Partners control. The analyses performed by Jefferies are not necessarily indicative of actual values or actual future results, which may be significantly more or less favorable than suggested by such analyses. In addition, analyses relating to the value of businesses or assets do not purport to be appraisals or to necessarily reflect the prices at which businesses or assets may actually be sold and are inherently subject to uncertainty. The analyses performed were prepared solely as part of Jefferies analysis of the fairness, from a financial point of view, of the Recapitalization Transaction and were provided to Star Gas board of directors in connection with the delivery of the Jefferies opinion.

The following is a summary of the material financial and comparative analyses performed by Jefferies that were presented to Star Gas board of directors on December 2, 2005 in connection with the delivery of its opinion. The financial analyses summarized below include information presented in tabular format. In order to fully understand Jefferies financial analyses, the tables must be read together with the text of each summary. The tables alone do not constitute a complete description of the financial analyses. Considering the data described below without considering the full narrative description of the financial analyses, including the methodologies and assumptions underlying the analyses, could create a misleading or incomplete view of Jefferies financial analyses.

### *Star Gas Partners Analysis*

*Historical Trading Analysis.* Jefferies reviewed the trading history of the common units for the thirteen month period ending November 18, 2005 both on a stand-alone basis and also in relation to the S&P 500 Index, the S&P 500 Energy Sector Index and to two composite indices consisting of the following propane master limited partnerships, or Propane MLPs, and pipeline master limited partnerships:

### Propane MLPs

AmeriGas Partners L.P.

Ferrellgas Partners L.P.

Inergy L.P.

Suburban Propane Partners L.P.

### Pipeline MLPs

Atlas Pipeline Partners L.P.

Buckeye Partners L.P.

Enterprise Products Partners L.P.

Enbridge Energy Partners L.P.

Energy Transfer Partners L.P.

Holly Energy Partners L.P.

Kinder Morgan Energy Partners L.P.

K-SEA Transportation Partners L.P.

Magellan Midstream Partners L.P.

Northern Border Partners L.P.

Plains All American Pipeline L.P.

Sunoco Logistics Partners L.P.

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TC Pipelines L.P.

TEPPCO Partners L.P.

Valero L.P.

US Shipping Partners L.P., and

Williams Partners L.P.

During this period, Jefferies noted that the common units traded as low as \$1.01 per unit and as high as \$7.74 per unit, compared to the closing price of the Star Gas common units on December 2, 2005 of \$1.32. Jefferies also noted that during the thirteen month period ending November 18, 2005, the price of the common units decreased 74.8%, the S&P 500 Energy Sector Index increased by 33.9%, the S&P 500 Index increased by 12.1%, the Pipeline MLPs increased 9.0%, and the Propane MLPs decreased 1.5%.

*Comparable Company Analysis.* Using publicly available information and information provided by Star Gas Partners, Jefferies analyzed the trading multiples of Star Gas Partners and the corresponding trading multiples of the Propane MLPs. In its analysis, Jefferies derived and compared multiples for Star Gas Partners and the Propane MLPs, calculated as follows:

the enterprise value divided by actual or estimated, as the case may be, earnings before interest, taxes, depreciation and amortization, or EBITDA, for fiscal year 2005, which is referred to as Enterprise Value/2005 EBITDA, ;

the enterprise value divided by estimated EBITDA for fiscal year 2006, which is referred to as Enterprise Value/2006E EBITDA, ; and

the latest indicative annualized common unit distribution divided by the common unit price on November 18, 2005, which is referred to as the 2006E Indicative Yield .

Jefferies noted that there are few public companies in the home heating oil space, and that the most similar publicly traded master limited partnerships are propane distributors. While there are a number of similarities between home heating oil and propane distributors, due to the more limited growth, higher historical customer attrition rates, elevated risk profile and volatility of Star Gas Partners' cash flows as compared to the Propane MLPs, as well as the distressed nature of Star Gas Partners' current financial situation, for purposes of this analysis the valuation multiples for the Propane MLPs were decreased by 25%.

This analysis indicated the following:

**Star Gas Partners Comparable Public Companies Multiples**



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Benchmark	Unadjusted				Adjusted <sup>1</sup>				Star Gas <sup>2</sup>
	High	Low	Median	Mean	High	Low	Median	Mean	
Enterprise Value/2005 EBITDA	13.3x	10.0x	12.5x	12.1x	9.9x	7.5x	9.4x	9.1x	13.9x
Enterprise Value/2006E EBITDA	10.6x	9.7x	10.2x	10.2x	7.9x	7.3x	7.6x	7.6x	7.5x
2006E Indicative Yield	9.7%	7.9%	8.6%	8.7%	12.1%	9.8%	10.8%	10.9%	0.0%

- Adjusted downward 25% for the home heating oil/Star Gas Partners distressed discount.
- Based upon Star Gas Partners management projections.

Using a reference range of 7.5x to 9.9x Star Gas Partners estimated 2005 EBITDA and 7.3x to 7.9x Star Gas Partners estimated 2006 EBITDA, Jefferies determined an implied enterprise value for Star Gas Partners. Jefferies then subtracted net long-term debt, estimated to be \$265 million as of November 30, 2005, from the enterprise value to determine an implied equity value. This analysis indicated a range of implied values per common unit of not meaningful ( NM ) using the 2005 EBITDA multiples and approximately \$0.90 to \$1.61 using the 2006E EBITDA multiples.

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Using a reference range of indicative yields from 9.8% to 12.1% Star Gas Partners' estimated 2006 distributable cash flow, or DCF, Jefferies determined an implied equity value for Star Gas Partners. This analysis indicated a range of implied values per common unit of NM using the estimated 2006 DCF, and approximately \$1.29 to \$1.59 using the hypothetical estimated 2006 DCF, which assumed for illustrative purposes that Star Gas Partners would be able to distribute DCF to common unit holders notwithstanding prohibitions under its current indebtedness. Under the stand alone projections, Jefferies noted that Star Gas Partners will not be in compliance with certain debt covenants and therefore cannot make distributions to common unit holders.

No company utilized in the comparable company analysis is identical to Star Gas Partners. In evaluating the selected companies, Jefferies made judgments and assumptions with regard to industry performance, general business, economic, market and financial conditions and other matters, many of which are beyond Star Gas Partners' and Jefferies' control. Mathematical analysis, such as determining the mean or median, is not in itself a meaningful method of using comparable company data.

*Discounted Cash Flow Analysis Terminal EBITDA Method.* Jefferies performed a discounted cash flow analysis to estimate the present value of the unlevered free cash flows of Star Gas Partners through the fiscal year ending September 30, 2010 using Star Gas Partners management's financial projections. Jefferies calculated the terminal value of the enterprise at September 30, 2010 by multiplying projected EBITDA in the fiscal year ending September 30, 2010 by multiples ranging from 8.0x to 10.0x. To discount the projected free cash flows and the terminal value to present value, Jefferies used a weighted average cost of capital ranging from 14.0% to 18.0%. To determine the implied total equity value for Star Gas Partners, Jefferies subtracted net long-term debt, estimated to be \$265 million as of November 30, 2005, from the implied enterprise value. This analysis indicated a range of implied values per common unit of approximately NM to approximately \$1.30.

*Discounted Cash Flow Analysis Hypothetical Terminal Distributable Cash Flow Yield Method.* Jefferies performed a discounted cash flow analysis to estimate the present value of the levered cash flows of Star Gas Partners through the fiscal year ending September 30, 2010 using Star Gas Partners management's financial projections, which assumed for illustrative purposes that Star Gas Partners would be able to distribute DCF to common unit holders notwithstanding prohibitions under its current indebtedness. Under the stand alone projections, Jefferies noted that Star Gas Partners will not be in compliance with certain debt covenants and therefore cannot make distributions to common unit holders. Jefferies calculated the terminal value of the enterprise at September 30, 2010 by dividing projected DCF in the fiscal year ending September 30, 2010 by indicative yields ranging from 10.0% to 14.0%. To discount the projected levered cash flows and the terminal value to present value, Jefferies used a cost of equity capital ranging from 20.0% to 30.0%. This analysis indicated a range of implied values per common unit of approximately \$0.57 to \$0.87.

*Pro Forma Financial Analysis.* Using Star Gas Partners management's financial projections, Jefferies analyzed the potential pro forma impact of the Recapitalization Transaction on Star Gas Partners for the periods 2006 to 2010. Jefferies analyzed the impact of the Recapitalization Transaction on Star Gas Partners coverage ratios, including (a) estimated debt divided by estimated EBITDA and (b) estimated EBITDA divided by estimated interest expense, in each case based upon forecasts provided by management.

The results of this pro forma analysis for these items for 2006 to 2010 are as follows:

	Status Quo Case		Pro Forma for the Recapitalization Transaction	
	Debt/EBITDA	EBITDA/Interest	Debt/EBITDA	EBITDA/Interest
2006	6.5x	1.35x	4.0x	1.91x

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2007	6.6x	1.36x	4.0x	2.05x
2008	6.8x	1.34x	3.8x	2.19x
2009	6.9x	1.32x	3.9x	2.33x
2010	7.1x	1.30x	4.0x	2.31x

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Jefferies also analyzed the pro forma effects on DCF per common unit, and DCF available for distribution, in each case for fiscal years 2006 to 2010 based on forecasts provided by management. The pro forma effects were as follows:

	Status Quo Case		Pro Forma for the Recapitalization Transaction	
	DCF Available for Distribution <sup>1</sup>	Hypothetical DCF per Unit <sup>2</sup>	DCF Available for Distribution <sup>3</sup>	Hypothetical DCF per Unit <sup>4</sup>
	(millions)		(millions)	
2006	\$ 0.0	\$ 0.17	\$ 0.0	\$ 0.20
2007	0.0	0.18	0.0	0.23
2008	0.0	0.16	0.0	0.29
2009	0.0	0.14	25.5	0.34
2010	0.0	0.12	27.8	0.36

1. Under the status quo projections, Star Gas Partners will not be in compliance with certain debt covenants and therefore cannot distribute DCF to common unit holders.
2. Assumes for illustrative purposes that that Star Gas Partners would be able to distribute DCF to common unit holders notwithstanding prohibitions under its current indebtedness.
3. Under the second amended and restated agreement of limited partnership, mandatory common unit distributions will be suspended through September 30, 2008.
4. Assumes for illustrative purposes that that Star Gas Partners would be able to distribute DCF to common unit holders in years 2006 – 2008 notwithstanding the suspension of mandatory common unit distributions through September 30, 2008 under the second amended and restated agreement of limited partnership.

Jefferies also compared and analyzed the potential accretion/dilution to existing common unit holders under the Recapitalization Transaction for the period 2006 through 2010 based on forecasts provided by management. This analysis showed that the Recapitalization Transaction would be accretive on a DCF basis throughout the period.

In addition, Jefferies performed a discounted cash flow analysis for Star Gas Partners taking into account the Recapitalization Transaction based on pro forma management financial projections. The discounted cash flow analysis estimated the present value of the unlevered free cash flows of Star Gas Partners through the fiscal year ending September 30, 2010 using Star Gas Partners management's financial projections. Jefferies calculated the terminal value of the enterprise at September 30, 2010 by multiplying projected EBITDA in the fiscal year ending September 30, 2010 by multiples ranging from 7.0x to 11.0x. To discount the projected free cash flows and the terminal value to present value, Jefferies used a weighted average cost of capital ranging from 14.0% to 18.0%. To determine the implied total equity value for Star Gas Partners, Jefferies subtracted net long-term debt of \$265 million from the implied enterprise value. This analysis indicated a range of implied values per common unit of approximately \$1.99 to \$4.27.

Jefferies' opinion was one of many factors taken into consideration by Star Gas' board of directors in making its determination to approve the proposed recapitalization and should not be considered determinative of the views of Star Gas' board of directors or management with respect to the proposed recapitalization.

Jefferies was selected by Star Gas' board of directors based on Jefferies' qualifications, expertise and reputation. Jefferies is an internationally recognized investment banking and advisory firm. Jefferies, as part of its investment banking business, is regularly engaged in the valuation of businesses and their securities in connection with mergers and acquisitions, negotiated underwritings, competitive biddings, secondary

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distributions of listed and unlisted securities, private placements, financial restructurings and other financial services. Jefferies, from time to time, may make a market in the securities of Star Gas Partners, and Jefferies and its affiliates may trade or hold such securities of Star Gas Partners for its own account and for the accounts of its customers and, accordingly, may at any time hold long or short positions in those securities.

Pursuant to an engagement letter between Star Gas Partners and Jefferies dated May 12, 2005, Star Gas Partners agreed to pay Jefferies a customary fee for its services in connection with the proposed recapitalization,

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a portion of which was paid upon delivery of Jefferies' written opinion and a significant portion of which is payable contingent upon consummation of the recapitalization. Jefferies will also be reimbursed for reasonable expenses incurred, including the fees and disbursements of its counsel. Star Gas Partners has also agreed to indemnify Jefferies against liabilities arising out of or in connection with the services rendered or to be rendered by it under its engagement.

### **2006 Forecast of Star Gas Partners**

Our management prepared a forecast for fiscal 2006 that was provided to Kestrel. The forecast was not prepared with a view to public disclosure. This forecast is included in this proxy statement only because it was provided to Kestrel in connection with the negotiation of the unit purchase agreement. The forecast was prepared in October 2005 as of September 30, 2005 and has not been updated to give effect to any developments since that time. The forecast was prepared by, and is the responsibility of, management of Star Gas Partners. No financial advisor or any independent registered public accounting firm examined, compiled or applied any procedures for the projections or expressed any opinion or provided any kind of assurance on the forecast.

While presented with numerical specificity, the forecast is based on a variety of assumptions relating to the business of Star Gas Partners that, although considered appropriate by Star Gas Partners at the time, may not be realized. The principal assumptions are discussed below. Moreover, the forecast and the assumptions upon which it is based are subject to significant uncertainties and contingencies, many of which are beyond the control of management of Star Gas Partners. Consequently, the forecast and the underlying assumptions are necessarily speculative in nature and inherently imprecise, and there can be no assurance that the forecasted financial results will be realized. It is expected that there will be differences between actual and forecasted results, and actual results are likely to vary materially from those shown. None of the financial advisors, Star Gas Partners, our Board of Directors, nor any of their affiliates or advisors intends to update or otherwise revise the forecast.

The inclusion of the forecast in this proxy statement should not be regarded as an indication that the financial advisors, Star Gas Partners, our Board of Directors, Kestrel or any of their affiliates or advisors considers the forecast likely to be an accurate prediction of future results. Star Gas Partners' unitholders are cautioned not to place undue reliance on the forecast, which should be read in conjunction with information relating to the business, assets and financial condition of Star Gas Partners included or incorporated by reference herein.

The forecast contains forward-looking information and is subject to a number of risks discussed elsewhere in this proxy statement. See *Important Considerations* and *Forward-Looking Statements*. These risks are likely to cause actual results in the future to differ significantly from results expressed or implied in the forecast.

The forecast set forth below is the most recent version of the forecast provided to Kestrel. Star Gas Partners believes that discussion of the earlier version would not add materially to the information provided here.

EBITDA from continuing operations should not be considered as an alternative to net income (as an indicator of operating performance) or as an alternative to cash flow (as a measure of liquidity or ability to service debt obligations), but provides additional information for evaluating our ability to make the minimum quarterly distribution. The working capital facility and the senior notes impose certain restrictions on our ability to pay distributions to unitholders. This definition of EBITDA may be different from that used by other companies.

*2006 Forecast of Star Gas Partners General Assumptions*

For fiscal 2006, volume of home heating oil sold is assumed to decline by 20.0 million gallons, or 4.1%, to 467.3 million gallons as compared to 487.3 million gallons sold in fiscal 2005. This assumption was based upon a 4.5% net customer loss assumption in fiscal 2006 and adjusted to match the most recent 10-year average weather. No incremental customer conservation was assumed and volume assumptions follow customer consumption behavior exhibited in fiscal 2005.

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For fiscal 2006, home heating oil margins are assumed to be 59 cents per gallon, which represents an increase of 3.3 cents per gallon over the level achieved in fiscal 2005 of 55.7 cents per gallon.

Service and installation revenues are assumed to increase due to a significant reduction in service contract discounting coupled with other price increases.

Projected operating expenses include the incremental effect of various cost reduction efforts undertaken in the second half of fiscal 2005. Headcount reductions and other cost curtailments are assumed to more than offset fiscal 2006 wage, medical and benefit cost increases. Operating expense assumes only recurring business overhead costs. The forecast excludes the potential restructuring related expenses incurred in connection with the recapitalization, which are currently estimated at \$6.5 million.

Interest expense is a status quo estimate and does not reflect prospective savings from the debt reduction which would occur in the Kestrel proposed recapitalization. The prospective savings from such debt reduction will range from \$8.7 million to \$10.3 million depending on the amount of senior notes which participate in the senior notes tender offer and change of control repurchase offer.

A contingency of \$4.1 million was established to offset current market risks. The contingency was established to offset the risk of conservation and margin compression due to higher than historical pricing levels and increased customer price sensitivity and awareness.

**Consolidated Statements of Operations**

(in thousands)	Fiscal 2006
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Sales:	
Product	\$ 1,189,545
Installation and services	190,049
	<hr/>
Total sales	1,379,594
Cost and expenses	
Cost of product	897,645
Cost of installations and service	193,649
Delivery and branch expenses	216,045
Depreciation and amortization	33,233
General and administrative expenses	25,155
Contingency	4,100
	<hr/>
Operating income	9,767
Net interest expense	30,060
Amortization of debt issuance costs	2,427
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Loss from operations before income tax	(22,720)
	<hr/>
Income tax expense	1,500
	<hr/>
Net loss	\$ (24,220)



**EBITDA**

(in thousands)

Net loss	\$ (24,220)
Plus:	
Income taxes	1,500
Amortization of debt issuance costs	2,427
Net interest expense	30,060
Depreciation and amortization	33,233
<b>EBITDA</b>	<b>\$ 43,000</b>

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### **Interests of Certain Persons in the Recapitalization**

In connection with the proposed recapitalization, our current general partner, Star Gas, will withdraw as general partner by contributing its general partner units and its .01% equity interest in Star/Petro to Star Gas Partners for no consideration.

Kestrel has proposed that following the closing of the recapitalization, Mr. Nicoletti, the chairman of the board of Star Gas, Mr. Cavanaugh, the chief executive officer and a director of Star Gas, and Mr. Donovan, the president of Star Gas, would become directors of Kestrel Heat. Mr. Biddelman, Mr. Russell and Mr. Sevin, the other three directors of Star Gas, will not become directors of Kestrel Heat. In addition, if the recapitalization is consummated, Mr. Cavanaugh, Mr. Donovan and Mr. Ambury, the chief financial officer of Star Gas, would continue to be employed by us under the terms of their current employment arrangements. If Kestrel Heat is elected successor general partner, the proposed directors and executive officers of Kestrel Heat shall have interests in the proposed recapitalization as described in Information Regarding Kestrel Heat below.

The unit purchase agreement provides in general that Kestrel will cause Star Gas Partners to maintain, for a period of six years after the completion of the transaction, the current indemnification agreements and provisions for Star Gas officers and directors and the current policies of directors and officers liability insurance maintained by Star Gas Partners, or policies of at least the same coverage and amounts containing terms and conditions that are no less advantageous, with respect to claims arising from facts or events that occurred before the date of the completion of the transaction.

The membership interests in Star Gas are owned by Irik P. Sevin, Audrey L. Sevin and Hanseatic Americas, Inc. Mr. Sevin is a director of Star Gas. Star Gas and its members own an aggregate of 314,305 senior subordinated units and 345,364, junior subordinated units that will be converted into common units in connection with the proposed recapitalization. Mr. Paul Biddelman, who is a director of Star Gas, is an executive officer of Hanseatic Corporation, the sole managing member of Hanseatic Americas, LDC, which is the indirect parent of Hanseatic Americas, Inc. Mr. Biddelman and a colleague of his each beneficially own an approximately 10% equity interest in Hanseatic Americas, Inc., and persons unaffiliated with Mr. Biddelman beneficially own an approximately 80% equity interest in Hanseatic Americas, Inc.

In addition, the executive officers and directors of Star Gas (excluding Mr. Sevin) own an aggregate of 18,561 senior subordinated units that will be converted into common units in connection with the proposed recapitalization.

Kestrel has acknowledged that Star Gas Partners is required to reimburse Star Gas for amounts that are payable by Star Gas to Mr. Sevin under his agreement dated March 7, 2005 and Kestrel has agreed to cause Star Gas Partners to continue to make such reimbursement without offsets, defenses or counterclaims, except that Star Gas Partners shall have such defenses as may become available to Star Gas pursuant to such agreement. See Information Regarding Kestrel Heat Interests of the Proposed Executive Officers and Directors in the Recapitalization.

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**MATERIAL U.S. FEDERAL INCOME TAX CONSEQUENCES**

The following discussion summarizes the material U.S. federal income tax consequences of the implementation of the proposed recapitalization to Star Gas Partners and the common, senior subordinated and junior subordinated unitholders.

The following summary is based on the Tax Code, Treasury regulations promulgated and proposed thereunder, judicial decisions and published administrative rules and pronouncements of the Internal Revenue Service ( " Service " ) as in effect on the date hereof. Changes in such rules or new interpretations thereof may have retroactive effect and could significantly affect the federal income tax consequences described below.

The federal income tax consequences of the recapitalization are complex and are subject to significant uncertainties. Star Gas Partners has not requested a ruling from the Service or an opinion of counsel with respect to any of the tax aspects of the recapitalization, other than an opinion from Baker Botts L.L.P. required under the partnership agreement to the effect that the withdrawal of Star Gas as our general partner will not cause Star Gas Partners to be treated as an association taxable as a corporation or otherwise to be taxed as an entity for federal income tax purposes. Thus, no assurance can be given as to the interpretation that the Service will adopt. In addition, this summary does not address foreign, state or local tax consequences of the recapitalization, nor does it purport to address the federal income tax consequences of the recapitalization to special classes of taxpayers (such as foreign taxpayers, members of management or other taxpayers who acquired their units in compensatory transactions, broker-dealers, banks, mutual funds, insurance companies, financial institutions, small business investment companies, regulated investment companies, tax-exempt organizations, and investors in pass-through entities). This summary addresses only the federal income tax consequences to unitholders whose interests in Star Gas Partners have been held as capital assets.

ACCORDINGLY, THE FOLLOWING SUMMARY OF THE MATERIAL FEDERAL INCOME TAX CONSEQUENCES IS FOR INFORMATIONAL PURPOSES ONLY AND IS NOT A SUBSTITUTE FOR CAREFUL TAX PLANNING AND ADVICE BASED UPON THE INDIVIDUAL CIRCUMSTANCES PERTAINING TO EACH UNITHOLDER. ALL UNITHOLDERS ARE URGED TO CONSULT THEIR OWN TAX ADVISORS FOR THE FEDERAL, STATE, LOCAL AND OTHER TAX CONSEQUENCES APPLICABLE TO THEM UNDER THE RECAPITALIZATION.

**Acquisition by Kestrel Heat and M2 of Common Units and General Partner Units**

Except as described in the remainder of this paragraph, neither Star Gas Partners nor the unitholders will recognize taxable income or gain upon the purchase of common units and general partner units by Kestrel Heat and its affiliates. However, (as occurs whenever a partnership sells new units) the unit purchase by Kestrel Heat and its affiliates may decrease the percentage interest of certain unitholders in Star Gas Partners. A decrease in a unitholder's percentage interest in Star Gas Partners would decrease the unitholder's share of Star Gas Partners' nonrecourse liabilities, and would result in a corresponding deemed distribution of cash to the unitholder. The deemed distribution of cash generally would not be taxable to the unitholder to the extent of the unitholder's tax basis in his units immediately before the deemed distribution, but would reduce such basis dollar for dollar. Any deemed cash distribution in excess of the unitholder's tax basis would be treated as taxable gain from the sale of the unitholder's units.

We believe that the issuance of units in our recapitalization will likely result in an ownership change of our corporate subsidiary, Star/Petro, under the Tax Code. As a result of this ownership change, Star/Petro will be materially restricted in its ability to use its net operating loss carryforwards to reduce its future taxable income. As of September 30, 2005, Star/Petro had federal net operating loss carryforwards of approximately \$181.7 million. The net operating loss carryforwards (prior to an ownership change) will begin to expire in 2025 and are generally available to reduce future taxable income that would otherwise be subject to federal income taxes.



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We believe that the restriction may entirely eliminate Star/Petro's ability to use its net operating loss carryforwards. The restriction on Star/Petro's ability to use net operating loss carryforwards to reduce its federal tax liability will reduce the amount of cash Star/Petro has available to make distributions to us. Consequently, the restriction will reduce the amount of cash we have available to distribute to our unitholders.

## **The Rights Offering**

Star Gas Partners will not recognize taxable income upon its issuance of non-transferable rights to purchase common units pursuant to the rights offering in connection with the recapitalization. Likewise, Star Gas Partners does not anticipate that unitholders will recognize taxable income as a result of the receipt of such rights. However, if the rights were determined to be consideration issued to a unitholder in exchange for his consent to the recapitalization proposal, that consideration would be subject to tax as ordinary income.

Neither Star Gas Partners nor the unitholders will recognize taxable income or gain upon a unitholder's exercise of the right to acquire common units. However, in order to comply with the capital account requirements of the Treasury Regulations, Star Gas Partners may be required to specially allocate, for tax and book purposes, items of income and gain or loss and deduction to the holders of common units acquired pursuant to the rights offering, existing holders, or both.

## **Conversion of Senior Subordinated and Junior Subordinated Units Into Common Units**

Neither Star Gas Partners nor the holders of senior subordinated units or junior subordinated units will recognize taxable income upon the conversion of the subordinated units into common units. Upon the conversion of senior subordinated and junior subordinated units into common units, the partnership agreement of Star Gas Partners provides that holders of the converted units will receive special allocations, for tax and book purposes, of income and gain or loss and deduction until the capital account associated with each converted unit is equal to the capital account of all other common units.

## **Senior Note Consent and Tender Offer**

The exchange of cash and new common units for a portion of the senior notes pursuant to the senior note exchange will reduce the total amount of Star Gas Partners' nonrecourse liabilities. Also, the exchange of a portion of the senior notes for new common units will cause a portion of the current unitholders' share of Star Gas Partners' nonrecourse liabilities to be allocated to such former holders of the senior notes. Accordingly, the senior note exchange will decrease the current unitholders' share of Star Gas Partners' nonrecourse liabilities and will result in a corresponding deemed distribution of cash to the unitholders. As previously discussed, any deemed cash distribution to a unitholder in excess of the unitholder's tax basis will be treated as taxable gain from the sale of the unitholder's units. In addition, if and to the extent that the amount of cash, and the fair market value of units exchanged is less than the principal amount of the old notes exchanged therefor, then unitholders (who are unitholders immediately prior to the exchange) would recognize an allocable portion of income from a deemed cancellation of indebtedness.

## **Amendments to the Partnership Agreement**

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*Distribution Adjustments.* A common unitholder is required to report on his income tax return his share of Star Gas Partner's income, gains, losses and deductions without regard to whether the unitholder receives corresponding cash distributions from Star Gas Partners. If the recapitalization is consummated, the partnership agreement of Star Gas Partners will be amended to (i) suspend all mandatory distributions to the common units; (ii) eliminate all cumulative distribution arrearages on the common units that have accrued through the closing of the recapitalization; and (iii) reduce the minimum quarterly distribution on the common units to \$0.0675 per unit. The suspension of mandatory distributions, elimination of distribution arrearages and reduction in the minimum

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quarterly distribution will increase the risk that a common unitholder will be allocated a portion of Star Gas Partner's taxable income without any cash being distributed to him or that he will be allocated taxable income in excess of the amount of cash distributed to him.

*Interim Closing of the Books.* If the recapitalization proposals are adopted, the partnership agreement of Star Gas Partners will be amended to provide for an interim closing of the partnership's books for federal income tax purposes upon the purchase of units by Kestrel Heat and its affiliates. Under the interim closing of the books method, each item of Star Gas Partners' income, gain, loss, deduction and credit for the 2006 taxable year will be determined based upon a closing of the partnership's books on the date of the unit purchase. Thus, all such items incurred by Star Gas Partners during the period from the beginning of the year through the date of the unit purchase will be allocated among the unitholders based upon their percentage interest in Star Gas Partners prior to the unit purchase. Correspondingly, all such items incurred by Star Gas Partners after the unit purchase will be allocated among the unitholders based upon their percentage interest in Star Gas Partners following the unit purchase.

**Table of Contents****INFORMATION REGARDING KESTREL HEAT**

The recapitalization would result in Kestrel Heat replacing Star Gas as our general partner. Kestrel Heat is a Delaware limited liability company that was formed on November 29, 2005 for the purpose of performing the duties of the general partner of Star Gas Partners. Kestrel Heat is wholly owned by Kestrel. Kestrel is a private equity investment partnership firm formed by Yorktown, Paul A. Vermynen, Jr. and other investors.

**Proposed Directors and Executive Officers of Kestrel Heat**

The following table sets forth the names, ages and positions of the individuals proposed to be designated as executive officers and directors of Kestrel Heat if the recapitalization is consummated. Additionally, if the recapitalization is consummated, Kestrel Heat intends to elect up to two additional directors who meet the independence requirements under applicable SEC and NYSE regulations for service on an audit committee. William P. Nicoletti currently serves as an independent director and a member of the audit committee of Star Gas.

<u>Name</u>	<u>Age</u>	<u>Position</u>
Joseph P. Cavanaugh	68	Chief Executive Officer and Director
Daniel P. Donovan	59	President, Chief Operating Officer and Director
Richard F. Ambury	48	Chief Financial Officer
Paul A. Vermynen, Jr.	59	Chairman, Director
Bryan H. Lawrence	62	Director
Sheldon B. Lubar	75	Director
William P. Nicoletti	60	Director

**Joseph P. Cavanaugh.** Mr. Cavanaugh has been Chief Executive Officer and a director of Star Gas LLC since March 2005. From December 2004, after the sale of Star Gas Partners propane segment to Inergy L.P. to March 2005, Mr. Cavanaugh was employed by Inergy to direct the transition of the business to them. From March 1999 to December 2004 Mr. Cavanaugh was Chief Executive Officer of Star Gas Partners propane segment. From December 1997 to March 1999, Mr. Cavanaugh served as President and Chief Executive Officer of Star Gas Corporation, the predecessor general partner. From October 1979 to December 1997, Mr. Cavanaugh held various financial and management positions with Petro. Mr. Cavanaugh is a graduate of Iona College and has an MS from Pace University.

**Daniel P. Donovan.** Mr. Donovan has been President of Star Gas Partners heating oil segment since May 2004 and President and Chief Operating Officer of Star Gas LLC since March 2005. From January 1980 to May 2004, he held various management positions with Meenan Oil, including Vice President and General Manager from 1998 to 2004. Mr. Donovan worked for Mobil Oil Corp. from 1971 to 1980. His last position with Mobil was President and General Manager of its heating oil subsidiary in New York City and Long Island. Mr. Donovan is a graduate of St. Francis College in Brooklyn, New York and also has an M.B.A. from Iona College.

**Richard F. Ambury.** Mr. Ambury has been Chief Financial Officer, Treasurer and Secretary of Star Gas LLC since May 2005. From November 2001 to May 2005, Mr. Ambury was Vice President and Treasurer of Star Gas LLC. From March 1999 to November 2001, Mr. Ambury was Vice President of Star Gas Propane, L.P. From February 1996 to March 1999, Mr. Ambury served as Vice President Finance of Star Gas Corporation, the predecessor general partner. Mr. Ambury was employed by Petro from June 1983 through February 1996, where he served in various accounting/finance capacities. From 1979 to 1983, Mr. Ambury was employed by a predecessor firm of KPMG, a public accounting firm. Mr. Ambury has been a Certified Public Accountant since 1981 and is a graduate of Marist College.





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**Paul A. Vermylen, Jr.** Mr. Vermylen is a founder and serves as President of Kestrel. Mr. Vermylen has been employed since 1971, serving in various capacities, including as a Vice President of Citibank N.A. and Vice President-Finance of Commonwealth Oil Refining Co. Inc. Mr. Vermylen served as Chief Financial Officer of Meenan Oil Co., L.P. from 1982 until 1992 and as President of Meenan Oil Co., L.P. until 2001, when Meenan was acquired by Star Gas Partners, L.P. Since 2001, Mr. Vermylen has pursued private investment opportunities. Mr. Vermylen is a director of Thermal Ventures II, LP, and he also serves as a director of certain non-public companies in the energy industry in which Kestrel holds equity interests including Downeast LNG, Inc. and COALition Energy, LLC. Mr. Vermylen is a graduate of Georgetown University, and also has a M.B.A. from Columbia University.

**Bryan H. Lawrence.** Mr. Lawrence is a founder and senior manager of Yorktown Partners LLC, the manager of the Yorktown group of investment partnerships, which make investments in companies engaged in the energy industry. The Yorktown partnerships were formerly affiliated with the investment firm of Dillon, Read & Co. Inc., where Mr. Lawrence had been employed since 1966, serving as a Managing Director until the merger of Dillon Read with SBC Warburg in September 1997. Mr. Lawrence also serves as a director of Crosstex Energy, Inc., D&K Healthcare Resources, Inc., Hallador Petroleum Company, TransMontaigne Inc. (each a United States publicly traded company) and certain non-public companies in the energy industry in which Yorktown partnerships hold equity interests including PetroSantander Inc., Savoy Energy, L.P., Athanor Resources Inc., Camden Resources, Inc., ESI Energy Services Inc., Ellora Energy Inc., and Dernick Resources Inc. Mr. Lawrence also serves as a director of Crosstex Energy GP, LLC, the general partner of Crosstex Energy, L.P. (a United States publicly traded company). Mr. Lawrence is a graduate of Hamilton College and also has an M.B.A. from Columbia University.

**Sheldon B. Lubar.** Mr. Lubar has been Chairman of the board of Lubar & Co. Incorporated, a private investment and venture capital firm he founded, since 1977. He was Chairman of the board of Christiana Companies, Inc., a logistics and manufacturing company, from 1987 until its merger with Weatherford International in 1995. Mr. Lubar had also been Chairman of Total Logistics, Inc., a logistics and manufacturing company until its acquisition in 2005 by SuperValu Inc. He serves as a director of Grant Prideco, Inc., an energy services company, since 2000; and Weatherford International, Inc., an energy services company, since 1995; a director of Crosstex Energy, Inc. since January 2004 and Crosstex Energy GP, LLC, the General Partner of Crosstex Energy, L.P. He is also a Director of several private companies. Mr. Lubar holds a bachelor's degree in Business Administration and a Law degree from the University of Wisconsin-Madison. He was awarded an honorary Doctor of Commercial Science degree from the University of Wisconsin-Milwaukee.

**William P. Nicoletti.** Mr. Nicoletti has been Non-Executive Chairman of the board of Star Gas LLC since March 2005. Mr. Nicoletti has been a Director of Star Gas LLC since March 1999 and was a Director of Star Gas Corporation, the predecessor general partner from November 1995 until March 1999. He is Managing Director of Nicoletti & Company, Inc., a private investment banking firm. Mr. Nicoletti was formerly a senior officer and head of Energy Investment Banking for E. F. Hutton & Company, Inc., PaineWebber Incorporated and McDonald Investments, Inc. Mr. Nicoletti is a director of MarkWest Energy Partners, L.P. and SPI Petroleum, LLC. Mr. Nicoletti is a graduate of Seton Hall University and also has an M.B.A. from Columbia University.

## **Interests of the Proposed Executive Officers and Directors in the Recapitalization**

Kestrel will have the ability to elect the board of directors of Kestrel Heat, including Messrs. Vermylen, Lawrence and Lubar. Messrs. Vermylen, Lawrence and Lubar are also members of the board of managers of Kestrel and, either directly or through affiliated entities, own equity interests in Kestrel. Kestrel owns all of the issued and outstanding membership interests of Kestrel Heat and M2. Kestrel Heat and M2 will receive an aggregate of 7,500,000 common units as a result of the recapitalization. M2 also will make a commitment to purchase all units which are not subscribed for in the rights offering of 17,500,000 common units. Kestrel Heat and M2, therefore, will receive an aggregate minimum of 7,500,000 common units and could receive an aggregate maximum of 25,000,000 common units as a result of the recapitalization. Mr. Vermylen also



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individually owns 50,000 common units and \$100,000 face amount of senior notes, which he owned prior to the commencement of the negotiations of the recapitalization transaction. See also [Unit Ownership](#) for additional information on the unit ownership by prospective directors and/or officers of Kestrel Heat who are currently officers and/or directors of Star Gas.

Kestrel Heat intends to establish management incentive programs whereby executive officers will be offered an opportunity to invest in Kestrel Heat. Pursuant to the proposed second and amended restated partnership agreement that, if approved by unitholders, will be adopted as part of the recapitalization, Kestrel Heat, as the general partner of Star Gas Partners, is entitled to incentive distributions commencing fiscal 2009 if minimum quarterly distributions to common unitholders exceed certain target levels. Kestrel Heat also intends to compensate non-management directors for service on the board and respective board committees in customary amounts and types. The specific types and amounts of management incentive compensation arrangements and non-management director fees are expected to be formulated and finalized prior to consummation of the recapitalization.

## **Future Plans of Kestrel Heat**

Except as part of the recapitalization disclosed in this proxy statement, Kestrel Heat does not have any specific intention with respect to Star Gas Partners that would involve any of the following transactions:

payment of extraordinary distributions;

issuance of additional equity to third parties;

refinancing, reducing or increasing existing indebtedness of Star Gas Partners;

additional purchases of interests in Star Gas Partners; and

mergers or other consolidation transactions involving Star Gas Partners.

However, if the recapitalization is consummated, Kestrel Heat will be able to consider those transactions and may recommend them to the unitholders of Star Gas Partners for approval or, if no other partnership approvals are required, effect those transactions as the general partner of Star Gas Partners. There is no assurance, however, as to when or whether any of the transactions referred to above might occur. Under applicable law, directors of Kestrel Heat, as general partner of Star Gas Partners, will owe fiduciary obligations to all of the unitholders of Star Gas Partners, not just M2 and affiliates of Kestrel. However, Kestrel's right to control the board of directors could have the effect of delaying, deterring or preventing tender offers or takeover attempts that some or a majority of Star Gas Partners' unitholders might consider in their best interests, including offers or attempts that might result in the payment of a premium over the market price for the units. If Star Gas Partners enters into a transaction, Kestrel Heat, M2 and Kestrel will participate in the benefits of that transaction to the extent of their ownership of interests in Star Gas Partners.

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**UNIT PURCHASE AGREEMENT**

*The following is a summary of the material provisions of the unit purchase agreement. This summary does not include all of the provisions of the unit purchase agreement, which is attached as Annex A to this proxy statement, and the full text of which is incorporated into this proxy statement by reference. Holders of common units and subordinated units should read the unit purchase agreement in its entirety.*

**Agreement to Sell and to Purchase Common Units**

The unit purchase agreement provides that subject to the terms and subject to the conditions set forth in the agreement, on the closing date Star Gas Partners shall sell to Kestrel Heat and M2, both wholly-owned subsidiaries of Kestrel:

- (a) 500,000 common units to Kestrel Heat;
- (b) 7,000,000 common units to M2;
- (c) 325,729 new general partner units to Kestrel Heat; and
- (d) a number of common units to M2 equal to the number of common units that are not subscribed for in the rights offering.

The purchase price for the common units is \$2.00 per unit. The general partner units will be issued for no additional consideration.

On January 23, 2006, the last trading day prior to the date of this proxy statement, the closing sales price of the common units on the NYSE was \$2.39 per unit and the closing sales price of the senior subordinated units on the NYSE was \$2.20 per unit. On December 2, 2005, the last trading day prior to the public announcement of the recapitalization transaction with Kestrel, the closing sales price of the common units on the NYSE was \$1.32 per unit and the closing sales price of the senior subordinated units was \$1.89 per unit. Unitholders are urged to obtain a current quotation for the common units and senior subordinated units.

**Replacement of the General Partner**

The unit purchase agreement provides, as a condition to closing, for the withdrawal of Star Gas as our general partner and the election of Kestrel Heat as our new general partner, effective as of the closing date. Star Gas shall contribute its existing general partner units and its .01% equity interest in Star/Petro to Star Gas Partners for no consideration. Kestrel Heat will agree to assume the rights and duties of Star Gas as our general partner and to be bound by the provisions of our partnership agreement.

**The Rights Offering**

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The unit purchase agreement provides, as a condition to closing, that we shall distribute to each record holder of common units, as a of a record date to be set by us, a non-transferable right (the right ) to purchase, at \$2.00 per unit, a pro-rata portion of 17,500,000 common units (subject to rounding as set forth below). It is currently anticipated that in the rights offering:

we will distribute .5441 non-transferable rights with respect to each common unit outstanding as of the record date for the rights offering, at no cost to the record holders;

one full right plus \$2.00 in cash will entitle the holder to purchase one common unit;

the rights will be evidenced by non-transferable subscription certificates;

no fractional rights or cash in lieu thereof will be issued or paid, and the number of rights distributed to each holder of common units will be rounded up to the nearest whole number of rights (provided that such rounding shall not cause the total purchase price of the common units issuable upon exercise of the right to exceed \$35,000,000); and

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brokers, dealers and other nominees holding common units on the record date of more than one beneficial owner will be entitled to obtain separate subscription certificates for their beneficial owners so that they may each receive the benefit of rounding.

M2 has agreed to purchase at \$2.00 per unit any common units that are not purchased in the rights offering.

## **Covenants of Star Gas Partners in the Unit Purchase Agreement**

The unit purchase agreement contains various covenants regarding the recapitalization. The unit purchase agreement requires that Star Gas Partners take all commercially reasonable action necessary to call and hold a special meeting of its unitholders as promptly as practicable to consider and vote on the adoption and approval of the issuance and sale of common units pursuant to the unit purchase agreement and other matters incident to the recapitalization for which unitholder approval is required.

The unit purchase agreement provides that, subject to its fiduciary duties, the board must:

recommend to the unitholders that they vote in favor of such adoption and approval;

use its reasonable best efforts to solicit from the unitholders proxies in favor of such adoption and approval; and

take all other action reasonably necessary to secure a favorable vote of the unitholders.

Star Gas Partners must also use its reasonable best efforts to obtain a statement from its officers and directors who own partnership securities to the effect that such persons intend to vote all of their partnership securities in favor of the recapitalization.

In addition the unit purchase agreement requires Star Gas Partners to prepare and file with the SEC a registration statement to register common units to be issued in the rights offering, and use its reasonable best efforts to have such registration statement declared effective as promptly as practicable after the special meeting. Star Gas Partners must also use its reasonable best efforts to cause the common units issuable upon exercise of the rights to be approved for listing on the NYSE prior to the closing.

## **Covenants Regarding the Conduct of Star Gas Partners Business Prior to Closing**

Under the unit purchase agreement, Star Gas Partners has agreed that, at all times prior to the earlier of the closing or the termination of the unit purchase agreement in accordance with its terms, Star Gas Partners will conduct its business in the ordinary and usual course. Except as otherwise contemplated by the unit purchase agreement, none of the Star Gas Partners entities, including Star Gas, may without the written consent of Kestrel do or engage in any of the following activities:

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amend its charter, bylaws or other organizational documents or make any material changes in its capital structure;

incur any liability or obligations or pay, discharge or satisfy any claims, liabilities or obligations except in the ordinary course of business consistent with past practice, or settle or compromise any litigation or claims involving liability in excess of \$500,000;

incur any indebtedness for borrowed money, except under Petro s existing credit facility or permitted indebtedness thereunder;

make any loans or advances to any person, subject to certain exceptions;

declare or pay any dividend or make any other distribution with respect to its capital stock or other securities, other than certain dividends paid by subsidiaries;

except for units issuable upon exercise of outstanding unit appreciation rights, issue, sell or deliver or purchase or otherwise acquire any of its partnership interests or other securities;



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encumber any of its assets or properties, other than by operation of law or in the ordinary and usual course of business or to secure its existing indebtedness or as permitted under its credit agreement;

other than in the ordinary course of business, dispose of any assets, or waive, release, grant or transfer any rights of value, subject to certain exceptions;

acquire any corporation or other business organization; create or make any investment in any subsidiary; or make any capital expenditure, other than one disclosed in the capital expenditure budget previously provided to Kestrel and other expenditures not to exceed \$500,000;

with certain exceptions, enter into, adopt or amend or terminate any collective bargaining agreement or any employee benefit plan; approve or implement any employee lay off or other personnel reorganization plan; approve or implement any employment severance arrangements; retain or discharge any officers and executive management personnel; authorize or enter into any employment, severance, consulting services or other agreement with any officers and executive management personnel; or change the compensation or benefits provided to any director, officer and employee;

other than supply and other contracts entered into in the ordinary course of business, enter into any material contract, agreement, lease or other commitment; or amend or modify in any material respect any of the agreements governing Star Gas Partners existing indebtedness or an other material contract, agreement, lease or other commitment;

other than hedges to supply and sales agreements entered into in the ordinary course of business, enter into any speculative or commodity swaps, hedges or other derivatives transactions or purchase any securities for investment purposes, other than in connection with cash management;

other than in the ordinary course of business and consistent with past practice, authorize, enter into or amend any contract, agreement, or other commitment with a director, officer, employee or other affiliate pursuant to which any such person will receive compensation, consideration or benefit of any kind from Star Gas Partners or any subsidiary; and

make or change any material tax election, change any method of tax accounting, grant any extension of time to assess any tax or settle any tax claim, amend any tax return in any material respect or settle or compromise any material tax liability.

## **Representations and Warranties**

The unit purchase agreement includes standard representations and warranties by Star Gas Partners as to itself and its subsidiaries, including with respect to:

organization, standing and authority;

capitalization;

the power and authority to execute the unit purchase agreement and consummate the transactions contemplated therein, including necessary partnership approval, subject to unitholder approval;

absence of defaults caused by the execution of the unit purchase agreement;

the accuracy of financial statements and reports filed with the SEC;

pending or threatened litigation;

compliance with applicable laws;

the absence of undisclosed contracts and defaults;

brokers and finders fees;

employee compensation and benefit plans and related matters;

labor matters;

the absence of violations or liabilities under environmental laws;

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certain tax matters;

the absence of any necessary regulatory approvals of the transaction, except under state securities or Blue Sky laws;

the conduct of business in the ordinary and usual course and the absence of certain materially adverse changes;

certain insurance matters;

the condition and sufficiency of certain tangible assets; and

the ownership and rights to use certain intellectual property.

The unit purchase agreement also includes standard representations and warranties by the Kestrel entities, including with respect to:

organization, standing and authority;

the power and authority to execute the unit purchase agreement;

the absence of defaults caused by the execution of the unit purchase agreement;

the absence of any necessary regulatory approvals of the transaction, except under state securities laws or Blue Sky Laws;

the buyers' investment intent and status as accredited investors; and

the buyers' financial resources.

**Conditions to Closing of the Unit Purchase Agreement**

The unit purchase agreement generally provides that the obligations of each of Star Gas Partners and the Kestrel entities to close the agreement are subject to a number of conditions, including the following:

approval of the transaction by the Star Gas Partners' unitholders;

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absence of any order, decree or injunction to prevent the transactions contemplated by the unit purchase agreement, or any pending governmental action, proceeding or investigation to enjoin, delay or restrict the transaction;

absence of any partnership material adverse effect which is defined below;

closing of the rights offering;

receipt of legal opinions as to certain corporate, partnership and tax matters;

approval of the Star Gas Partners common units to be issued to Kestrel Heat and M2 and in the rights offering for listing on the NYSE, subject to official notice of issuance;

the consent of the senior lenders under Star Gas Partners existing credit facility (i) that the appointment of Kestrel Heat as our new general partner shall not constitute a change of control and (ii) to permit the heating oil segment to distribute to us funds to repurchase the minimum amount of senior notes which we are required to repurchase under our agreements with our noteholders;

as to the Kestrel entities, the absence of any breaches in the representations and warranties of Star Gas Partners which would reasonably be expected to result in loss or liability of \$2,500,000 or more; and

the successful completion and closing of the senior notes exchange offer whereby holders of at least 93% in principal amount of our senior notes agree to tender such notes at par (a) for a pro rata portion of \$60 million in cash (less amounts required to be paid upon a change in control), (b) in exchange for approximately \$26.9 million in new common units at a price of \$2.00 per unit and (c) in exchange for an agreement that the noteholders shall not take any action to accelerate the indebtedness due under the indenture for the senior notes.

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Partnership material adverse effect means, except as disclosed in our financial statements and SEC reports, including a draft of our fiscal 2005 Annual Report on Form 10-K that we provided to Kestrel in connection with the execution of the unit purchase agreement, an event that would have a material adverse effect on the financial condition, business, properties, or results of operations of the partnership entities, taken as a whole, except for changes affecting the economy generally or changes in commodity prices or other changes affecting the heating oil industry generally.

## **Amendment and Waiver**

The unit purchase agreement provides that any provision of the unit purchase agreement may be:

waived in writing by the party benefited by that provision; or

modified or amended at any time by a written agreement signed by all of the parties.

## **Indemnification of Kestrel and Star Gas Partners**

The unit purchase agreement contains certain mutual indemnification agreements between Kestrel and Star Gas Partners for claims and liabilities arising from the unit purchase agreement, the recapitalization and breaches of representations, warranties, covenants and agreements contained in the unit purchase agreement; provided that claims with respect to the breach of representations and warranties must be brought within a one year period following closing. The parties' indemnification obligations do not apply to any individual claim of less than \$50,000 until the aggregate of all claims less than \$50,000 exceeds \$500,000. Once the \$500,000 threshold is exceeded, the indemnified parties are entitled to recovery from the first dollar of liability up to a cap of 25% of the aggregate purchase price paid by the Kestrel entities for their common units.

## **Directors and Officers Indemnification and Insurance**

The unit purchase agreement also provides that Kestrel will cause Star Gas Partners to maintain, for a period of six years after the completion of the transaction, the current indemnification agreements and provisions for Star Gas Partners' officers and directors and the current policies of directors and officers' liability insurance maintained by Star Gas Partners, or policies of at least the same coverage and amounts containing terms and conditions that are no less advantageous, with respect to claims arising from facts or events that occurred before the date of the completion of the transaction; provided, however, Star Gas Partners will not be required to expend in any one year an amount more than current annual premiums paid by Star Gas Partners for directors' and officers' liability insurance, and if that insurance cannot be obtained or if the annual premiums of that insurance coverage exceed this amount, Star Gas Partners will be obligated to obtain a policy with the most advantageous policies available for a cost not exceeding that amount. Alternatively, Star Gas Partners may purchase a six-year tail prepaid policy covering liabilities arising from facts or events that occurred on or prior to the closing date (including acts and omissions occurring in connection with the approval of the unit purchase agreement and the transactions contemplated thereby) on terms and conditions no less advantageous to the insured than the directors and officers' insurance; provided, that in no event shall Star Gas Partners be required to expend in excess of the current annual premiums.

## **Covenants Regarding Exclusivity**

We have agreed that we will not, and will use reasonable efforts to insure that our affiliates and representatives do not, directly or indirectly, solicit any offer from, initiate or engage in any discussions or negotiations with, or provide any information other than publicly available information to, any person concerning any acquisition proposal. In addition, subject to the other provisions described below, we have agreed that we will not engage in any communications whatsoever, directly or indirectly, with any party that initiates discussions regarding a potential acquisition proposal except for communications that are wholly unrelated to such a potential acquisition proposal or to notify such party that it will not engage in any communications at such time.

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Acquisition proposal means (i) any proposal to commence or conduct a tender or exchange offer involving Star Gas Partners or one or more of the partnership entities, (ii) any proposal for a merger, consolidation or other business combination involving Star Gas Partners or one or more of the partnership entities, (iii) any proposal or offer to acquire in any manner a substantial equity interest in Star Gas Partners or one or more of the partnership entities, (iv) any proposal or offer to acquire in any manner a substantial portion of our business or the assets associated with our business, (v) any proposal or offer with respect to any recapitalization or restructuring (whether of equity or debt or a combination thereof) with respect to Star Gas Partners or one or more of the partnership entities, or (vi) any proposal or offer with respect to any other transaction similar to any of the foregoing with respect to Star Gas Partners or any of the partnership entities.

Notwithstanding the foregoing, nothing contained in the unit purchase agreement prohibits us from (x) in the event of an unsolicited acquisition proposal, requesting from the third party such information as may be reasonably necessary for the board of directors of Star Gas to inform itself as to the material terms of such acquisition proposal for the sole purpose of determining whether such acquisition proposal constitutes a superior proposal, (y) taking (and disclosing to our unitholders or partners) our position with respect to a tender or exchange offer by a third party pursuant to Rules 14d-9 and 14e-2 under the Exchange Act or (z) making such disclosure to our unitholders or partners as in the good-faith judgment of the board of directors of Star Gas, after receipt of advice from outside legal counsel, that such disclosure is advisable for the board of directors of Star Gas to comply with its fiduciary duties under applicable law.

Notwithstanding the foregoing, prior to the closing date, we may furnish information concerning our business or the assets associated with our business to any person pursuant to a confidentiality agreement with terms no less favorable to us or our affiliates than those contained in the confidentiality agreement with Kestrel and may negotiate and participate in discussions and negotiations with such person concerning an acquisition proposal if, but only if, (i) such acquisition proposal is reasonably likely to be consummated (taking into account the legal aspects of the proposal, the person making the acquisition proposal and approvals required in connection therewith), (ii) such person has on an unsolicited basis, and in the absence of any violation of the nonsolicitation provisions by us or our affiliates, submitted a bona fide, written proposal to us relating to any such transaction that the board of directors of Star Gas determines in good faith, after receiving advice from our financial advisors, may reasonably be expected to be more favorable to us or our unitholders or partners from a financial point of view than the transactions contemplated by the unit purchase agreement, and (iii) in the good faith opinion of the board of directors of Star Gas, after consultation with our outside legal counsel, providing such information or access or engaging in such discussions or negotiations is in the best interests of Star Gas Partners and its unitholders or partners and necessary in order for the board of directors of Star Gas to discharge its fiduciary duties to our unitholders or partners under applicable law (an acquisition proposal that satisfies clauses (i), (ii) and (iii) being referred to as a superior proposal).

Except as set forth above, neither the board of directors of Star Gas nor any committee thereof may (i) withdraw or modify, or propose to withdraw or modify, in a manner adverse to the transactions contemplated by the unit purchase agreement or to the Kestrel entities, the approval or recommendation by the board of directors of Star Gas of the unit purchase agreement or the transactions contemplated by the unit purchase agreement, (ii) approve or recommend or propose to approve or recommend, any acquisition proposal or (iii) enter into any contract or other agreement with respect to any acquisition proposal. Notwithstanding the foregoing, prior to the closing, the board of directors of Star Gas may (subject to the terms of this and the following sentence) withdraw or modify its approval or recommendation of the unit purchase agreement or the transactions contemplated by the unit purchase agreement, approve or recommend a superior proposal, or enter into a contract or other agreement with respect to a superior proposal.

We may terminate the unit purchase agreement, and we or our affiliates may enter into an acquisition agreement with respect to a superior proposal, provided that, prior to any such termination we have provided certain required notice to the Kestrel entities and have paid the break-up fee and expense reimbursement payments described below under Termination; Break-up fee and Expense Reimbursement.

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**Termination; Break up Fee**

The unit purchase agreement may be terminated, and the transaction abandoned, at any time prior to the completion of the transaction, whether before or after approval of the restructuring by the Star Gas Partners unitholders:

by the mutual consent of Kestrel and Star Gas Partners;

by either Kestrel or Star Gas Partners:

if the other party materially breaches any of its representations, warranties and covenants and the breach is not cured or curable within the prescribed time;

if approval of Star Gas Partners unitholders is not obtained; or

upon the occurrence of a bankruptcy event with respect to Star Gas Partners or any of its subsidiaries;

by Kestrel if Star Gas Partners breaches any of its exclusivity obligations or if the senior lender or the non-consenting bondholders take steps to accelerate their existing indebtedness; and

by Star Gas Partners if it elects to accept a superior proposal.

Furthermore, the unit purchase agreement may be terminated by Star Gas Partners or Kestrel if the transaction is not completed on or before April 30, 2006.

The unit purchase agreement provides that, in addition to the fees and expenses which Star Gas Partners is obligated to reimburse Kestrel (described below), Star Gas Partners shall pay Kestrel a break-up fee of \$4,000,000 in the event:

the unit purchase agreement is terminated by Star Gas Partners in order to accept a superior proposal or by Kestrel upon a breach by us of our exclusivity obligations;

the unit purchase agreement is terminated for any reason, other than by Star Gas Partners by reason of or resulting from any breach by Kestrel of any of its representations, warranties, covenants, or agreements contained in the unit purchase agreement, and at the time of such termination a superior proposal existed; or

(x) the unit purchase agreement is terminated for any reason, other than by Star Gas Partners by reason of or resulting from any breach by Kestrel of any of its representations, warranties, covenants, or agreements contained in the unit purchase agreement, (y) an acquisition proposal existed at any time during the term of the unit purchase agreement and (z) prior to the twelve-month anniversary of such termination, Star Gas Partners or any of its affiliates consummates an acquisition proposal that is from a financial point of



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view to the holders of the common units equal to or superior to the transactions contemplated by the unit purchase agreement and such acquisition proposal resulted, directly or indirectly, from any communication with respect to such acquisition proposal which occurred either during the term of the unit purchase agreement or within six months following the termination of the unit purchase agreement. If Kestrel terminates the purchase agreement and one or more of the noteholders who have entered into lockup agreements with Star Gas Partners (as long as such noteholders have not interfered with the transaction with Kestrel and are not otherwise in breach of such lockup agreements) consummates an acquisition proposal pursuant to the terms of the lock-up agreements, then Kestrel will be entitled only to expenses, and not to the break-up fee.

If the parties disagree as to whether the consummated acquisition proposal is, from the financial point of view of the holders of common units, equal to or superior to the transactions contemplated by the unit purchase agreement for purposes of triggering the payment of the termination fee, Star Gas Partners and Kestrel shall jointly engage and equally share the expense of a mutually agreeable nationally recognized investment banking firm within 30 days of the date of the consummation of the acquisition proposal to make such determination and

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the decision of such investment banking firm shall be binding upon all parties. Except for claims for indemnification pursuant to the provisions discussed above or circumstances involving fraud, any amount payable as set forth above shall, when paid, be the sole and exclusive remedy of Kestrel and shall be in lieu of all remedies at law or equity of the Kestrel parties.

### **Expense Reimbursement**

Star Gas Partners will bear all of its own expenses incurred for the unit purchase agreement and the transactions contemplated therein. Star Gas Partners shall also reimburse the Kestrel entities for all out-of-pocket expenses reasonably incurred by them in connection with the proposed transaction including, without limitation, the fees and expenses of Kestrel's legal counsel and all third party consultants engaged by the Kestrel entities to assist in the transaction, subject to the requirement that any such third party consultants other than accountants or environmental consultants, shall be subject to the approval of Star Gas Partners, which approval will not be unreasonably withheld. Such reimbursements to the Kestrel entities shall be due at the closing, or promptly following any earlier termination of the unit purchase agreement by any of the parties for any reason, other than a termination by Star Gas Partners as a result of Kestrel's breach of its obligations or if Kestrel's representations and warranties should fail to be accurate in all material respects; provided, that in the event of such earlier termination, the amount of expense reimbursement shall be limited to between \$350,000 and \$500,000 depending on the reason for such termination. The \$350,000 reimbursement would be payable due to a termination for the failure of the limited partners of Star Gas Partners to adopt the matters proposed in this proxy statement necessary for the completion of the transaction, while the \$500,000 reimbursement would be payable due to a termination for any other reason other than a breach by Kestrel.

### **Equity Maintenance Agreement**

Yorktown, Kestrel's principal investor, has entered into an equity maintenance agreement with the Kestrel entities pursuant to which Yorktown has agreed to provide Kestrel with sufficient funds to permit the Kestrel entities to purchase the common units that they have agreed to purchase under the unit purchase agreement. Star Gas Partners is a third party beneficiary of this agreement.

### **Registration Rights**

If Kestrel Heat replaces Star Gas as general partner of Star Gas Partners, Kestrel Heat and M2 will have three demand and unlimited piggyback registration rights by virtue of the provisions in the amended and restated agreement of limited partnership, including our partnership agreement as currently in effect.

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**AMENDMENTS TO THE PARTNERSHIP AGREEMENT**

*The following is a summary of the material amendments to the current Star Gas Partners amended and restated agreement of limited partnership to be voted upon by the Star Gas Partners unitholders, which is qualified in its entirety by reference to the full text of the proposed Star Gas Partners second amended and restated agreement of limited partnership attached as Annex B. Annex B shows the portions of the existing Star Gas Partners amended and restated agreement of limited partnership that will be deleted or changed and provisions that will be added if the transaction is completed.*

**Introduction; Vote Required by Unitholders in Order to Amend the Partnership Agreement**

Star Gas, the current general partner, proposes the adoption of the amendments described below to the Star Gas Partners amended and restated agreement of limited partnership. This amendment proposal must receive the approval of the holders of a unit majority. The enclosed proxy affords unitholders an opportunity to separately vote for or against the amendment proposal by marking the appropriate box on their proxy card. **However, the other proposals relating to the recapitalization proposal will not be effected unless the amendments are adopted.**

The following are the principal amendments proposed to be adopted in the recapitalization. Please read this section in connection with Comparison of the Star Gas Partnership Agreement Before and After the Recapitalization and Cash Distribution Policy, as those sections will provide more detail about the second amended and restated partnership agreement that will be in effect after the recapitalization.

*Conversion of Senior Subordinated Units and Junior Subordinated Units into Common Units.* The proposed amendments will provide for the mandatory conversion of each outstanding senior subordinated unit and each junior subordinated unit into one common unit, as a result of which the subordination period will end. Collectively, 3,391,982 senior subordinated units and 345,364 junior subordinated units will convert into 3,737,346 common units. The termination of the subordination period will have the following effects:

There will no longer be senior subordinated units or junior subordinated units whose distributions are subordinated to the common units. The converted common units will share pro rata with all distributions on the existing common units.

The cumulative accrued and unpaid arrearages in payment of the minimum quarterly distribution on the common units as of the effective date of the recapitalization will be eliminated. Under our partnership agreement as currently in effect, no distributions of available cash from operating surplus may be made on the senior subordinated units, junior subordinated units and general partner units, including incentive distributions, until all arrearages on the common units have been paid. As of November 30, 2005, the amount of accrued and unpaid arrearages on the common units was \$92.5 million. Assuming that the number of outstanding common units remained at 32,165,528 and that we did not distribute any available cash from operating surplus, these arrearages would increase by \$18.5 million per quarter. If the recapitalization is not consummated, it is unlikely that regular distributions on the common units would be resumed in the foreseeable future and it is considerably less likely that regular distributions would ever resume on the senior subordinated units because of their subordination terms.

Our partnership agreement currently requires a unitholder vote during the subordination period for us to issue units senior to the common units or in excess of 5,500,000 additional common units except in connection with accretive acquisitions or capital improvements or in certain other circumstance. The amendment proposal would eliminate all restrictions on our ability to issue additional partnership units.

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*Reduction of the Minimum Quarterly Distribution.* The proposed amendments will reduce the minimum quarterly distribution on the common units from \$0.575 per unit per quarter, or \$2.30 per year, to \$0.0 per unit through September 30, 2008, or, if we elect to commence making distributions sooner, the quarter in which any distribution of available cash is made, and to \$0.0675 per unit per quarter, or \$0.27 per unit per year, thereafter.

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We believe that this amendment will more closely align the minimum quarterly distribution with the levels of available cash that we may be expected to generate in the future.

*Reduction of Incentive Distribution Levels.* The proposed amendments will reduce the target distribution levels for the incentive distribution rights so that, commencing with the quarter beginning October 1, 2008, or, if we elect to commence making distributions sooner, the quarter in which any distribution of available cash is made, the new general partner units in the aggregate will be entitled to receive 10% of the cash distribution in a quarter once each common unit and general partner unit has received \$.0675 for that quarter, plus any arrearages on the common units from prior quarters, and 20% of the cash distributions in a quarter once each common unit and general partner unit has received \$.1125 for that quarter, plus any arrearages on common units from prior quarters. Under the partnership agreement as currently in effect, the senior subordinated units, junior subordinated units and general partner units are not entitled to receive incentive distributions until \$0.604 has been distributed on each common unit for a quarter, plus any arrearages on the common units for prior quarters.

*Suspension of Mandatory Distribution of Available Cash.* We suspended distributions on our senior subordinated units, junior subordinated units and general partner units on July 29, 2004 and on our common units on October 18, 2004. The proposed amendments will provide that we are not required to distribute available cash through the quarter ending September 30, 2008. We do not intend to make distributions of available cash during this period, even if we have available cash to distribute.

*Amendment to Distributions Upon Liquidation.* The proposed amendments will modify the manner in which net income, net loss, net termination gain and net termination loss are allocated among the unitholders. The allocation provisions will be modified to be consistent with the reduction of the incentive distribution levels. The amendments in the allocation provisions will affect the balances in the unitholders' capital accounts. Consequently, the amendments will affect the amount of distributions that the unitholders will receive upon liquidation.

*Reduction of Initial Unit Price.* The initial unit price will be reduced from \$22.00 to \$2.00, which means that distributions of available cash from capital surplus will be made 100% on all units, pro rata, until each common unit outstanding on the closing date of the recapitalization has received available cash from capital surplus of \$2.00 per unit, plus any unpaid arrearages in payment of the minimum quarterly distribution on the common units, at which time the general partner units will be entitled to receive incentive distributions on further distributions of available cash from capital surplus. The effect of this change is to substantially reduce the amount of the distributions from capital surplus to be made to holders of the common units before the general partner units will receive 20% of distributions of capital surplus.

*Amendment to the Definition of Operating Surplus.* The definition of operating surplus will be amended to (1) change the operating surplus basket from \$20,340,600 to \$22,000,000, (2) reset the measurement date for cash on hand to be included in operating surplus from the closing date of our initial public offering to the closing date of the recapitalization and (3) reset the measurement date for calculating operating surplus from the closing date of our initial public offering to the closing date of the recapitalization. The cumulative operating surplus through September 30, 2005, including cash on hand as of the closing date of the initial public offering and the operating surplus basket, is a negative \$120.5 million, meaning that without this change, we would have to generate over \$120.5 million in positive operating surplus before we would be able to make any payments toward the minimum quarterly distribution on the common units.

*Change to the Definition of Operating Expenditure.* Clarifies that non-pro rata purchases of common units, other than those made with the proceeds of interim capital transactions, are operating expenditures that reduce available cash from operating surplus. See *Important Considerations* and *Information Regarding Kestrel Heat Interests of the Proposed Executive Officers and Directors in the Recapitalization.*

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*Changes to the Audit Committee.* Our partnership agreement currently provides that the audit committee of the general partner shall, if requested by the general partner, approve transactions that involve potential

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conflicts of interest between the general partner and its affiliates, on one hand, and the partnership, any partner or any assignee, on the other hand. If such a transaction is approved by the audit committee, it is deemed fair and reasonable to the partnership. The amendment proposal would provide for a conflicts committee comprised of independent directors to assume this role in place of the audit committee and would tighten the independence requirements for membership on the committee. See *Important Considerations* and *Information Regarding Kestrel Heat Interests of the Proposed Executive Officers and Directors in the Recapitalization*.

*Changes to Tax Provisions.* Because taxable income and loss are allocated among the unitholders in a manner consistent with the manner in which distributions are made, the amendments to the distribution provisions disclosed above will require corresponding modifications in the allocation of taxable income and loss among the unitholders. In addition, the proposed amendments will require an interim closing of our books for federal income tax purposes in 2006 on the effective date of the recapitalization. In 2006, tax items incurred on or before the effective date will be allocated among the unitholders based upon their percentage interest in Star Gas Partners prior to the effective date, and tax items incurred after the effective date will be allocated among the unitholders based upon their percentage interest following the effective date.

*Conforming Changes.* Additional changes will be required to conform our current partnership agreement to the amendments and to facilitate the restructuring proposal. It is the good faith opinion of Star Gas that the conforming changes do not adversely affect the unitholders in any material respect. Thus, under the current partnership agreement, Star Gas may make any or all conforming changes without the consent of the unitholders.

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**Comparison of the Star Gas Partnership Agreement Before and After the Recapitalization**

The following chart summarizes the material provisions of the Star Gas Partners partnership agreement in effect now and as will be in effect if the recapitalization is approved:

<b>Before Recapitalization</b>	<b>Requirement to Distribute Available Cash</b>	<b>After Recapitalization</b>
<p>Within 45 days following the end of each quarter, Star Gas Partners is required to distribute 100% of its available cash with respect to such quarter to partners as of the record date selected by the general partner in its reasonable discretion.</p>	<p>Requirement to Distribute Available Cash</p>	<p>Within 45 days following the end of each quarter commencing with the quarter beginning October 1, 2008, Star Gas Partners is required to distribute 100% of its available cash with respect to such quarter to partners as of the record date selected by the general partner in its reasonable discretion. Star Gas Partners has no obligation to distribute available cash through the quarter ending September 30, 2008 and currently has no intention of making any such distributions.</p>
<p>Available cash for any quarter consists generally of all cash on hand at the end of that quarter, as adjusted for reserves. The general partner has broad discretion in establishing reserves.</p>	<p><b>Definition of Available Cash</b></p>	<p>Available cash for any quarter will continue to consist of all cash on hand at the end of that quarter, as adjusted for reserves. The general partner has broad discretion in establishing reserves.</p>
<p>\$0.575 per unit per quarter or \$2.30 per unit per year.</p>	<p><b>Minimum Quarterly Distribution</b></p>	<p>\$0.0 through the quarter ending September 30, 2008, or, if we elect to commence making distributions sooner, the quarter in which any distribution of available cash is made, and \$0.0675 per unit per quarter, or \$0.27 per unit per year, thereafter.</p>
<p>First target distribution level \$0.604 per unit per quarter. Second target distribution level \$0.711 per unit per quarter. Third target distribution level \$0.926 per unit per quarter</p>	<p><b>Target Distribution Levels</b></p>	<p>First target distribution level \$0.1125 per unit per quarter. The second and third target distribution levels have been eliminated.</p>



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<b>Before Recapitalization</b>	<b>Distribution of Available Cash from Operating Surplus</b>	<b>After Recapitalization</b>
<p>Available cash from operating surplus with respect to any quarter during the subordination period will be distributed in the following manner:</p> <p>First, 100% to the common units, pro rata, until we distribute to each common unit the minimum quarterly distribution of \$0.575;</p> <p>Second, 100% to the common units, pro rata, until we distribute to each common unit any arrearages in payment of the minimum quarterly distribution on the common units for prior quarters;</p> <p>Third, 100% to the senior subordinated units, pro rata, until we distribute to each senior subordinated unit the minimum quarterly distribution of \$0.575;</p> <p>Fourth, 100% to the junior subordinated units and general partner units, pro rata, until we distribute to each junior subordinated unit and general partner unit the minimum quarterly distribution of \$0.575;</p> <p>Fifth, 100% to all units, pro rata, until we distribute to each unit an amount equal to the first target distribution of \$0.604 (exclusive of payments of arrearages);</p> <p>Sixth, 86.7% to all units, pro rata, and 13.3% to all senior subordinated units, junior subordinated units and general partner units, pro rata, until we distribute to each common unit an amount equal to the second target distribution of \$0.711 (exclusive of payments of arrearages);</p>		<p>Available cash from operating surplus with respect to any quarter will be distributed in the following manner:</p> <p>First, 100% to the common units, pro rata, until we distribute to each common unit the minimum quarterly distribution of \$0.0675;</p> <p>Second, 100% to the common units, pro rata, until we distribute to each common unit any arrearages in payment of the minimum quarterly distribution on the common units for prior quarters;</p> <p>Third, 100% to the general partner units, pro rata, until we distribute to each general partner unit the minimum quarterly distribution of \$0.0675;</p> <p>Fourth, 90% to the common units, pro rata, and 10% to the general partner, pro rata, until we distribute to each common unit the first target distribution of \$0.1125;</p> <p>Thereafter, 80% to the common units, pro rata, and 20% to the general partner units, pro rata.</p>

Seventh, 76.5% to all units, pro rata, and 23.5%  
to all senior

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<b>Before Recapitalization</b>	<b>Distribution of Available Cash from Operating Surplus</b>	<b>After Recapitalization</b>
<p>subordinated units, junior subordinated units and general partner units, pro rata, until we distribute to each common unit an amount equal to the third target distribution of \$0.926 (exclusive of payments of arrearages);</p> <p>Thereafter, 51% to all units, pro rata, and 49% to all senior subordinated units, junior subordinated units and general partner units, pro rata.</p> <p>the adjusted operating surplus generated during each of the three immediately preceding non-overlapping four-quarter periods equaled or exceeded the sum of the minimum quarterly distribution on all units on a fully diluted basis; and</p> <p>there are no arrearages in payment of the minimum quarterly distribution on the common units.</p> <p>Upon the expiration of the subordination period, each senior subordinated unit and junior subordinated unit shall convert into one class B common unit and each common unit will be redesignated as a class A common unit. The main difference between the class A common units and the class B common units is that the class B common units will continue to have the right to receive incentive distributions. Based on current conditions, we do not expect the subordination period to end in the foreseeable future, since we have not been generating sufficient operating surplus to pay</p>	<p><b>Subordination Period</b></p>	<p>Because all senior subordinated units and junior subordinated units will convert into common units, the subordination period will end. All outstanding limited partner units will be common units.</p>

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<b>Before Recapitalization</b>	<b>Subordination Period</b>	<b>After Recapitalization</b>
<p>the minimum quarterly distribution and as of November 30, 2005 there were \$92.5 million in arrearages on the common units and we are not currently making any distributions on our units.</p> <p>Approval of a unit majority is required for the following:</p> <p style="padding-left: 40px;">the issuance of additional common units during the subordination period, with certain exceptions;</p> <p style="padding-left: 40px;">the issuance of units senior to the common units during the subordination period;</p> <p style="padding-left: 40px;">certain amendments to our partnership agreement;</p> <p style="padding-left: 40px;">the merger of our partnership or the sale of all or substantially all our assets; and</p> <p style="padding-left: 40px;">the dissolution of our partnership. A unit majority during the subordination period means at least a majority of outstanding common units, voting as a class, and a majority of outstanding senior subordinated units and junior subordinated units voting as a single class, in each case excluding units owned by our general partner and its affiliates. After the subordination period, a unit majority means at least a majority of the outstanding common units.</p>	<p><b>Voting</b></p>	<p>Approval of a majority of the outstanding common units, including common units owned by the general partner and its affiliates, is required for the following:</p> <p style="padding-left: 40px;">certain amendments to our partnership agreement;</p> <p style="padding-left: 40px;">the merger of our partnership or the sale of all or substantially all our assets; and</p> <p style="padding-left: 40px;">the dissolution of our partnership.</p>

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**DESCRIPTION OF DEBT AMENDMENTS**

**Amendment to Revolving Credit Facility**

On November 3, 2005, our heating oil segment entered into an amendment to its revolving credit facility that increased the borrowing limits by \$50 million to \$310 million (subject to certain borrowing base limitations and coverage ratios) for the peak winter months of December through March.

In addition, it is a condition of closing of the unit purchase agreement that we obtain the agreement of the lenders that the appointment of Kestrel Heat as our new general partner shall not constitute a change of control. Further, we will need the consent of our bank lenders to permit the heating oil segment to distribute to us funds to repurchase the minimum amount of senior notes which we are required to repurchase under our agreements with our noteholders. Our ability to repurchase these senior notes is also a condition of closing of the unit purchase agreement.

**Senior Note Consent Solicitation and Tender Offer**

Effective as of December 5, 2005, we entered into agreements with the consenting noteholders. The obligations of the consenting noteholders under the agreements are contingent upon the continued effectiveness of, and closing of the transactions contemplated by, the Kestrel unit purchase agreement.

The agreements with the consenting noteholders provide that:

- (a) The consenting noteholders commit to and will tender their senior notes at par in exchange for:
  - (i) a pro rata portion of \$60 million or, at Star Gas Partners' option, up to approximately \$73.1 million in cash (less any principal, interest and premium payments required to be reserved for payment to non-tendering noteholders in the senior notes tender offer);
  - (ii) 13,433,962 (subject to adjustment based on rounding) newly issued common units at a conversion price of \$2.00 per unit (which new units would be acquired by certain noteholders exchanging approximately \$26.9 million senior notes); and
  - (iii) new senior notes representing the remaining face amount of the tendered senior notes.

The tender offer is conditioned upon closing of the transactions under the unit purchase agreement and receipt of valid tenders from holders of at least 93% of the outstanding senior notes.

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- (b) The consenting noteholders will not, without the prior written consent of Star Gas Partners, sell, transfer, assign, pledge, grant an option on, grant proxies on, deposit with a voting trust, enter into a voting agreement with respect to or otherwise dispose of or encumber their senior notes, subject to the right to transfer notes to a person that becomes a signatory to the agreement.
- (c) The consenting noteholders will not short sell any equity securities of Star Gas Partners other than in connection with the recapitalization and will not take any action to oppose or interfere with the transactions contemplated by the unit purchase agreement, including the vote of unitholders contemplated by the unit purchase agreement.
- (d) The consenting noteholders have agreed not to:
  - (i) take any action, and direct the trustee to take any action, to accelerate indebtedness due under the indenture for the senior notes; and
  - (ii) initiate, or have initiated on their behalf, any litigation or proceeding with respect to the senior notes, Star Gas Partners or any act or omission of Star Gas Partners prior to the closing of the transactions under the unit purchase agreement.

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- (e) The consenting noteholders will:
- (i) forbear from exercising any rights or remedies in respect of any default, breach or claim under the indenture governing the existing senior notes ( Indenture ) resulting from the sale of Star Gas Partners propane business in December 2004, including Star Gas Partners use of such proceeds to purchase working capital inventory and Star Gas Partners determination that excess proceeds (as defined in the Indenture) shall not include any amounts invested in such inventory, the granting of liens or collateral to the lenders pursuant to the credit facility and to oppose any request or attempt to assert any default under the Indenture arising from the same;
  - (ii) not tender the senior notes held by such consenting noteholders in the change of control offer which will be required to be made following the closing of the transactions under the unit purchase agreement;
  - (iii) consent to the amendments to the amended indenture to which Star Gas Partners and the consenting noteholders agreed (which amended indenture will eliminate restrictive covenants);
  - (iv) approve the indenture for the new senior notes which will, among other things, provide a restricted payments basket of \$22 million, provide a basket for acquisitions of \$60 million and provide that proceeds of asset sales may not be invested in current assets for purposes of the asset sale covenant; and
  - (v) subject to the approval of the required consenting noteholders (2/3 of the principal amount of the outstanding senior notes), waive the right to object to confirmation of a plan of reorganization in the event that Star Gas Partners files a petition for protection under Chapter 11 and to support Star Gas Partners Chapter 11 plan.
- (f) Following the termination of the Kestrel unit purchase agreement (other than as a result of a failure to obtain a favorable unitholder vote or because the board of directors of Star Gas accepts a superior proposal), certain of the noteholders will have the right, at the option of such noteholders, to step into the Kestrel transaction and effect the Kestrel transaction with Star Gas Partners.

Certain of the noteholders agreements provide that the consenting noteholders retain the right to not exchange their notes for common units if a material adverse change occurs to Star Gas Partners prior to the exchange offer. In such event, the senior notes held by such consenting noteholders which would have been exchanged for common units would be subject to Star Gas Partners right, for the life of the notes, to call the notes at par.

The agreements with the consenting noteholders provide for the termination of its provisions in the event that the unit purchase agreement is no longer in effect, in the event that the unit purchase agreement has not closed by April 30, 2006, or in the event that the required consenting noteholders have consented to the commencement of Chapter 11 proceedings in accordance with Section 12(a) of the agreement, in which case the agreement will terminate 120 days after the filing for Chapter 11 protection, or such other date as the consenting noteholders agree.

Star Gas Partners has also entered into backstop agreements with two of the noteholders under which such noteholders each agreed to subscribe for 50% of the common units that are not subscribed for by other noteholders in connection with the exchange of approximately \$26.9 million in senior notes for 13,433,962 (subject to adjustment based on rounding) common units. Star Gas Partners has further agreed to enter into a registration rights agreement with noteholders who, upon consummation of the tender offer, own 10% or more of the then outstanding common units, or provide an opinion of counsel that no such registration is required for the sale of the new units.

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We intend to commence the tender/exchange offer and consent solicitation for the senior notes promptly following the mailing of this proxy statement.



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The closing of the recapitalization will be deemed a change of control under the indenture for our senior notes. Consequently, we will be required to make an offer to repurchase any senior notes that are not otherwise tendered in the senior notes tender offer at a purchase price equal to 101% of their face value. As of the date of this proxy statement, the holders of an aggregate of approximately \$15.3 million in senior notes have not yet agreed to tender their notes in the tender offer. The principal amount of any senior notes, plus any interest and premium payments that we are required to make in respect of senior notes tendered for repurchase in the change of control repurchase offer, will reduce on a dollar-for-dollar basis the amount of senior notes that we shall repurchase for cash in connection with the closing of the recapitalization.

**Table of Contents****UNIT OWNERSHIP**

The following table shows the beneficial ownership as of January 23, 2006 of common units, senior subordinated units, junior subordinated units and general partner units by:

- (1) Star Gas LLC and certain beneficial owners;
- (2) each of the named executive officers and directors of Star Gas LLC;
- (3) all directors and executive officers of Star Gas LLC as a group; and
- (4) each person Star Gas Partners knows to hold 5% or more of Star Gas Partners units.

Except as indicated, the address of each person is c/o Star Gas Partners, L.P. at 2187 Atlantic Street, Stamford, Connecticut 06902-0011.

Name	Common Units		Senior Subordinated Units		Junior Subordinated Units		General Partner Units(a)	
	Number	Percentage	Number	Percentage	Number	Percentage	Number	Percentage
Star Gas LLC		%	29,133	*%		%	325,729	100%
Irik P. Sevin	33,000	*	300,609(b)	8.8	53,426	15.5	325,729(b)	100
Audrey L. Sevin	6,000	*	42,829(b)	1.3	153,131	44.3	325,729(b)	100
Hanseatic Americas, Inc.			29,133(b)	*	138,807	40.2	325,729(b)	100
Paul Biddelman			8,057	*				
William P. Nicoletti			5,252	*				
Stephen Russell			5,252	*				
Richard F. Ambury	2,125	*						
Joseph P. Cavanaugh		*						
Daniel P. Donovan								
All officers and directors and Star Gas LLC as a group (11 persons)	35,125	*	290,037	8.6%	53,426	16.4%	325,729	100%
Third Point Management Company LLC(c)	2,000,000	6.2%						
Dalal Street, Inc.(d)	1,802,926	5.4						
Lime Capital Management LLC(e)	1,690,100	5.3						
Atticus Capital LLC(f)	1,749,000	5.4						

- (a) For purpose of this table, the number of General Partner Units is deemed to include the 0.01% equity partner interest in Star/Petro.
- (b) Assumes each of Star Gas LLC owners may be deemed to beneficially own all of Star Gas LLC's general partner units and senior subordinated units, however, they disclaim beneficial ownership of these units, except to the extent of their proportionate interest therein. The membership interests in Star Gas LLC are owned by its members in the following proportions: Audrey Sevin 44.2580%; Irik Sevin 15.6363%; and Hanseatic Americas, Inc. 40.1057%.
- (c) According to a Schedule 13G filed with the SEC on November 11, 2004, Third Point Management Company L.L.C. ( Third Point ) is a Delaware limited liability company, which serves as investment manager or adviser to a variety of hedge funds and managed accounts with respect to Common Units directly owned by the funds and accounts. Mr. Daniel S. Loeb is the managing director of Third Point and

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- controls its business activities with respect to the Common Units. Third Point's address is 360 Madison Avenue, New York, NY 10017.
- (d) According to a Schedule 13G filed with the SEC on January 21, 2005, Dalal Street, Inc. and Mr. Mohnish Prabai in his capacity as chief executive officer of Dalal Street, Inc., have the shared power to vote or to direct the vote and the shared power to dispose or direct the disposition of the common units owned by The Pabrai Investment Fund II, L.P.; Pabrai Investment Fund 3, Ltd.; Pabrai Investment Fund IV, L.P.; Dalal Street, Inc.; and Mohnish Prabai. Their address is 17 Spectrum Point Drive, Suite 503, Lake Forest, CA 92630.

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- (e) According to a Schedule 13G filed with the SEC on April 29, 2005, includes 1,156,050 common units beneficially owned by Lime Capital Management LLC and 534,050 common units beneficially owned by Lime Capital Management Administrators LLC, an affiliate of Lime Capital Management LLC, for which Lime Capital Management LLC disclaims beneficial ownership. Lime Capital Management LLC is the investment manager and a managing member of Lime Fund LLC. Lime Capital Management Administrators LLC is the investment manager of Lime Overseas Fund Ltd. and a managing member of Lime Fund LLC. Gregory E. Bylinsky and Mark Gorton are the managing members of Lime Capital Management LLC and Lime Capital Management Administrators LLC. The principal business office address of each of Lime Capital Management LLC, Lime Capital Management Administrators LLC, Lime Fund LLC, Gregory E. Bylinsky and Mark Gorton is 377 Broadway, 11th Floor, New York, New York 10013. The principal business office address of Lime Overseas Fund is c/o Meridian Corporate Services Limited, P.O. Box HM 528, 73 Front Street, Hamilton, HM CX, Bermuda.
- (f) According to a Schedule 13G filed with the SEC on May 6, 2005, Atticus Capital LLC and Timothy R. Barakett share voting and disposition power with respect to the common units listed above. Their address is 152 West 57th Street, 45th Floor, New York, NY 10019.
- \* Amount represents less than 1%.

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### **DESCRIPTION OF COMMON UNITS**

The common units have been registered under the Exchange Act and we are subject to the reporting and certain other requirements of the Exchange Act. We are required to file periodic reports containing financial and other information with the SEC.

Purchasers of common units may hold their common units in nominee accounts, provided that the broker, or other nominee, executes and delivers a transfer application and becomes a limited partner. We will be entitled to treat the nominee holder of a common unit as the absolute owner of that unit, and the beneficial owner's rights will be limited solely to those that it has against the nominee holder.

### **The Rights of Unitholders**

Generally, the common units represent limited partner interests, which entitle the holders of those units to participate in our distributions and exercise the rights or privileges available to limited partners under the partnership agreement. For a description of the relative rights and preferences of holders of common units in and to our distributions, see Cash Distribution Policy.

### **Transfer Agent and Registrar**

We have retained LaSalle Bank National Association as registrar and transfer agent for the common units. The transfer agent receives a fee from us for serving in these capacities. All fees charged by the transfer agent for transfers of common units will be borne by us and not by the holders of common units, except that fees similar to those customarily paid by stockholders for surety bond premiums to replace lost or stolen certificates, taxes and other governmental charges, special charges for services requested by a holder of a common unit and other similar fees or charges will be borne by the unitholder. There will be no charge to holders for disbursements of cash distributions. We will indemnify the transfer agent, its agents and each of their shareholders, directors, officers and employees against all claims and losses that may arise out of acts performed or omitted for its activities as transfer agent, except for any liability due to any negligence, gross negligence, bad faith or intentional misconduct of the indemnified person or entity.

The transfer agent may resign, or be removed by us. If no successor is appointed within 30 days, the general partner may act as the transfer agent and registrar until a successor is appointed.

### **Obligations and Procedures for the Transfer of Units**

Until a common unit has been transferred on our books, we and the transfer agent, notwithstanding any notice to the contrary, may treat the record holder as the absolute owner for all purposes, except as otherwise required by law or stock exchange regulations. Any transfers of a common unit will not be recorded by the transfer agent or recognized by us unless the transferee executes and delivers a transfer application. By executing and delivering a transfer application, the transferee of common units does the following:

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becomes the record holder of those units and shall be constituted as an assignee until admitted into Star Gas Partners as a substituted limited partner;

automatically requests admission as a substituted limited partner in Star Gas Partners;

agrees to be bound by the terms and conditions of, and executes, the partnership agreement;

represents that the transferee has the capacity, power and authority to enter into the partnership agreement;

grants powers of attorney to the general partner and any liquidator of Star Gas Partners as specified in the partnership agreement; and

makes the consents and waivers contained in the partnership agreement.

An assignee will become a substituted limited partner of Star Gas Partners for the transferred common units upon satisfaction of the following two conditions:

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the consent of the general partner, which may be withheld for any reason in its sole discretion; and

the recording of the name of the assignee on the books and records of Star Gas Partners.

Common units are securities and are transferable according to the laws governing transfer of securities. In addition to other rights acquired upon transfer, the transferor gives the transferee the right to request admission as a substituted limited partner in Star Gas Partners for the transferred common units. A purchaser or transferee of common units who does not execute and deliver a transfer application obtains only the following rights:

the right to assign the common unit to a purchaser or other transferee; and

the right to transfer the right to seek admission as a substituted limited partner in Star Gas Partners for the transferred common units.

Thus, a purchaser or transferee of common units who does not execute and deliver a transfer application will not receive cash distributions, unless the common units are held in a nominee or street name account and the nominee or broker has executed and delivered a transfer application for those common units. In addition, such purchaser or transferee may not receive some federal income tax information or reports furnished to record holders of common units. The transferor of common units will have a duty to provide the transferee with all information that may be necessary to obtain registration of the transfer of the common units, but a transferee agrees, by acceptance of the certificate representing common units, that the transferor will not have a duty to insure the execution of the transfer application by the transferee and will have no liability or responsibility if the transferee neglects or fails to execute and forward the transfer application to the transfer agent.

## **Unit Purchase Rights**

Each common unit and each other partnership security consisting of a unit of limited or general partnership interest includes a right to purchase from us a Class A common unit at an exercise price of \$80.00 per unit, subject to adjustment. The rights, which we refer to as the 2001 rights, are different than the rights that would be issued under the proposed rights offering that is discussed above. The 2001 rights are issued pursuant to a rights agreement dated as of April 17, 2001, as amended, between us and American Stock Transfer & Trust Company, as rights agent. We have summarized selected portions of the rights agreement and the 2001 rights below. For a complete description of the 2001 rights, we encourage you to read the summary below and the rights agreement, which we have filed as an exhibit to our Annual Report on Form 10-K, attached to this proxy statement as Annex C.

## **Detachment of 2001 Rights; Exercisability**

The 2001 rights are attached to all certificates representing our currently outstanding units and will attach to all unit certificates we issue prior to the distribution date. That date will occur, except in some cases, on the earlier of:

ten days following a public announcement that a person or group of affiliated or associated persons, who we refer to collectively as an acquiring person, has acquired, or obtained the right to acquire, beneficial ownership of 15% or more of either our outstanding common units or the aggregate of our outstanding senior subordinated units and junior subordinated units, or

ten business days following the start of a tender offer or exchange offer that would result in a person becoming an acquiring person.

Our general partner may defer the distribution date in some circumstances. Also, some inadvertent acquisitions of our units will not result in a person becoming an acquiring person if the person promptly divests itself of sufficient units.

Until the distribution date:

unit certificates will evidence the 2001 rights,



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the 2001 rights will be transferable only with those certificates,

new unit certificates will contain a notation incorporating the rights agreement by reference, and

the surrender for transfer of any unit certificate will also constitute the transfer of the 2001 rights associated with the units represented by the certificate.

The 2001 rights are not exercisable until the distribution date and will expire at the close of business on April 16, 2011, unless we redeem or exchange them at an earlier date as described below.

As soon as practicable after the distribution date, the rights agent will mail certificates representing the 2001 rights to holders of record of units as of the close of business on the distribution date. From that date on, only separate rights certificates will represent the 2001 rights. We will issue 2001 rights with all units issued prior to the distribution date. We will also issue 2001 rights with units issued after the distribution date in connection with some employee benefit plans or upon conversion of some securities. Except as otherwise determined by our board of directors, we will not issue 2001 rights with any other units issued after the distribution date.

## **Flip-In Event**

A flip-in event will occur under the rights agreement when a person becomes an acquiring person otherwise than pursuant to a permitted offer. The rights agreement defines permitted offer as a tender or exchange offer for all outstanding units at a price and on terms that our general partner determines to be fair to and otherwise in the best interests of our unitholders.

If a flip-in event occurs, each 2001 right, other than any 2001 right that has become null and void as described below, will become exercisable to receive the number of common units, or in some specified circumstances, cash, property or other securities, which has a current per unit market price equal to two times the exercise price of the 2001 right. Please refer to the rights agreement for the definition of current per unit market price.

## **Flip-Over Event**

A flip-over event will occur under the rights agreement when, at any time from and after the time a person becomes an acquiring person:

we are acquired or we acquire such person in a merger or other business combination transaction, other than specified mergers that follow a permitted offer, or

50% or more of our assets, cash flow or earning power is sold, leased or transferred.

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If a flip-over event occurs, each holder of a 2001 right, except 2001 rights that are voided as described below, will thereafter have the right to receive, on exercise of the 2001 right, a number of common units or equivalent securities of the acquiring company that has a current market price equal to two times the exercise price of the 2001 right.

When a flip-in event or a flip-over event occurs, all 2001 rights that then are, or under the circumstances the rights agreement specifies previously were, beneficially owned by an acquiring person or specified related parties will become null and void in the circumstances the rights agreement specifies.

### **Common Units**

After the distribution date and following the end of the subordination period, each 2001 right will entitle the holder to purchase common units.

### **Anti-dilution**

The number of 2001 rights associated with a unit, the number of common units issuable upon exercise of a 2001 right and the exercise price of the 2001 right are subject to adjustment in the event of a unit distribution on,

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or a subdivision, combination or reclassification of, our common units occurring prior to the distribution date. The exercise price of the 2001 rights and the number of common units or other securities or property issuable on exercise of the 2001 rights are subject to adjustment from time to time to prevent dilution in the event of some specified transactions affecting the common units.

With some exceptions, we will not be required to adjust the exercise price of the 2001 rights until cumulative adjustments amount to at least 1% of the exercise price. The rights agreement also will not require us to issue fractional common units and, in lieu thereof, we will make a cash payment based on the market price of the common units.

## **Redemption of 2001 Rights**

At any time until the time a person becomes an acquiring person, we may redeem the 2001 rights in whole, but not in part, at a price of \$0.01 per right, payable, at our option, in cash, securities or such other consideration as our general partner may determine. Upon such redemption, the 2001 rights will terminate and the only right of the holders of 2001 rights will be to receive the \$0.01 redemption price.

## **Exchange of 2001 Rights**

At any time after the occurrence of a flip-in event and prior to a person's becoming the beneficial owner of 50% or more of our outstanding units or the occurrence of a flip-over event, we may exchange the rights, other than rights owned by an acquiring person or an affiliate or an associate of an acquiring person, which will have become void, in whole or in part, at an exchange ratio of one Class A common unit, and/or other equity securities deemed to have the same value as one Class A common unit, per right, subject to adjustment.

## **Substitution**

If we have an insufficient number of authorized common units available to permit an exercise or exchange of 2001 rights upon the occurrence of a flip-in event, we may substitute other specified types of property for common units so long as the total value received by the holder of the 2001 rights is equivalent to the value of the common units that the unitholder would otherwise have received. We may substitute cash, property, equity securities or debt, reduce the exercise price of the 2001 rights or use any combination of the foregoing.

## **No Rights as a Unitholder; Taxes**

Until a 2001 right is exercised, a holder of 2001 rights will have no rights to vote or receive distributions or any other rights as a holder of our units. Unitholders may, depending upon the circumstances, recognize taxable income in the event that the 2001 rights become exercisable for our common units, or other consideration, or for the common units or equivalent securities of the acquiring company or are exchanged as described above.

**Amendment of Terms of 2001 Rights**

Our general partner may amend any of the provisions of the rights agreement, other than some specified provisions relating to the principal economic terms of the 2001 rights and the expiration date of the 2001 rights, at any time prior to the time a person becomes an acquiring person. Thereafter, our general partner may only amend the rights agreement in order to cure any ambiguity, defect or inconsistency or to make changes that do not materially and adversely affect the interests of holders of the 2001 rights, excluding the interests of any acquiring person.

**Rights Agent**

American Stock Transfer & Trust Company serves as rights agent with regard to the 2001 rights.

**Antitakeover Effects**

The 2001 rights will have anti-takeover effects. They will cause substantial dilution to any person or group that attempts to acquire us without the approval of our general partner. As a result, the overall effect of the 2001

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rights may be to make more difficult or discourage any attempt to acquire us even if such acquisition may be favorable to the interests of our unitholders. Because our general partner can redeem the 2001 rights or approve a permitted offer, the 2001 rights should not interfere with a merger or other business combination approved by our general partner.

### **First Amendment to Rights Agreement**

Effective as of December 2, 2005, we entered into an amendment to the rights agreement that provides that notwithstanding anything contained in the rights agreement to the contrary, Kestrel, Kestrel Heat, M2 and their affiliates or associates shall not become or be an acquiring person solely by virtue of either:

- (i) the execution, delivery and performance of either the unit purchase agreement or the ancillary documents (as defined in the unit purchase agreement); or
  
- (ii) the consummation of the transaction (as defined in the unit purchase agreement);

unless and until such time as any such person together with its respective affiliates and associates, is then the beneficial owner of 15% or more of the common units then outstanding (including, without limitation, by virtue of beneficial ownership referenced in clause (i) or (ii) above) and either (1) such person shall then purchase or otherwise become (as a result of actions taken by such person or its affiliates or associates) the beneficial owner of additional common units more than 1% of the common units then outstanding or otherwise than as permitted by the unit purchase agreement and ancillary documents or (2) any other person who is the beneficial owner of more than 1% of the common units then outstanding shall become an affiliate or associate of Kestrel, Kestrel Heat or M2.

### **Article 20 of Second Amended and Restated Agreement of Limited Partnership**

Article 20 of the second amended and restated agreement of limited partnership, is substantially the same as Section 203 of the Delaware General Corporation Law.

Article 20 prohibits an interested holder, which is defined generally as a person or group owning 15% or more of the partnership's outstanding units, but excluding Kestrel Heat and any of its affiliates or associates, from engaging in a business combination with the partnership for three years following the date such person became an interested holder unless:

- (i) Before such person or group became an interested holder, the general partner approved either the transaction in which the interested holder became an interested holder or the proposed business combination;

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(ii) Upon consummation of the transaction that resulted in the interested holder becoming an interested holder, the interested holder owns at least 85% of the outstanding units at the time the transaction commenced (excluding units held by the general partner and its affiliates); or

(iii) Following the transaction in which such person or group became an interested holder, the business combination is approved by the general partner and authorized at a meeting of the unitholders by the affirmative vote of the holders of two-thirds of the outstanding units that are not owned by the interested holder.

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**CASH DISTRIBUTION POLICY**

*The following description gives effect to the adoption of the second amended and restated agreement of limited partnership. For information concerning our cash distribution policy under our partnership agreement, as currently in effect, see Amendments to the Partnership Agreement.*

**General Description of Cash Distribution**

There will be no mandatory distributions of available cash by us through the fiscal quarter ending September 30, 2008. Thereafter, in general, we intend to distribute to our partners on a quarterly basis, all of our available cash, if any, in the manner described below. Available cash generally means, for any of our fiscal quarters, all cash on hand at the end of that quarter, less the amount of cash reserves that are necessary or appropriate in the reasonable discretion of the general partner to:

- (1) provide for the proper conduct of our business;
- (2) comply with applicable law, any of our debt instruments or other agreements; or
- (3) provide funds for distributions to the common unitholders during the next four quarters, in some circumstances.

Cash distributions will be characterized as distributions from either operating surplus or capital surplus. This distinction affects the amounts distributed among different classes of units. See Quarterly Distributions of Available Cash.

Operating surplus generally means:

- (1) \$22 million, plus all of our cash on the date of closing of the recapitalization, plus all of our cash receipts, excluding cash receipts that constitute capital surplus, that are generated after the closing of the recapitalization; less
- (2) all of our operating expenses, debt service payments, maintenance capital expenditures and reserves established for future operations and certain amounts expended to repurchase common units after the closing of the recapitalization.

Capital surplus is generally generated only by borrowings other than for working capital purposes, sales of debt and equity securities and sales or other dispositions of assets for cash, other than inventory, accounts receivable and other assets, all as disposed of in the ordinary course of business.

All available cash distributed from any source will be treated as distributed from operating surplus until the sum of all available cash distributed since the closing date of the recapitalization equals the operating surplus as of the end of the quarter before that distribution. This method of cash distribution avoids the difficulty of trying to determine whether available cash is distributed from operating surplus or capital surplus. Any

excess available cash, irrespective of its source, will be deemed to be capital surplus and distributed accordingly.

If capital surplus is distributed on each common unit issued and outstanding on the date of closing of the recapitalization in an aggregate amount per unit equal to \$2.00 per common unit, the distinction between operating surplus and capital surplus will cease. All distributions after that date will be treated as from operating surplus. The general partner does not expect that there will be significant distributions from capital surplus.

#### **Quarterly Distributions of Available Cash**

Except for the limitations and prohibitions on distributions discussed below, commencing with the fiscal quarter ending December 31, 2008, we will make distributions to our partners for each of our fiscal quarters before liquidation in an amount equal to all of our available cash for that quarter. Distributions will be made approximately 45 days after each March 31, June 30, September 30 and December 31, to holders of record on the applicable record date.



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### **Distributions of Available Cash from Operating Surplus**

Distributions of available cash from operating surplus will be made in the following manner:

- (1) First, 100% to all common units, pro rata, until there has been distributed to each common unit an amount equal to the minimum quarterly distribution of \$0.0675 for that quarter.
- (2) Second, 100% to all common units, pro rata, until there has been distributed to each common unit an amount equal to any arrearages in the payment of the minimum quarterly distribution for prior quarters.
- (3) Third, 100% to all general partner units, pro rata, until there has been distributed to each general partner unit an amount equal to the minimum quarterly distribution.
- (4) Fourth, 90% to all common units, pro rata, and 10% to all general partner units, pro rata, until each common unit has received the first target distribution of \$0.1125.
- (5) Thereafter, 80% to all common units, pro rata, and 20% to all general partner units, pro rata.

### **Distributions from Capital Surplus**

Distributions of available cash from capital surplus will be made 100% on all units, pro rata, until each common unit that was issued and outstanding on the closing date of the recapitalization receives distributions equal to \$2.00. This was the unit price paid by Kestrel and, thereafter, all distributions from capital surplus will be distributed as if they were from operating surplus.

When a distribution is made from capital surplus, it is treated as if it were a repayment of the \$2.00 unit price paid in the recapitalization. To reflect repayment, the minimum quarterly distribution and the first target distribution will be adjusted downward by multiplying each amount by a fraction. This fraction is determined as follows: the numerator is the unrecovered initial unit price immediately after giving effect to the repayment and the denominator is the unrecovered initial unit price immediately before the repayment. For example, based on the unrecovered initial unit price of \$2.00 per unit and assuming available cash from capital surplus of \$1.00 per unit is distributed on all common units outstanding on the closing date of the recapitalization, then the amount of the minimum quarterly distribution and the target distribution levels would each be reduced to 50% of its initial level.

A payback of the initial unit price from the recapitalization occurs when the unrecovered initial unit price is zero. At that time, the minimum quarterly distribution and the first target distribution levels each will have been reduced to zero. All distributions of available cash from all sources after that time will be treated as if they were from operating surplus. Because the minimum quarterly distribution and the first target distribution level will have been reduced to zero, the holders of the general partner units will then be entitled to receive 20% of all distributions of available cash, after distributions for cumulative common unit arrearages.

Distributions from capital surplus will not reduce the minimum quarterly distribution or the first target distribution level for the quarter in which they are distributed.

**Adjustment of Minimum Quarterly Distribution and First Target Distribution Level**

In addition to adjustments made upon a distribution of available cash from capital surplus, the following will each be proportionately adjusted upward or downward, as appropriate, if any combination or subdivision of units should occur:

- (1) the minimum quarterly distribution;
- (2) the first target distribution;
- (3) the unrecovered initial unit price; and
- (4) other amounts calculated on a per unit basis.

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However, no adjustment will be made by reason of the issuance of additional units for cash or property. For example, if a two-for-one split of the common units should occur, the minimum quarterly distribution, the first target distribution and the unrecovered initial unit price would each be reduced to 50% of its initial level.

The minimum quarterly distribution and first target distribution may also be adjusted if legislation is enacted or if existing law is modified or interpreted in a manner that causes us to become taxable as a corporation or otherwise subject to taxation as an entity for federal, state or local income tax purposes. In this event, the minimum quarterly distribution and first target distribution for each quarter after that time would be reduced to amounts equal to the product of:

- (1) the minimum quarterly distribution or first target distribution; multiplied by
- (2) one minus the sum of:
  - (x) the highest marginal federal corporate income tax rate to which we are then subject as an entity; plus
  - (y) any increase in the effective overall state and local income tax rate to which we are subject as a result of the new imposition of the entity level tax, after taking into account the benefit of any deduction allowable for federal income tax purposes for the payment of state and local income taxes, but only to the extent of the increase in rates resulting from that legislation or interpretation.

For example, assuming we are not previously subject to state and local income tax, if we were to become taxable as an entity for federal income tax purposes and we became subject to a maximum marginal federal, and effective state and local, income tax rate of 38%, then the minimum quarterly distribution and the first target distribution level would each be reduced to 62% of the amount thereof immediately before the adjustment.

The minimum quarterly distribution and first target distribution may also be adjusted in connection with the occurrence of certain events under our unit purchase rights agreement.

## **Distributions of Cash Upon Liquidation**

Following the beginning of the dissolution and liquidation, assets will be sold or otherwise disposed of and the partners' capital account balances will be adjusted to reflect any resulting gain or loss. The proceeds of liquidation will first be applied to the payment of our creditors in the order of priority provided in the partnership agreement and by law and, thereafter, be distributed on the units in accordance with respective capital account balances, as so adjusted.

Partners are entitled to liquidation distributions in accordance with capital account balances. Although operating losses are allocated on all units pro rata, the allocations of gains attributable to liquidation are intended to favor the holders of outstanding common units over the holders of all other outstanding units, to the extent of the unrecovered initial unit price plus any cumulative common unit arrearages. However, no assurance can be given that there will be sufficient gain upon liquidation of Star Gas Partners to enable the holders of common units to fully recover their

unrecovered initial unit price and arrearages.

Any gain, or unrealized gain attributable to assets distributed in kind, will be allocated to the partners in the following manner:

First, to the partners that have negative balances in their capital accounts to the extent of and in proportion to those negative balances;

Second, 100% to all common units, until the capital account for each common unit is equal to the unrecovered initial unit price, plus the amount of the minimum quarterly distribution for the fiscal quarter during which the dissolution occurs, plus any then existing common unit arrearages;

Third, 100% to all general partner units until the capital account for each general partner unit is equal to the unrecovered initial unit price, plus the amount of the minimum quarterly distribution for the fiscal quarter during which the dissolution occurs;

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Fourth, 90% to all common units, pro rata, and 10% to general partner units, pro rata, until there has been allocated under this clause an amount per common unit equal to (a) the excess of the first target distribution per common unit over the minimum quarterly distribution per common unit for each quarter of our existence, less (b) the amount per common unit of any distributions of available cash from operating surplus in excess of the minimum quarterly distribution but not in excess of the first target distribution for each quarter of our existence;

Thereafter, 80% to all common units, pro rata, and 20% to all general partner units, pro rata.

Any loss or unrealized loss will be allocated to the general partner units and the common units, pro rata, in proportion to the positive balances in their capital accounts, until the positive balances in those capital accounts have been reduced to zero and thereafter to the general partner units.

Interim adjustments to capital accounts will be made at the time we issue additional interests or make distributions of property. These adjustments will be based on the fair market value of the interests issued or the property distributed and any gain or loss resulting from the adjustments will be allocated to the unitholders in the same manner as gain or loss is allocated upon liquidation.

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**INCORPORATION BY REFERENCE**

The following sections from Star Gas Partners' Annual Report on Form 10-K for the fiscal year ended September 30, 2005, which is attached hereto as Annex C, are hereby incorporated into the proxy statement by this reference:

<b><u>Item</u></b>	<b><u>Description</u></b>
1A	Risk Factors
3	Legal Proceedings Litigation
5	Market for the Registrant's Units and Related Matters
6	Selected Historical Financial and Operating Data
7	Management's Discussion and Analysis of Financial Condition and Results of Operations
7A	Quantitative and Qualitative Disclosures about Market Risk
8	Financial Statements and Supplementary Data

**OTHER MATTERS**

Representatives of KPMG LLP, the independent registered public accounting firm of Star Gas Partners, are expected to attend the special meeting, will be afforded the opportunity to make a statement if they desire to do so, and will be available to respond to appropriate questions by unitholders.

If other matters are properly presented at the special meeting for consideration, the persons named in the proxy will have the discretion to vote on those matters for you. At the date this proxy statement went to press, we did not know of any other matters to be raised at the special meeting.

The Board of Directors of  
Star Gas LLC, the general partner of  
Star Gas Partners, L.P.

January 24, 2006

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**UNAUDITED CONDENSED PRO FORMA FINANCIAL INFORMATION**

The unaudited pro forma condensed consolidated balance sheet of Star Gas Partners as of September 30, 2005 reflects our financial position after giving effect to the recapitalization which includes (i) receipt of \$50.0 million in cash from the sale of 25.0 million common units at \$2.00 per unit, (ii) conversion of the senior subordinated units and junior subordinated units into common units at an exchange rate of 1.00 to 1.00, (iii) repurchase for cash approximately \$73.1 million of senior notes (assuming full noteholder participation in the senior notes tender offer) and (iv) conversion of approximately \$26.9 million of senior notes into 13,433,962 (subject to adjustment based on rounding) common units at \$2.00 per unit.

As of the date of this proxy statement, the holders of approximately \$15.3 million in face amount of senior notes had not yet agreed to exchange their notes in the tender offer. The principal amount of any senior notes, plus any interest and premium payments that we are required to make in respect of senior notes tendered for repurchase in the change of control repurchase offer, will reduce on a dollar-for-dollar basis the amount of senior notes that we shall repurchase for cash in connection with the closing of the recapitalization. Thus, if none of these noteholders participate in the senior notes tender offer and none tender their notes in connection with the subsequent change of control repurchase offer, the amount of senior notes that we would repurchase for cash in connection with the recapitalization would be at least approximately \$44.4 million but not more than approximately \$57.5 million.

The unaudited pro forma condensed consolidated statement of operations for the year ended September 30, 2005 assumes the aforementioned transaction took place on October 1, 2004 and is based on our operations for the year ended September 30, 2005.

The unaudited pro forma condensed consolidated financial statements have been prepared by us based upon assumptions deemed appropriate by us. These statements are not necessarily indicative of future financial position or results of operations or of the actual results that would have occurred had the recapitalization been in effect as of the dates presented. The unaudited pro forma consolidated financial statements should be read in conjunction with our financial statements and related notes as reported in our Annual Report on Form 10-K for the fiscal year ended September 30, 2005.

Page 82	Unaudited Pro Forma Condensed Consolidated Balance Sheet at September 30, 2005
Page 83	Unaudited Pro Forma Condensed Consolidated Statement of Operations for the year ended September 30, 2005
Page 83	Explanatory notes to unaudited pro forma condensed consolidated financial statements

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**STAR GAS PARTNERS, L.P. AND SUBSIDIARIES**  
**UNAUDITED PRO FORMA FINANCIAL INFORMATION**  
**PRO FORMA CONDENSED CONSOLIDATED BALANCE SHEET**

(in thousands)	Historical		Pro Forma
	Sept. 30, 2005	Pro Forma Adjustments	Sept. 30, 2005
<b>ASSETS</b>			
<b>Current Assets</b>			
Cash and cash equivalents	\$ 99,148	\$ (30,913)(a)	\$ 68,235
Receivables, net of allowance of \$8,433	89,703		89,703
Inventories	52,461		52,461
Prepaid expenses and other current assets	70,120		70,120
<b>Total current assets</b>	<b>311,432</b>	<b>(30,913)</b>	<b>280,519</b>
Property and equipment, net	50,022		50,022
Long-term portion of accounts receivables	3,788		3,788
Goodwill	166,522		166,522
Intangibles, net	82,345		82,345
Deferred charges and other assets, net	15,152	(2,313)(b)	12,839
<b>Total assets</b>	<b>\$ 629,261</b>	<b>\$ (33,226)</b>	<b>\$ 596,035</b>
<b>LIABILITIES AND PARTNERS CAPITAL</b>			
<b>Current liabilities</b>			
Accounts payable	\$ 19,780		\$ 19,780
Working capital facility borrowings	6,562		6,562
Current maturities of long-term debt	796		796
Accrued expenses	56,580	(1,281)(c)	55,299
Unearned service contract revenue	36,602		36,602
Customer credit balances	65,287		65,287
<b>Total current liabilities</b>	<b>185,607</b>	<b>(1,281)</b>	<b>184,326</b>
Long-term debt	267,417	(100,876)(d)	166,541
Other long-term liabilities	31,129		31,129
<b>Partners capital</b>	<b>145,108</b>	<b>68,931(e)</b>	<b>214,039</b>
<b>Total liabilities and partners capital</b>	<b>\$ 629,261</b>	<b>\$ (33,226)</b>	<b>\$ 596,035</b>



**Table of Contents****STAR GAS PARTNERS, L.P. AND SUBSIDIARIES****UNAUDITED PRO FORMA FINANCIAL INFORMATION****PRO FORMA CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS**

<b>(in thousands, except per unit data)</b>	<b>Historical</b>	<b>Pro Forma</b>	<b>Pro Forma</b>
	<b>Sept. 30, 2005</b>	<b>Adjustments</b>	<b>Sept. 30, 2005</b>
<b>Sales:</b>			
Product	\$ 1,071,270		\$ 1,071,270
Installation and service	188,208		188,208
<b>Total sales</b>	<b>1,259,478</b>		<b>1,259,478</b>
<b>Cost and expenses:</b>			
Cost of product	786,349		786,349
Cost of installations and service	197,430		197,430
Delivery and branch expenses	231,581		231,581
Depreciation and amortization expenses	35,480		35,480
General and administrative expenses	43,418		43,418
Goodwill impairment charge	67,000		67,000
<b>Operating income (loss)</b>	<b>(101,780)</b>		<b>(101,780)</b>
Interest expense	(36,152)	10,136(f)	(26,016)
Interest Income	4,314	(885)(g)	3,429
Amortization of debt issuance costs	(2,540)	310(h)	(2,230)
Gain (loss) on redemption of debt	(42,082)		(42,082)
<b>Loss from continuing operations before income taxes</b>	<b>(178,240)</b>	<b>9,561</b>	<b>(168,679)</b>
Income tax expense	696		696
<b>Loss from continuing operations</b>	<b>\$ (178,936)</b>	<b>\$ 9,561</b>	<b>\$ (169,375)</b>
<b>General Partners interest in loss from continuing operations</b>	<b>\$ (1,614)</b>	<b>\$ 874</b>	<b>\$ (740)</b>
<b>Limited Partners interest in loss from continuing operations</b>	<b>\$ (177,322)</b>	<b>\$ 8,687</b>	<b>\$ (168,635)</b>
<b>Basic and diluted loss from continuing operations per Limited Partner Unit</b>	<b>\$ (4.95)</b>		<b>\$ (2.27)</b>
<b>Weighted average number of Limited Partner units outstanding:</b>			
Basic and Diluted	35,821	38,434	74,255

Explanatory Notes:

(a) As a result of the recapitalization, cash decreases by \$30.9 million. The components of the change are as follows:

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(in thousands)

<i>Net Change in Cash</i>	
Proceeds from the sale of 25,000 common units	\$ 50,000
10.25% senior notes repurchased	(73,132)
Costs associated with the transaction	(6,500)
Payment of accrued interest	(1,281)
Net decrease in cash	<u>\$ (30,913)</u>

Pursuant to the tender offer for the senior notes, we must offer to exchange for cash at least \$60 million of the senior notes but not more than approximately \$73.1 million (reduced by principal, interest and premium payments required to be offered to non-tendering holders of senior notes in a change of control repurchase offer). We intend to repurchase approximately \$73.1 million of the senior notes, subject to cash availability

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at the time of closing. If we tender for \$60.0 million of the senior notes, the decrease in cash would be \$17.6 million. We have reached an agreement with the holders of \$249.7 million of senior notes to participate in the senior notes tender offer. Currently, we do not know whether the holders of the \$15.3 million balance of the senior notes will participate in the tender offer. If the holders of the \$15.3 million of senior notes do not participate in the tender offer, we will tender for \$57.8 million in senior notes. For those senior notes that are not tendered to us, we have an obligation under the change of control provision of our indenture to offer to repurchase such notes at 101% of face value (the change of control repurchase offer). If the \$15.3 million in senior notes accept our change of control repurchase offer, we will pay a prepayment penalty of \$0.2 million. Furthermore, if these \$15.3 million in senior notes do not accept our change of control repurchase offer, the decrease in cash would be \$15.4 million.

- (b) Represents the elimination of unamortized debt issuance costs relating to the senior notes. If we tender for \$60.0 million of senior notes, the write-off of unamortized debt issuance costs would be \$2.0 million. If we tender for \$57.8 million of senior notes and \$15.3 million of senior notes do not participate in the tender offer and if the \$15.3 million in senior notes do not accept our change of control repurchase offer, the write-off of unamortized debt issuance costs would be \$2.0 million.
- (c) Represents accrued interest on the retirement of \$100.0 million in senior notes, \$73.1 million for cash in the tender offer and \$26.9 million exchanged for equity. If we tender for \$60 million of senior notes, accrued interest would decline by \$1.1 million. If we tender for \$57.8 million of senior notes and \$15.3 million of senior notes do not participate in the tender offer and if the \$15.3 million in senior notes do not accept our change of control repurchase offer, accrued interest would decline by \$1.1 million.
- (d) Represents the repurchase of approximately \$73.1 million in senior notes, the exchange of approximately \$26.9 million face value of senior notes into common units at \$2.00 per unit and a reduction in debt premium of \$0.9 million. If we tender for \$60 million of senior notes, long-term debt would decrease by \$87.7 million, including \$0.8 million in debt premiums. If we tender for \$57.8 million of senior notes and \$15.3 million of senior notes do not participate in the tender offer and if the \$15.3 million in senior notes do not accept our change of control repurchase offer, long-term debt would decrease by \$85.4 million, including \$0.7 million in debt premiums.
- (e) As a result of the recapitalization, Partners' capital increases by \$68.9 million. The components of the change are as follows:

(in thousands)

Proceeds from the sale of common units	\$ 50,000
Exchange of debt for equity	26,868
Write-off of deferred charges	(2,313)
Unamortized debt premium	876
Transaction expenses	(6,500)
<b>Net increase in Partners' capital</b>	<b>\$ 68,931</b>

If we tender for \$60 million of senior notes, Partners' capital would increase by \$69.2 million as write-off of deferred charges would be less by \$0.3 million and write-off of the unamortized debt premium would be less by \$0.1 million. If we tender for \$57.8 million of senior notes, Partners' capital would increase by \$69.2 million as write-off of deferred charges would be less by \$0.4 million and write-off of the unamortized debt premium would be less by \$0.1 million.

As a result of the recapitalization, we will record a loss of \$1.4 million on the early extinguishment of debt, as the write-off of unamortized deferred charges of \$2.3 million is reduced by the write-off of unamortized debt premium of \$0.9 million. These pro forma financial statements assume that approximately \$26.9 million of senior notes are converted into 13,433,962 common units at \$2.00 per unit. If the market price of our common units differs at the time of conversion, the loss on early extinguishment of debt will be adjusted. For example, if the market value of our

common units is \$1.75 per unit, the loss will be reduced by

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\$3.4 million. Conversely, if the market value of our common units is \$2.25 per unit, the loss will be increased by \$3.4 million.

- (f) Reflects the reduction to interest expense of \$10.2 million due to the recapitalization and a reduction in the amortization of a net debt premium of \$0.1 million. If we tender for \$60 million of senior notes and exchange \$26.9 million of senior notes for equity, interest expense would decline by \$8.8 million. If we tender for \$57.8 million of senior notes and \$15.3 million of senior notes do not participate in the tender offer and if the \$15.3 million in senior notes do not accept our change of control repurchase offer (and we exchange \$26.9 million of senior notes into equity), interest expense would decline by \$8.7 million.
- (g) Reflects the reduction to interest income of \$0.9 million from the use of cash to partially fund the repurchase of the senior notes. If we tender for \$60 million of senior notes and exchange \$26.9 million of senior notes for equity, interest income would decline by \$0.5 million. If we tender for \$57.8 million of senior notes and \$15.3 million of senior notes do not participate in the tender offer and if the \$15.3 million in senior notes do not accept our change of control repurchase offer (and we exchange \$26.9 million of senior notes into equity), interest income would decline by \$0.4 million.
- (h) Reflects the reduction to amortization of debt issuance costs of \$0.3 million relating to the repurchase and exchange of \$100.0 million in senior notes. If we tender for \$60 million of senior notes and exchange \$26.9 million of senior notes for equity, the reduction to amortization of debt issuance costs would be \$0.3 million. If we tender for \$57.8 million of senior notes and \$15.3 million of senior notes do not participate in the tender offer and if the \$15.3 million in senior notes do not accept our change of control repurchase offer and we further exchange \$26.9 million of senior notes into equity, the reduction to amortization of debt issuance costs would be \$0.3 million.

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**GLOSSARY OF TERMS**

**The following glossary gives effect to the adoption of the second amended and restated agreement of limited partnership of Star Gas Partners.**

**Available Cash:** For any quarter prior to liquidation:

- (a) the sum of:
  - (1) all cash and cash equivalents of Star Gas Partners and its subsidiaries on hand at the end of that quarter, and
  - (2) all additional cash and cash equivalents of Star Gas Partners and its subsidiaries on hand on the date of determination of Available Cash for that quarter resulting from Working Capital Borrowings after the end of that quarter;
- (b) less the amount of cash reserves that is necessary or appropriate in the reasonable discretion of the general partner to: