IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

IN RE :	)	
	)	
HALLWOOD ENERGY, L.P.,	)	**CASE NO. 09-31253**
A DELAWARE LIMITED PARTNERSHIP,	)	**JOINTLY ADMINISTERED**
HALLWOOD ENERGY	)	
MANAGEMENT, LLC, A DELAWARE	)	**CHAPTER 11**
LIMITED LIABILITY COMPANY,	)	
HALLWOOD GATHERING, L.P.,	)	
A DELAWARE LIMITED PARTNERSHIP,	)	
HG II MANAGEMENT, LLC,	)	
A DELAWARE LIMITED LIABILITY COMPANY,	)	
HALLWOOD PETROLEUM, LLC,	)	
A DELAWARE LIMITED LIABILITY COMPANY,	)	
HALLWOOD SWD, LLC	)	
A DELAWARE LIMITED LIABILITY COMPANY,	)	
	)	
DEBTORS.	)	

DISCLOSURE STATEMENT FOR PLAN OF REORGANIZATION FOR THE DEBTORS PROPOSED BY HALL PHOENIX/INWOOD, LTD.

(Dated: July 14 , 2009)

FRANK J. WRIGHT
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ATTORNEYS FOR HALL PHOENIX/INWOOD, LTD.

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INTRODUCTION

This Disclosure Statement ("**Disclosure Statement**") and the accompanying Ballots are being furnished to you, the holders of Claims against and Interests in the Chapter 11 debtors Hallwood Energy, L.P., a Delaware limited partnership ("**Hallwood Energy**"); Hallwood Energy Management, LLC, a Delaware limited liability company ("**Hallwood Energy Management**"); Hallwood Gathering, L.P., a Delaware limited partnership ("**Hallwood Gathering**"), HG II Management, LLC, a Delaware limited liability company ("**HG II**"); Hallwood Petroleum, LLC, a Delaware limited liability company ("**Hallwood Petroleum**"); and Hallwood SWD, LLC, a Delaware limited liability company ("**Hallwood SWD**") (collectively "**Hallwood Energy**" or the "**Debtors**"), pursuant to Section 1125 of the United States Bankruptcy Code in connection with the solicitation of ballots for the acceptance of a Plan of Reorganization (the "**Plan**") Proposed by Hall Phoenix/Inwood, Ltd. ("**HPI**" or the "**Plan Proponent**") under Chapter 11 ("**Chapter 11**") of Title 11 of the United States Code (the "**Bankruptcy Code**").

Capitalized terms used in this Disclosure Statement and not defined herein shall have their respective meanings as defined in the Plan or, if not defined in the Plan, as defined in the Bankruptcy Code.

On March 1, 2009 (the "**Petition Date**"), the Debtors filed voluntary petitions under Chapter 11 of the Bankruptcy Code in the United States Bankruptcy Court, Northern District of Texas, Dallas Division (the "**Bankruptcy Court**"). On or about March 12, 2009, the Official Committee of Unsecured Creditors ("**Committee**") was appointed by the Office of the United States Trustee. HPI is the largest secured and unsecured creditor of the Debtors holding claims of at least $118,000,000 secured by substantially all of the Debtors' assets. On June 15, 2009, the Bankruptcy Court terminated the Debtor's exclusive right to file a plan in these Cases thereby allowing HPI to file the Plan. **THE COMMITTEE, ON BEHALF OF THE UNSECURED CREDITORS IN THESE CASES, SUPPORTS CONFIRMATION OF THE PLAN.**

The Debtors have filed their own plan of reorganization. The Debtors' plan requires a substantive consolidation of all of the assets and liabilities of the Debtors, a subordination of the secured claims of HPI, and a subordination of the claims of holders of convertible notes. Unlike the Plan proposed by HPI as Plan Proponent, the Debtors' plan depends virtually entirely on the success of three (3) separate and equally unlikely to occur events: (1) the Debtors' winning costly and protracted litigation to subordinate HPI's debt and the debt of all holders of convertible subordinated notes, to substantively consolidate the Debtors' Estates, and to recover over $6 million from FEI Shale, LP; (2) the Debtors raising $25 million in new capital investments; and (3) the Debtors drilling successful and profitable wells and achieving future business success, a task the Debtors' dismal historical business performance simply does not support. HPI proposes its Plan as an alternative to the uncertainties inherent in the Debtors' plan.

On _____, 2009, after notice and hearing, the Bankruptcy Court approved this Disclosure Statement and authorized the Plan Proponent to solicit votes with respect to the Plan. The purpose of this Disclosure Statement is to enable those persons whose Claims against and Interests in the Debtors are Impaired and entitled to vote under the Plan to make an informed decision on whether

to vote for or against the Plan. Holders of Claims should read this Disclosure Statement and the Plan in their entirety before voting on the Plan. No solicitation of votes with respect to the Plan may be made except pursuant to this Disclosure Statement. No statement or information concerning the Debtors (particularly as to the results or financial condition of, or with respect to distributions to be made under the Plan) or any of the Debtors' assets, properties or business that is given for the purpose of soliciting acceptances or rejections of the Plan, is authorized other than as set forth in this Disclosure Statement. In the event of any inconsistencies between the provisions of the Plan and this Disclosure Statement, the provisions of the Plan shall control. A copy of the Plan is attached as **Exhibit "A"** to this Disclosure Statement.

After carefully reviewing this Disclosure Statement and all exhibits and schedules attached hereto, please indicate your acceptance or rejection of the Plan by voting in favor of or against the Plan on the enclosed Ballot.

BALLOTS SHOULD BE MARKED, SIGNED, DATED AND RETURNED SO THAT THEY ARE STAMPED AS HAVING BEEN RECEIVED BY NO LATER THAN 4:00 P.M., CENTRAL STANDARD TIME, ON _____ (THE "VOTING DEADLINE") AT THE FOLLOWING ADDRESS, AS SET FORTH ON THE ENCLOSED RETURN ENVELOPE:

HALLWOOD BALLOTS
c/o WRIGHT GINSBERG BRUSILOW P.C.
600 SIGNATURE PLACE
14755 PRESTON ROAD
DALLAS, TEXAS 75254

THE PLAN PROPONENT BELIEVES THAT ACCEPTANCE OF THE PLAN IS IN THE BEST INTERESTS OF ALL CLAIMANTS OF THE DEBTORS AND, CONSEQUENTLY, THE PLAN PROPONENT URGES ALL CLAIMANTS TO VOTE TO ACCEPT THE PLAN.

Any Ballots received after the Voting Deadline will not be counted (unless otherwise ordered by the Bankruptcy Court). Ballots that are received after the Voting Deadline may not be used in connection with the Plan Proponent's request for confirmation of the Plan or any modification thereof, except to the extent allowed by the Bankruptcy Court.

This Disclosure Statement has been compiled by the Plan Proponent to accompany the Plan. The factual statements, projections, financial information, and other information contained in this Disclosure Statement have been taken primarily from documents prepared by the Debtors, including the Debtors' Schedules and Statement of Financial Affairs, the Debtors' Monthly Operating Reports, pleadings filed in the Bankruptcy Case, and documents produced by the Debtors in discovery. As such, the Plan Proponent can not warrant that the information is accurate. Nothing contained in this Disclosure Statement shall have any preclusive effect against the Plan Proponent (whether by waiver, admission, estoppel or otherwise) in any cause or proceeding which may exist or occur in the future. This Disclosure Statement shall not be construed or deemed to constitute an acceptance of fact or an admission by the Plan Proponent with regard to any of the statements made herein, and all rights

and remedies of the Plan Proponent are expressly reserved in this regard. This Disclosure Statement contains statements which constitute the Plan Proponent's, the Debtors' or other third parties' views of certain facts. All such disclosures should be read as assertions of such parties. To the extent any paragraph does not contain an express reference that it constitutes an assertion of a particular party, it should be read as an assertion of the party indicated by the context and meaning of such paragraph.

The statements contained in this Disclosure Statement are made either as of the Petition Date or the date hereof unless another time is specified herein, and neither delivery of this Disclosure Statement nor any exercise of rights granted in connection with the Plan shall, under any circumstances, create an implication that there has been no change in the information set forth herein since the date of this Disclosure Statement.

Certain of the information contained in this Disclosure Statement, by its nature, is forward looking, contains estimates and assumptions which may prove to be inaccurate, and contains projections which may prove to be wrong, or which may be materially different from actual future results. Each Claimant should independently verify and consult its individual attorney and accountant as to the effect of the Plan on such individual Claimant or Interest holder.

The Plan Proponent strongly urges each recipient entitled to vote on the Plan to review carefully the contents of this Disclosure Statement, the Plan, and the other documents that accompany or are referenced in this Disclosure Statement in their entirety before making a decision to accept or reject the Plan.

IT IS OF THE UTMOST IMPORTANCE TO THE PLAN PROPONENT THAT YOU VOTE PROMPTLY TO ACCEPT THE PLAN BY COMPLETING AND SIGNING THE BALLOT ENCLOSED HEREWITH AND RETURNING IT TO COUNSEL FOR HPI, AT THE ADDRESS SET FORTH IN THE BALLOT INSTRUCTIONS THAT ACCOMPANY THE BALLOT. SHOULD YOU HAVE ANY QUESTIONS REGARDING THE VOTING PROCEDURES, YOUR BALLOT, OR THE BALLOT INSTRUCTIONS, OR IF YOUR BALLOT IS DAMAGED OR LOST, CONTACT COUNSEL FOR HPI AT THE FOLLOWING ADDRESS:

C. ASHLEY ELLIS
WRIGHT GINSBERG BRUSILOW P.C.
600 SIGNATURE PLACE
14755 PRESTON ROAD
DALLAS, TEXAS 75254
(972) 788-1600
(972) 239-0138 (facsimile)

The Approval Order fixes _____, Central Standard Time, in the Courtroom of the Honorable Stacey G.C. Jernigan, United States Bankruptcy Judge, United States Bankruptcy Court for the Northern District of Texas, Dallas Division, 1100 Commerce Street, Room 1428, Dallas, Texas 75242-1496, as the date, time, and place for the hearing on Confirmation of the Plan,

and fixes _____, as the date by which all objections to Confirmation of the Plan must be filed with the Bankruptcy Court and received by counsel for the Plan Proponent. Counsel for the Plan Proponent will request Confirmation of the Plan at the Confirmation Hearing.

Counsel for the Plan Proponent strongly urges each recipient entitled to vote on the Plan to review carefully the contents of this Disclosure Statement, the Plan, and the other documents that accompany or are referenced in this Disclosure Statement in their entirety before making a decision to accept or reject the Plan.

THIS DISCLOSURE STATEMENT HAS NOT BEEN APPROVED OR DISAPPROVED BY THE SECURITIES AND EXCHANGE COMMISSION, NOR HAS THE SECURITIES AND EXCHANGE COMMISSION PASSED UPON THE ACCURACY OR ADEQUACY OF THE STATEMENTS CONTAINED HEREIN.

ARTICLE I

HISTORICAL BACKGROUND AND PREPETITION BUSINESS OPERATIONS

The Debtors are in the oil and gas exploration and development business. They are headquartered in Dallas, Texas but have had drilling operations in Texas, Arkansas, Louisiana and Mississippi. Each of the Debtors were formed under the laws of the State of Delaware. Hallwood Energy, LP was formed on December 31, 2005 as the surviving entity in the consolidation of three privately held energy partnerships and owns the Debtors' mineral interests and drilling operations. Hallwood Energy, LP was promoted by the Debtors as a new venture intended to utilize the extraordinary unconventional gas drilling skills of the Defendants by exploring and exploiting new plays in West Texas, Louisiana and Arkansas. Hallwood Gathering, L.P. owns and operates the Debtors' pipeline gathering system in Arkansas. Hallwood Petroleum, LLC manages and operates the Debtors' properties. Hallwood SWD, LLC owns the Debtors' disposal wells. HG II Management, LLC's only purpose is to serve as the general partner of Hallwood Gathering, LP. Hallwood Energy Managment, LLC's only purpose is to serve as the general partner of Hallwood Energy, LP.

In February 2006, Hallwood Energy entered into a $65 million loan facility with J. Aron and Company ("J. Aron"), an affiliate of the Goldman Sachs investment banking firm, and immediately drew down $40 million of this facility (the "J. Aron Facility"). As a result of multiple drilling failures during 2006, by year-end Hallwood Energy was out of compliance with several covenants in the J. Aron Facility and was unable to draw on the remaining $25 million under the J. Aron Facility. Hallwood Energy explored a restructure of the J. Aron Facility as well as other financing sources in early 2007. In April 2007, the Debtors' loan with Goldman Sachs was replaced by a $100 million loan commitment from HPI. Thus, HPI is the senior secured (and by far the largest) creditor of the Debtors and a party in interest in these cases. HPI has a properly perfected, first priority lien on all or substantially all of the property of the Debtors' estates.

It is always reasonable to ask how a company ends up in Chapter 11 and what factors precipitated the filing of a case. In the Debtor's own disclosure statement, they suggest that these

bankruptcy cases were largely the result of two causes: first, the failure of the Debtors' intended AIM Exchange offering in the fall of 2008, and second, the decline in the price of natural gas. While these events no doubt had some relevance to the timing of the filing of these cases, in HPI's opinion they simply do not paint a complete and factually correct explanation. In HPI's opinion, the most important and basic reason for why these Debtors are in Chapter 11 is the failure of the management team at Hallwood Energy. Drilling operations in three separate areas including West Texas, Arkansas, and Louisiana all resulted in failures.

According to the Debtors, the fair market value of their assets with today's gas prices is between $28 and $38 million. This fact is shocking considering how much money has been invested in and loaned to the Debtors. The Debtors have spent over $575 million provided through loans, equity capital, the Farmout Agreement and related transactions and proceeds from asset sales. That $575 million includes $115 million loaned to the Debtors by HPI. So what happened to all the money? As a partial accounting, the Debtors spent and lost over $160 million of those funds acquiring land and mineral rights, $350 million drilling wells and $18 million on a pipeline system (probably worth less than $4 million today). The Debtors lost $80 million in their drilling operations in Louisiana and $280 million in their drilling operations in Arkansas Fayetteville Shale. The fact is over $550 million was turned into approximately $25 million by the Debtors. Approximately 95% of all the money the Debtors spent has been lost.

It is partially for these reasons that HPI simply does not believe that any plan the Debtors may propose to pay creditors from profits of successful drilling operations is feasible. They have already lost well over $500 million and their CFO has stated the number is closer to $600 million. As stated above, the Debtors' Plan also hinges on the subordination of HPI's claims. HPI does not believe those subordination allegations have any merit, and intends to vigorously defend against any effort to subordinate its claims. In ruling on HPI's stay motion, the Bankruptcy Court also cast doubt on the validity of the subordination claims. A copy of the stay order and findings of the Bankruptcy Court are attached as Exhibit "B." HPI's lack of confidence in the Debtors' business operations, coupled with the delay and costs of what HPI believe is meritless litigation against it, have lead HPI to believe that confirmation of HPI's Plan is in the best interests not only of HPI but of all creditors and parties in interest of the Debtors' estates.

ARTICLE II

PURPOSE OF CHAPTER 11

Chapter 11 is the principal business reorganization chapter of the Bankruptcy Code. The commencement of a Chapter 11 case creates an "estate" comprised of all the legal and equitable interests of a debtor. Sections 1101, 1107, and 1108 of the Bankruptcy Code provide that a debtor may remain in possession of its property and continue to operate its business as a "debtor-in-possession". Thus, since the Petition Date, the Debtors have been operating and managing their business operations in the ordinary course of business and under the supervision of the Bankruptcy Court.

Confirmation of a plan of reorganization is the principal purpose of a Chapter 11 case. The plan is the vehicle for satisfying the holders of claims against and equity interests in a debtor. Under the Bankruptcy Code, when soliciting acceptance or rejection of a plan of reorganization, a plan proponent must transmit to the holders of claims or interests a disclosure statement approved by the court as containing "adequate information." The Bankruptcy Court found that this Disclosure Statement contained information that is in compliance with the adequate information requirement of the Bankruptcy Code. The Disclosure Statement describes various transactions contemplated under the Plan and is supplied to you for purposes of assisting in your evaluation of, and your decision of how to vote on, the Plan. The Plan is attached hereto as Exhibit "A."

ARTICLE III

ASSETS OF THE DEBTORS ON THE PETITION DATE

In summary, the Debtors' assets generally consist of about $23 million in mineral interests pursuant to the Debtors' third party reserve report; $15 million in a pipeline gathering system (however fair market value is closer to $2.3 million); $8.7 million in pipe (however fair market value is half that amount); $500,000 in the HPI Operating Account; approximately $1 million in the Project Account; and $3 million in other assets. The Debtors have asserted that at fair market value they have between $28 and $38 million in assets all of which are subject to Liens of HPI and/or FEI Shale as well as certain M&M Liens. Thus, the Debtors have no equity in their assets above the secured debt.

However, since the Debtors are separate entities, the real picture in these cases is as follows: two of the Debtors (Hallwood Energy Management, LLC, HG II Management, LLC) have no assets at all other than their equity interests in one of the other Debtors, but owe HPI over $118 million. Another Debtor (Hallwood SWD, LLC) seemingly has no assets at all. Still another Debtor (Hallwood Gathering, LP) has listed assets of approximately $15 million (at book value), but again has secured debt to HPI of in excess of $118 million. Similarly, another Debtor (Hallwood Petroleum, LLC) has listed assets of approximately $2 million, but secured debt to HPI of in excess of $118 million and trade debt of $11 million. And, finally, Hallwood Energy, the "lead" Debtor as it were, has listed assets allegedly of approximately $40 million, against which it has secured debt to HPI of in excess of $118 million, and subordinated convertible debt of $49 million. ***It is HPI's opinion that the Debtors, individually and collectively, are hopelessly insolvent***. The Bankruptcy Court likewise found in lifting the stay as to HPI that the Debtors have no equity in their assets. (See Exhibit "B.")

The following is a summary description of each of the Debtors' principal assets as they existed on the Petition Date. The information has been compiled from the Debtors' records and the Debtors' Schedules, Statements of Financial Affairs and Monthly Operating Reports and has not been independently verified by the Plan Proponent. ***HPI has a valid and existing Lien on all assets of all of the Debtors, save and except for the Project Account.***

3.1 Hallwood Energy, L.P., a Delaware Limited Partnership

Real Property. The Schedules filed by Hallwood Energy list real property consisting of oil and gas leases located in Texas, Arkansas and Louisiana valued as of December 31, 2008 at $23,232,109.40. The Debtors obtained a reserve report from LaRoche Petroleum Consultants, Ltd. dated May 1, 2009. According to the reserve report, the Debtors' net reserves discounted at 10% as of April 1, 2009 were $21,783,197 consisting of $20,746,623 in Proved Developed Producing, $300,995 in Non-Producing, and $735,579 in Proved Undeveloped. HPI's consultant, Marvin M. Chronister, has reviewed the reserve report and determined that the oil and gas properties have an approximate range of value of between $13,621,244 and $15,182,166. He values the Produced Developed Producing reserves at $13,500,000 to $15,000,000; the Proved Developed Non-Producing reserves at $121,244 to $182,166; and the Proved Undeveloped reserves at no value. All of the property interests are subject to the Liens of HPI.

Checking, Savings or Other Financial Accounts, Certificates of Deposit, or Shares in Banks, Savings and Loan, Thrift, Building and Loan, and Homestead Associations, or Credit Unions, Brokerage Houses or Cooperatives: The Debtors' Schedules for Hallwood Energy, L.P. listed a bank account established pursuant to the prepetition loan documents with HPI located at Wells Fargo, N.A., Dallas, TX in the amount of $2,996,230.95; an escrow account at Wells Fargo, N.A., Dallas, TX in the amount of $49,108.73; and the FEI Shale Project Account located at Wells Fargo, N.A., Dallas, TX in the amount of $6,703,803.23. Since the Petition Date, the Debtors have been permitted to use certain of the cash to fund general and administrative expenses and lease operating expenses. In addition, the Bankruptcy Court has entered orders on the stay motions of HPI and FEI Shale resulting in the transfer to them of the bulk of the cash. Pursuant to an order of the Bankruptcy Court, the balance of the Project Account (less certain reserved amounts of $770,953.66 for G&E expense and professional fees and $250,000 for health, safety and enviormental costs) has now been transferred to FEI Shale for payment of approved Investment Invoices (as defined in the Farmout Agreement), which primarily consist of Priority M&M Lien Claims and Junior M&M Lien Claims. A copy of the order on the stay motion of FEI Shale is attached as Exhibit "C." Pursuant to the Bankruptcy Court's order on HPI's stay motion, all monies in the HPI Operating Account in excess of $500,000 have been transferred to HPI. (See Exhibit "B.") The remaining $500,000 has been designated for the payment of up to $50,000 in professional fees of the Committee for each of the months of June, July and August 2009; reservation of $100,000 to secure the Liens, if any, of Wells Fargo and the balance for payment of other expenses as mutually agreed to by the Committee and HPI with any unused amount to be paid to HPI.

Interest in Insurance Policies: The Schedules filed by Hallwood Energy list an insurance policy with Chubb/Federal Insurance Company for business property and comprehensive general liability covering the period of 5/1/08 - 5/1/09; an insurance policy with Chubb/Federal Insurance Company for comprehensive automobile liability covering the period of 5/1/08 - 5/1/09; an insurance policy with Pacific Insurance Company/Chubb for pollution covering the period of 5/1/08 - 5/1/09; an insurance policy with federal Insurance Company/Chubb for umbrella liability covering the period 5/1/08 - 5/1/09; an insurance policy with Arch Insurance Company for excess umbrella liability covering the period 5/1/08 - 5/1/09; and an insurance policy with AIG for D&O coverage including employment practices and securities claims for the period July 31, 2008 to July 31, 2009 with an aggregate limit of liability of $10 million.

Interests in IRA, ERISA, Keogh, or other pension or profit sharing plans. The Schedules filed by Hallwood Energy list the following plans: 1st Odyssey Group 401(k) Profit Sharing Plan, EIN #75-2569853, Plan Identification Number 333, administered by 1st Odyssey Group, 204 North Ector, Euless, TX 76039; and a balance held in escrow with First Odyssey for "funding of Retention Bonus" in the amount of $107,958.25.

Stock and Interests in Incorporated and Unincorporated Businesses. The Schedules filed by Hallwood Energy list Hallwood Energy as the 100% owner and sole member of Hallwood SWD, LLC; and the 100% owner and sole member of Hallwood Petroleum, LLC.

Interests in Partnerships or Joint Ventures: The Schedules filed by Hallwood Energy list Hallwood Energy as a limited partner of Hallwood Gathering, LP holding 99.99% of the outstanding limited partnership interests.

Accounts Receivable: The Schedules filed by Hallwood Energy list accounts receivable in the amount of $1,162,340.06.

Other Liquidated Debts: The Schedules filed by Hallwood Energy list a claim against Arkansas Energy Group LLC for overpayment in connection with the purchase of Arkansas oil and gas leases in 2005 and 2006; and claims against The Hallwood Group, Inc. for breach of the Equity Support Agreement dated June 9, 2008. The Debtors have filed a motion to approve a compromise and settlement agreement with Arkansas Energy Group, LLC, FEI Shale and Ark-Tex Energy Group, LLC. The Bankruptcy Court approved the settlement by order entered on July 1, 2009.

Licenses, Franchises, and Other General Intangibles: The Schedules filed by Hallwood Energy list a license of OGSYS Software from Oil & Gas Information Systems, Inc. dated September 13, 2002.

Inventory: The Schedules filed by Hallwood Energy list tubular inventory including pipe, casing, etc. valued at $8,770,443.87. The fair market value of the inventory is approximately 50% of the book value.

3.2 Hallwood Energy Management, LLC, a Delaware Limited Liability Company

Stock and Interests in Incorporated and Unincorporated Businesses. The Schedules filed by Hallwood Energy Management indicate that Hallwood Energy Management owns 100% of the membership interests of HG II Management, LLC.

Interest in Partnerships or Joint Ventures: The Schedules filed by Hallwood Energy Management indicate that Hallwood Energy Management is a General Partner of Hallwood Energy owning .01% of outstanding partnership interests.

3.3 Hallwood Gathering, L.P., a Delaware Limited Partnership

Real Property: The Schedules filed by Hallwood Gathering indicate that Hallwood Gathering owns real property located in White Country, Arkansas for a compressor site which Hallwood Gathering values at approximately $44,000.00. Hallwood Gathering further asserts an equitable interest in easements and other rights of way related to a pipeline, the value of which Hallwood Gathering states is unknown.

Pipeline and Related Gathering Facilities: The Schedules filed by Hallwood Gathering indicate that Hallwood Gathering owns pipeline and gathering facilities valued at approximately $15,250,994.00. RW Beck, a consultant engaged by HPI, valued the pipeline system as of June 20, 2009 at $2.3 million.

3.4 HG II Management, LLC, a Delaware Limited Liability Company

Interests in Partnerships or Joint Ventures: The Schedules filed by HG II indicate that HG II is the General Partner of Hallwood Gathering, L.P. holding 0.01% of outstanding partnership interests.

3.5 Hallwood Petroleum, LLC, a Delaware Limited Liability Company

Checking, Savings or Other Financial Accounts, Certificates of Deposit, or Shares in Banks, Savings and Loan, Thrift, Building and Loan, and Homestead Associations, or Credit Unions, Brokerage Houses or Cooperatives: The Schedules filed by Hallwood Petroleum list a Certificate of Deposit In Time Account located at Wells Fargo, N.A. in Dallas, TX, securing Letter of Credit NTS832348 for the benefit of the Arkansas Oil and Gas Commission for plug and abandon costs in the amount of $50,000.00; a Certificate of Deposit In Time Account located at Wells Fargo, N.A. in Dallas, TX securing Letter of Credit NzS629973 for the benefit of Texas Railroad Commission for plug and abandon costs in the amount of $25,000.00; a bank account established pursuant to the prepetition loan documents with HPI located at Wells Fargo, N.A., Dallas, TX in the amount of $417,334.93; and a Petty Cash Account located at J.P. Morgan Chase, Dallas, TX in the amount of $1,712.51. Pursuant to the Bankruptcy Court's order on HPI's stay motion, all monies in the HPI Operating Account in excess of $500,000 have been transferred to HPI. (See Exhibit "B.") The remaining $500,000 has been designated for the payment of up to $50,000 in professional fees of the Committee for each of the months of June, July and August 2009; reservation of $100,000 to secure the Liens, if any, of Wells Fargo and the balance for payment of other expenses as mutually agreed to by the Committee and HPI with any unused amount to be paid to HPI.

Security Deposits with Public Utilities, Telephone Companies, Landlords, and Others: The Schedules filed by Hallwood Petroleum indicate that Hallwood Petroleum placed a prepetition security deposit with Odyssey One Source, Inc. in connection with an October 15, 2004, contract for employee services, including payroll, in the amount of $86,000.00; a security deposit with GE Capital for Minolta copiers in the amount of $2,894.00; and a security deposit with Consolidated Information Systems, Inc., as landlord of the Searcy office, in the amount of $500.00.

Interests in Insurance Policies: The Schedules filed by Hallwood Petroleum list an insurance policy with Dallas National Insurance Company for Worker's Compensation and Employers Liability as co-employer for employees leased from Odyssey covering the period 8/10/08 - 8/10/09, the value of which is presently unknown; and a seismic bond for the State of Arkansas posted by RLI Surety, a division of RLI Insurance Company, the value of which is $50,000.00.

Accounts Receivable: The Schedules filed by Hallwood Petroleum list joint interest billing accounts receivable with a stated value of $350,413.48.

Other Liquidated Debts Owed to Debtor Including Tax Refunds: The Schedules filed by Hallwood Petroleum list a sales, use and severance tax refund due from the State of Arkansas, the value of which is presently unknown.

Licenses, Franchises, and Other General Intangibles: The Schedules filed by Hallwood Petroleum list drilling permits for Harrison State 56-10 #1, 56-36 #1 and 57-31 #1 in Reeves Co., TX the value of which are presently unknown; and licenses from Landmark Graphics Corporation for use of Aries System and Geographics software, the value of which is presently unknown.

Automobiles, Trucks, Trailers and Other Vehicles and Accessories: The Schedules filed by Hallwood Petroleum list the following automobiles: 2006 Chevrolet 1500 Slvr. 15 Ext. 4x4 StdB 4.8L 8 cyl., location, 403 S. Poplar, Suite F, Searcy, Arkansas 72143 with a fair market value of approximately $29,732.44; 2007 Honda TRX500 FM FourTrax Foreman ATV 475cc, location, 403 S. Poplar, Suite F, Searcy, Arkansas 72143 with a fair market value of approximately $7,924.24; 2007 Utility Trailer Flatbed, Light Duty 6' Standard Hitch, 403 S. Poplar, Suite F, Searcy, Arkansas 72143, the value of which is presently unknown; 2007 Cargo Trailer 12' x 6'8" w/2 3500# Axle, location, 403 S. Poplar, Suite F, Searcy, Arkansas 72143, with a fair market value of approximately $4,937.06; 2007 Chevrolet 1500 Slvr 4WD Ext Cab Lt1, location, 403 S. Poplar, Suite F, Searcy, Arkansas 72143 with a fair market value of approximately $26,780.65; 2005 Cargo Trailer 12', VIN # 5HABV121X6N057294, the value of which is presently unknown; and 2006 Trailer Cargo 12', VIN# 4RACS12106C006228 with a fair market value of $3,217.90.

Office Equipment, Furnishings, and Supplies: The Schedules filed by Hallwood Petroleum list office furniture, computers, computer software and office improvements valued at $972,896.74.

3.6 Hallwood SWD, LLC, a Delaware Limited Liability Company

The Schedules filed by Hallwood SWD, LLC do not list any assets.

3.7 Claims and Causes of Action: All Debtors: The Debtors collectively own the following claims and Causes of Action:

(a) Preferential Transfers/Fraudulent Transfers. Within 90 days of the Petition Date in the case of non-insiders and one year in the case of insiders, several of the Debtors made a number of payments to creditors. Each of these payments is potentially an avoidable preference or fraudulent transfer. A list of the payments made by each Debtor

within the 90 day period and one year period respectively preceding that specific Debtor's Petition Date is contained in the Statement of Financial Affairs filed by each Debtor in response to question 3.A therein and attached hereto as Exhibit "D." In addition, each of the Debtors may have made other payments or transfers before the Petition Date that may be avoidable. Section 546 of the Bankruptcy Code provides a time frame of two years from the entry of Order for Relief (the Order for Relief is the same as the Petition Date for each Debtor) within which to bring an action to set aside an avoidable preference or fraudulent transfer. Under the Plan, these Avoidance Actions are transferred to the Trusts for investigation and pursuit. The Plan Proponent has not attempted to estimate the potential recoveries on such Avoidance Actions. All Preference Actions will be transferred to Trust II. All other Avoidance Actions will be transferred to Trust I.

(b) Claims Against Hallwood Group. The Hallwood Group Incorporated ("Hallwood Group") is a public company controlled by Anthony Gumbiner. Hallwood Group is the largest limited partner of the Debtors. Mr. Gumbiner was the chairman of both Hallwood Group and the Debtors until the bankruptcy filing when he resigned as a director of the Debtors. William Guzzetti was the President of both Hallwood Energy and Hallwood Group. The Debtors have sued Hallwood Group for $3.2 million for breach of a prepetition contract called an Equity Support Agreement. Under that agreement, Hallwood Group was to contribute up to $12 million to the Debtors to, in part, fund the interest payments on HPI's loans to the Debtors. The Equity Support Agreement was also a requirement of FEI Shale's funding to the Debtors under a Farmout Agreement (discussed elsewhere herein). Hallwood Group not only breached the Equity Support Agreement by failing to fund $3.2 million that was due to be paid to the Debtors, but further breached that agreement by declaring a dividend of $12 million to Hallwood Group's shareholders in direct violation of the terms of the Equity Support Agreement.

HPI filed a motion to intervene in the lawsuit against Hallwood Group as, at least HPI believes, it is unconscionable that the Debtors (whose President on the Petition Date was Guzzetti) should be permitted to be in charge of a lawsuit against Hallwood Group (whose President is also Guzzetti). On June 12, 2009, the Court granted HPI's motion to intervene, making HPI a party to the lawsuit. Immediately thereafter, HPI filed additional claims on behalf of the estates against Hallwood Group seeking actual damages of over $20 million resulting from Hallwood Group's actions including tortious interference with the FEI Shale Farmout Agreement, and seeking exemplary damages in excess of $100 million for Hallwood Group's willful, wanton and malicious interference with the Farmout Agreement and HPI's loan agreement with the Debtors. HPI intends to amend its complaint to assert additional claims against Hallwood Group.

Additionally, it is HPI's position that Hallwood Group engineered the Debtors' bankruptcy cases for its own personal benefit. The Debtors' bankruptcy filings drove down the value of the stock of Hallwood Group (again, Hallwood Group is the largest investor in the Debtors) and created an opportunity for Hallwood Group's largest shareholder, Mr. Gumbiner, to attempt to take Hallwood Group private at a substantially lower stock price (the stock actually dropped from over $40 to around $12 in a matter of months). Mr. Gumbiner

has in fact made a tender offer to take Hallwood Group private. In HPI's opinion, it is a logical deduction that Mr. Gumbiner controlled and likely had everything to do with planning of these bankruptcy cases.

(c) Claims Against the Debtors' Management, Officers and Directors. The Plan Proponent believes that causes of action may exist against the directors, officers, managers, employees and partners of the Debtors or anyone acting in concert therewith, including, but not limited to, claims for breach of fiduciary duty against former officers, directors, managers and general partners of the Debtors, including, but not limited to, Anthony Gumbiner, Bill Guzzetti, Russ Meduna, William Marble, Tony Strehlow and the general partner entities of the Debtors. Under the Plan, these causes of action are transferred to Trust I for investigation and pursuit. These claims would include claims for mismanagement, neglect, omission, breach of fiduciary duty, errors, mistatements, and negligence arising out of the operations of the Debtors' properties, the raising of monies from investors, the acquisition of properties, the drilling of wells, the failure to reduce costs, the conflicts between the Debtors and Hallwood Group, and the loss of approximately $600 million. The Plan Proponent has not attempted to estimate the potential recoveries on such causes of action but believes such recoveries will be substantial. The Debtors also have insurance for D&O Claims in the amount of $10 million.

(d) J. Aron Claims. The Debtors may have claims and Causes of Action against J. Aron and Company, a Goldman Sachs affiliate, with respect to the loans it made to the Debtors prior to the Petition Date and the payoff of such loans. J. Aron and Company received payment of approximately $10 million in pre-payment penalty in connection with the payoff of its loan which may be avoidable. All of these claims and Causes of Actions are transferred under the Plan to Trust III. The Plan Proponent has not attempted to value such claims.

(e) Claims Against Suppliers. The Debtors are currently involved in litigation with certain suppliers for defective pipe that was sold to the Debtors. Those suits involve Premier Pipe and Oil Country Tubular. The Debtors may also have additional claims against other suppliers of goods and services to the Debtors.

(f) Claims Against Professionals. The Debtors were represented by Hunton & Williams, Deloitte & Touche and other professionals prior to the Petition Date. Since the Petition Date, the Debtors have been represented by Rochelle McCullough LLP and Blackhill Partners among others. Both Hunton & Williams and Deloitte & Touche also represented Hallwood Group. The Debtors may have claims against such firms for malpractice, conflicts of interest, breach of duty and other errors, omissions or acts resulting from their representation.

(g) Other Causes of Action. One or more of the Debtors may have other causes of action, including any and all claims, rights and causes of action that have been or could have been brought by or on behalf of any of the Debtors arising before, on or after the Petition Date, known or unknown, in contract or in tort, at law or in equity or under any

theory of law, including, but not limited to any and all claims, rights and causes of action any of the Debtors or the Estates may have against any Person arising under chapter 5 of the Bankruptcy Code, or any similar provision of state law or any other law, rule, regulation, decree, order, statute or otherwise including avoidance actions as stated above, any and all claims, causes of action, counterclaims, demands, controversies, against third parties on account of costs, debts, sums of money, accounts, reckonings, bonds, bills, damages, obligations, liabilities, objections, and executions of any nature, type, or description which any of the Debtors have or may come to have, including, but not limited to, negligence, gross negligence, usury, fraud, deceit, misrepresentation, conspiracy, unconscionability, duress, economic duress, defamation, control, interference with contractual and business relationships, conflicts of interest, misuse of insider information, concealment, disclosure, secrecy, misuse of collateral, wrongful release of collateral, failure to inspect, environmental due diligence, negligent loan processing and administration, wrongful setoff, violations of statutes and regulations of governmental entities, instrumentalities and agencies (both civil and criminal), racketeering activities, securities and antitrust laws violations, tying arrangements, deceptive trade practices, breach or abuse of fiduciary duty, breach of any alleged special relationship, course of conduct or dealing, obligation of fair dealing, obligation of good faith, whether or not in connection with or related to this Plan, at law or in equity, in contract in tort, or otherwise, known or unknown, suspected or unsuspected.

(h) Subordination Claims Against HPI. On May 7, 2009, the Debtors filed an adversary proceeding against HPI, Craig Hall and Don Braun. The Debtors assert claims for (a) equitable subordination, (b) recharacterization, (c) breach of fiduciary duty, (d) declaratory relief, and (e) objections to HPI's claims. HPI disputes each of the Debtors' allegations asserted in this adversary proceeding. A more detailed discussion of the alleged claims against HPI, and why HPI believes them to be without merit, is set forth elsewhere in this Disclosure Statement. Under the Plan, any and all causes of action against HPI, Mr. Hall and Mr. Braun are settled, released and will be dismissed with prejudice. In ruling on the stay motion of HPI, the Bankruptcy Court found that the claims lacked merit. (See Exhibit "B.")

(i) HPI's Direct Claims. Further, it is HPI's position that HPI was defrauded by Hallwood Group in connection with the loan underlying HPI's Senior Secured Claim against the Debtors. Hallwood Group fraudulently lured HPI into making a loan to the Debtors, thanked HPI for making that loan, and then engineered the filing of the Debtors' bankruptcy cases to subordinate HPI's debt. If HPI's debt is subordinated, Hallwood Group can make a recovery on its $90 million equity investment in the Debtors. If HPI's claims are not subordinated, Hallwood Group has no hope of any recovery on its investment - Hallwood Group loses $90 million. Under the Plan, HPI's Direct Claims against Hallwood Group for the damage Hallwood Group has caused HPI will be transferred to Trust I for investigation and pursuit. HPI has not attempted to estimate the potential recoveries on such causes of action, but believes that such recoveries could be in the millions of dollars.

ARTICLE IV

LIABILITIES OF THE DEBTORS

4.1 Administrative Claims: All Debtors. Administrative Claims are any claims defined in §503(b) of the Code as "administrative expenses" and granted priority under § 507(a)(1) of the Code, including:

> **(1)** a Claim for any cost or expense of administration in connection with the Case, including, without limitation, any actual, necessary cost or expense of preserving the Debtor's estate and of operating the business of the Debtor incurred on or before the Effective Date;
>
> **(2)** the full amount of all Claims for compensation for legal, accounting and other services or reimbursement of costs under §§330, 331 or 503 of the Bankruptcy Code;
>
> **(3)** all fees and charges assessed against the Debtor's estate under Chapter 123 of Title 28 of the United States Code; and
>
> **(4)** a Claim for post-petition taxes and related items, including any interest and penalties on such post-petition taxes.

(a) Debtors' Professionals. The Debtors employed the law firm of Rochelle McCullough, LLP as their bankruptcy counsel, Blackhill Partners as financial and restructuring advisor, James R. Latimer, III as Chief Restructuring Officer, and State Tax Analysis, Research & Recovery, LLC to pursue certain potential state tax refunds. The Plan Proponent does not have the ability to estimate the total fees of the Debtors' employed professionals. Rochelle McCullough has filed interim fee statements totaling $244,926.69 for the months of March and April 2009 but nothing for the months of May and June. The Plan Proponent expects that Rochelle McCullough will seek payment of a similar amount for May and June. With regard to the fees of Blackhill Partners, the Court capped Blackhill's fees at $100,000 per month for four (4) months and held that Blackhill may request a success fee based on the work performed for the Debtors, but that payment of a success fee is not guaranteed. Blackhill Partners and James Latimer have filed interim fee statements for the months of March and April seeking payment of $200,000. All parties in interest will have an opportunity to review and, if they wish, object to such fees, and final allowance of all fees to Debtors' professionals is subject to Court approval. As for State Tax Analysis, Research & Recovery, LLC, that company is to be paid strictly on a contingency fee basis; if no tax refunds are recovered, the company will not earn a fee.

(b) Committee's Professionals. The Committee has employed the law firm of Okin Adams & Kilmer, LLP as bankruptcy counsel. To date, Okin Adams has filed interim fee statements for March and April of $108,852.13; for May of $$71,096.08; and for June of $76,674.26. All parties in interest will have an opportunity to review and, if they wish,

object to such fees, and final allowance of all fees to the Committee's bankruptcy counsel is subject to Court approval.

(b) Other Asserted Administrative Claims. The following motions for allowance of administrative claim have been filed: Baker Hughes Oilfield Operations, Inc. in the amount of $17,720.64; TanMar Rentals, LLC in the amount of $10,027.84; and J-W Power Company in the amount of $26,406.05.

4.2 Scheduled and Known Secured and Priority Claims, Pending Litigation: All Debtors. The scheduled and filed Claim amounts listed below do not include the accrual of interest after the filing of the Cases, to the extent such post-petition interest may be applicable.

(A) Hallwood Energy, LP

(a) Secured Claim of HPI. In summary, HPI holds a claim in excess of $118,000,000.00 secured by a first lien on all of the assets of all of the Debtors (the "HPI Secured Claim"). HPI's Senior Secured Claim is secured by all assets of Hallwood Energy, including the stock of Hallwood Energy's subsidiaries, also Debtors herein, and all of the assets of each of the other Debtors herein, save an except the Project Account funded by FEI Shale, L.P. discussed herein. Each of the other Debtors also guaranteed HPI's Senior Secured Claim against Hallwood Energy. The details of HPI's Senior Secured Claim are as follows.

Pursuant to a certain Credit and Guaranty Agreement dated as of April 19, 2007 (as same has been subsequently modified or amended, the ("Senior Secured Credit Agreement") between Hallwood Energy and HPI, HPI established in favor of the Debtors a senior secured credit facility in the maximum amount of $100,000,000 together with certain other financial accommodations. Hallwood Energy secured its obligations to HPI under the Senior Secured Credit Agreement by granting to HPI a first priority lien on all of its assets, including a pledge of all of the capital stock of each of the other Debtors. Each of the other Debtors is a guarantor of Hallwood Energy's obligations under the Senior Secured Credit Agreement.

Pursuant to the terms of the Senior Secured Credit Agreement, Hallwood Energy agreed to deposit or cause to be deposited all gross cash revenues and receipts from any source or activity into only specified deposit accounts covered under a deposit account control agreement with HPI. The Senior Secured Credit Agreement and all notes, security agreements, deposit account control agreements, guaranty agreements, mortgages, subordination and intercreditor agreements, lien waivers, assignments, pledges, and other instruments or documents executed in connection therewith or related thereto shall be referred to herein as the "Senior Secured Credit Documents."

Pursuant to a certain Second Lien Credit and Guaranty Agreement dated as of January 18, 2008 (as same has been subsequently modified or amended, the ("Junior Secured Credit Agreement") between Hallwood Energy and HPI, HPI established in favor

of the Debtors a junior secured credit facility in the maximum amount of $15,000,000 together with certain other financial accommodations. Hallwood Energy secured its obligations to HPI under the Junior Secured Credit Agreement by granting to HPI a second priority lien on all of its assets. Each of the other Debtors is a guarantor of Hallwood Energy's obligations under the Junior Secured Credit Agreement.

Pursuant to the terms of the Junior Secured Credit Agreement, Hallwood Energy agreed to deposit or cause to be deposited all gross cash revenues and receipts from any source or activity into only specified deposit accounts covered under a deposit account control agreement with HPI. The Junior Secured Credit Agreement and all notes, security agreements, deposit account control agreements, guaranty agreements, mortgages, subordination and intercreditor agreements, lien waivers, assignments, pledges, and other instruments or documents executed in connection therewith or related thereto shall be referred to herein as the "Junior Secured Credit Documents."

Together, the Senior Secured Credit Documents and the Junior Secured Credit Documents shall be referred to herein as the "Pre-petition Claim Documents." Under the Pre-petition Claim Documents and applicable law, HPI thus holds a valid, enforceable, and allowed claim against the Debtors as of the Petition Date in the amount of at least $118,000,000, inclusive of accrued but unpaid interest, fees and costs ("HPI's Senior Secured Claim" as defined above).

HPI's Senior Secured Claim is secured by fully enforceable and properly perfected first-priority liens and security interests in all of the property of the Debtors including, without limitation, all of the following property (as further provided and more fully described in the Pre-petition Claim Documents, the "Pre-petition Collateral"), but not including the Project Account as defined herein:

(a) Accounts;
(b) Chattel Paper;
(c) Documents;
(d) General Intangibles;
(e) Goods (including Inventory and Equipment);
(f) Instruments;
(g) Insurance;
(h) Intellectual Property;
(i) Investment Related Property (including the equity interests of Hallwood Energy in its subsidiaries Hallwood Petroleum, LLC, HG II Management, LLC, and Hallwood Gathering, LP, also Debtors herein and guarantors of the Senior Note);
(j) Letter of Credit Rights;
(k) Money (including a lien on $3,200,000.00 cash held by Hallwood Group Incorporated in a segregated account for the benefit of Hallwood Energy, subject to a superior lien held by FEI Shale, L.P.);
(l) Receivables and Receivable Records;

(m) Commercial Tort Claims;

(n) to the extent not otherwise included above, all Collateral Records, Collateral Support and Supporting Obligations relating to any of the foregoing;

(o) to extent not otherwise included above, all Proceeds, products, accessions, rents and profits of or in respect to any of the foregoing;

(p) all of Hallwood Energy's oil and gas properties, located in the States of Texas, Arkansas, Mississippi and Louisiana;

(q) all assets of Hallwood Energy Management, LLC, Hallwood Energy's general partner, and all the assets of Hallwood Energy's subsidiaries Hallwood Petroleum, LLC, HG II Management, LLC, Hallwood Gathering, LP, and Hallwood SWD, LLC, all Debtors in this jointly-administered case; and

(r) to the extent not otherwise set forth herein, all other Collateral defined as such in the Pre-petition Claim Documents.

The foregoing categories of Pre-Petition Collateral are more specifically defined in the Pre-petition Claim Documents. HPI's liens and security interests in the Pre-petition Collateral were granted pursuant to the Pre-petition Claim Documents. HPI has properly perfected its first priority liens and security interests in the Pre-petition Collateral by documents filed with the appropriate state and county offices, possession of certain documents and control of collateral accounts. The Pre-petition Claim Documents are genuine, valid, existing, and legally enforceable.

The Debtors were, as of the Petition Date, and remain in default of their debts and obligations to HPI under the Pre-petition Claim Documents. These defaults exist, have not been timely cured, and are continuing. The filing of this Case has accelerated HPI's Senior Secured Claim for all purposes in this Case and in connection with HPI's enforcement of its rights and remedies under applicable law. HPI's Senior Secured Claim remains due and owing.

HPI holds enforceable, non-avoidable, and perfected liens and security interests in the Pre-petition Collateral and Cash Collateral (as defined herein), in the amount of HPI's Senior Secured Claim, plus, without limitation, any other amounts allowable under the Bankruptcy Code and applicable law whether pre-petition or post-petition. The Bankruptcy Court has granted HPI's stay motion and permitted HPI to post its Pre-petition Collateral for foreclosure, and take possession of its Pre-petition Collateral including the Cash Collateral and oil and gas properties. (See Exhibit "B.")

The HPI Secured Lenders hold a security interest and lien in all HPI claims against the Debtors, including the HELP/HPI Notes, and in all of the HPI Collateral to secure the payment of the HPI Secured Lender Note, which security interest and lien shall continue in effect after the transfer of the HELP/HPI Notes and HPI Collateral to HPE. In the event of foreclosure by HPE on any of the HPI Collateral or the transfer of title by the Debtors to HPE of any of the HPI Collateral, HPE shall simultaneously execute a mortgage and security

agreement covering such property in favor of the HPI Secured Lenders which mortgage and security agreement shall evidence the existing and continuing security interest and lien of the HPI Secured Lenders in and to such property. Such mortgage and security agreement shall be in form and substance acceptable to the HPI Secured Lenders.

The HPI Secured Lenders shall own and hold a continuing security interest and lien in all amounts payable to HPI or HPE from Trust I and Trust II. HPI and HPE shall execute a security agreement covering such payments in form and substance acceptable to the HPI Secured Lenders.

The continuing security interests and liens of the HPI Secured Lenders in all HPI claims against the Debtors, including the HELP/HPI Notes and the HPI Collateral and all proceeds and products thereof, and the obligation of HPI and/or HPE to execute new mortgages and security agreements as provided herein, shall be acknowledged and confirmed in the Confirmation Order in form and substance acceptable to the HPI Secured Lenders.

(b) Potential Secured Claim of FEI Shale, LP: In addition to the secured claim of HPI, the Schedules filed by Hallwood Energy reflect a secured claim in an unknown amount in favor of FEI Shale. FEI Shale has filed a proof of claim in these Cases asserting a secured claim in excess of $6,600,000 (the "FEI Shale Claim"). As detailed herein, Hallwood Energy and FEI Shale are parties to an agreement entitled Acquisition and Farmout Agreement dated June 9, 2008 (the "Farmout Agreement") which contemplated that, pursuant to budgets submitted by the Debtors to FEI Shale, FEI Shale would provide funds to the Debtors for operational costs. In consideration of that funding, FEI Shale would earn an undivided interest in certain of the Debtors' assets as specified in the Farmout Agreement. Incident to the Farmout Agreement, the Debtors established a separate deposit account (the "Project Account") into which funds advanced by FEI Shale were placed. It is clearly FEI Shale's position that the Farmout Agreement granted FEI Shale a first priority security interest in the funds in the Project Account to secure the Debtors' obligation to assign the undivided interest in the Debtors' assets contemplated in the Farmout Agreement. On the Schedules filed by Hallwood Energy, Hallwood Energy lists a n "asserted" secured claim by FEI Shale, but lists that claim as unknown in amount as well as contingent, unliquidated and disputed. FEI Shale has filed a motion to compel the Debtors to assume or reject the Farmout Agreement and a motion to lift the stay. The Bankrupcty Court has entered an order terminating the Farmout Agreement and lifting the stay to permit FEI Shale to take possession of the Project Account except certain amounts reserved for payment of general and administrative expenses, professional fees and health, safety and environmental expenses. (See Exhibit "C.")

(c) Potential Secured Claim of M&M Lien Holders: Although the Debtors did not list any M&M Liens on their Schedules, the Debtors have provided HPI with a list of potential M&M Liens. The potential M&M Liens total approximately $6.6 million with roughly two-thirds of that amount relating to properties in Texas and one-third properties in Arkansas. The relative priority of those asserted liens, as well as issues incident to the perfection of same, has not yet been determined.

(d) Priority Claims: The Schedules filed by Hallwood Energy reflect the following priority claims:

Claimant	***Amount***
City of Cleburne	$0.00
Cleburne ISD	$0.00
Dallas County Tax Assessor	$2,016.47
Harris County	$0.00
Harrison County, Texas	$0.00
Hill County Junior College	$0.00
Internal Revenue Service	$0.00
Johnson County, Texas	$0.00
San Patricio County	$0.00
White County, Arkansas	$36,657.35

The Plan Proponents cannot dispute or validate these alleged priority claims based upon the information known at this time.

(e) Pending Litigation: Hallwood Energy lists the following pending litigation:

Style of Case	**Status**
Lavelle T. Paschal v. Wade Love, Hallwood Petroleum, LLC and Hallwood Energy, LP; Case No. 4:08-CV-02493; personal injury; U.S .District Court for the Southern District of Texas	pending
Premier Pipe, LLC v. J.D. Fields & Company, Inc., Hallwood Petroleum, LLC and Hallwood Energy, LP; Cause No. 2008-57050; District Court for 189th Judicial District, Harris County	pending
Eagle Domestic Drilling Operations, LLC and Eagle Drilling, LLC v. Hallwood Petroleum, LLC and Hallwood Energy, L.P.; Adversary Case No. 07-1209; U.S. Bankruptcy Court, Western District of Oklahoma	settled pending court approval
Hallwood Petroleum LLC and Hallwood Energy, L.P. v. Eagle Domestic Drilling Operations, LLC and Eagle Drilling, LLC; Adversary Case No. 08-1007; U.S. Bankruptcy Court, Western District of Oklahoma	settled pending court approval

James R. Usery and Rhonda S. Usery as Trustee for the Jim and Rhonda Usery Revocable Trust v. Anadarko Petroleum Corp. and Hallwood Energy, LP; Case No. 09-1113; U.S. Court of Appeals for the Eighth Circuit	pending
Eagle Domestic Drilling Operations, LLC and Eagle Drilling, LLC v. Hallwood Petroleum, LLC and Hallwood Energy, L.P.; Adversary Case No. 07-03282; U.S. Bankruptcy Court for the Southern District of Texas	settled
Eagle Domestic Drilling Operations, LLC and Eagle Drilling, LLC v. Hallwood Petroleum, LLC and Hallwood Energy, L.P.; Cause No. 348-219823-06; 348th Judicial District Court, Tarrant County, Texas	pending
Eagle Domestic Drilling Operations, LLC and Eagle Drilling, LLC v. Hallwood Petroleum, LLC and Hallwood Energy, LP.; Case No. CJ-2006-1694-L; District Court of Cleveland County, Oklahoma	pending

(B) Hallwood Energy Management, LLC, a Delaware Limited Liability Company

Other than HPI's Senior Secured Claim, the Schedules filed by this Debtor do not reflect any other liabilities.

(C) Hallwood Gathering, L.P., a Delaware Limited Partnership

Other than HPI's Senior Secured Claim, the FEI Shale Claim and a $500.00 claim for partnership taxes owed to the IRS, the Schedules filed by this Debtor do not reflect any other liabilities.

(D) HG II Management, LLC, a Delaware Limited Liability Company

Other than HPI's Senior Secured Claim, the Schedules filed by this Debtor do not reflect any other liabilities.

(E) Hallwood Petroleum, LLC, a Delaware Limited Liability Company

The Schedules filed by this Debtor list HPI's Senior Secured Claim, the FEI Shale Claim, and the amount of $64,456.93 as alleged priority claims of employees for wages and related taxes and benefits. As for pending litigation, Hallwood Petroleum lists the following:

Style of Case	Status

In re Eagle Domestic Drilling Operations, LLC and Eagle Drilling, LLC v. Hallwood Petroleum, LLC and Hallwood Energy, L.P.; Adversary Case No. 07-03282; U.S. Bankruptcy Court for the Southern District of Texas	settled
Lavelle T. Paschal v. Wade Love, Hallwood Petroleum, LLC and Hallwood Energy, LP; Case No. 4:08-CV-02493; personal injury; U.S .District Court for the Southern District of Texas	pending
Premier Pipe, LLC v. J.D. Fields & Company, Inc., Hallwood Petroleum, LLC and Hallwood Energy, LP; Cause No. 2008-57050; District Court for 189th Judicial District, Harris County	pending
Oil Country Tubular Corporation v. Hallwood Petroleum, LLC; Case No. 2:08-cv-03546-MVL-JCW; United States District Court, Eastern District of Louisiana, Magistrate Court, Division 2	pending
Eagle Domestic Drilling Operations, LLC and Eagle Drilling, LLC v. Hallwood Petroleum, LLC and Hallwood Energy, L.P.; Adversary Case No. 07-1209; U.S. Bankruptcy Court, Western District of Oklahoma	settled pending court approval
Hallwood Petroleum LLC and Hallwood Energy, L.P. v. Eagle Domestic Drilling Operations, LLC and Eagle Drilling, LLC; Adversary Case No. 08-01007; U.S. Bankruptcy Court, Western District of Oklahoma	settled pending court approval
Eagle Domestic Drilling Operations, LLC and Eagle Drilling, LLC v. Hallwood Petroleum, LLC and Hallwood Energy, LP.; Case No. CJ-2006-1694-L; District Court of Cleveland County, Oklahoma	pending
Eagle Domestic Drilling Operations, LLC and Eagle Drilling, LLC v. Hallwood Petroleum, LLC and Hallwood Energy, L.P.; Cause No. 348-219823-06; 348th Judicial District Court, Tarrant County, Texas	pending

(F) Hallwood SWD, LLC, a Delaware Limited Liability Company

Other than the amount owed to HPI based on the Junior Secured Credit Documents, approximately $15,500,000.00 the Schedules filed by this Debtor do not reflect any other liabilities.

4.3 Unsecured Claims: All Debtors. Each of the Debtors has filed Schedules which list creditors holding unsecured nonpriority claims in the below amounts:

ENTITY	SCHEDULE F: UNSECURED NON-PRIORITY CLAIMS

Hallwood Energy, L.P.	$49,414,924.00
Hallwood Energy Management, LLC	$0.00
Hallwood Gathering, L.P.	$0.00
HG II Management, LLC	$0.00
Hallwood Petroleum, LLC	$11,560,382.85
Hallwood SWD, LLC	$0.00

The bar dates for filing additional proofs of claim against each of the Debtors is July 8, 2009.

ARTICLE V

MATTERS ARISING DURING THE CHAPTER 11 CASES

5.1 Commencement of the Debtors' Cases. Each of the Debtors' Chapter 11 cases was commenced by the filing of a voluntary petition under Chapter 11 on the dates identified herein as each Debtor's Petition Date. Shortly after these cases were commenced, the Debtors filed several motions incident to the management of the Bankruptcy Cases that were granted by the Court, including the authority to retain certain professionals and the joint administration of all the Debtors' cases under one case number.

5.2 Stay Litigation Commenced by HPI. On April 8, 2009, HPI filed a Motion for Relief from the Automatic Stay (the "Stay Motion"). In the Stay Motion, HPI argues that the Court should grant relief from the automatic stay under 11 U.S.C. § 362(d)(1) and/or (d)(2). HPI's arguments in the Stay Motion are that HPI is entitled to relief from the automatic stay "for cause" under §362(d)(1) because HPI's interests in the Debtors' assets are not adequately protected, the Debtors' post-petition cash position is continuing to deteriorate, and the Debtors' and related parties' actions immediately prior to the filing of these cases are indicative of bad faith. Alternatively, HPI also argues that HPI is entitled to relief from the automatic stay under § 362(d)(2) because the Debtors do not have any equity in the property securing HPI's loans, and such property is not necessary to an effective reorganization. In summary, HPI argues that the Debtors' indebtedness to HPI vastly exceeds the present value of the Debtors' assets upon which HPI has a lien, and the Debtors cannot move forward with a reorganization without HPI's consent. HPI's Stay Motion was set for a final hearing on June 25, 2009. After hearing the evidence, the Bankruptcy Court granted HPI's Stay Motion and lifted the stay to permit HPI to take all action necessary to post its collateral for foreclosure, to take immediate possession of its cash collateral, and to immediately assume control and management of the Debtors' assets. The Bankruptcy Court made extensive findings in connection with its order and found that the Debtors have no equity in their assets and that their was no validity to the Debtors' claims to subordinate the debt of HPI. (See Exhibit "B.")

5.3 Stay Litigation Commenced by FEI Shale. On April 13, 2009, FEI Shale filed a motion for relief from stay seeking termination of the Farmout Agreement, authority to take the

funds remaining in the Project Account and to terminate Debtors as operator on the subject wells. The "swap" agreements between HPI and FEI Shale set forth in HPI's Plan are not materially impacted by whether the Court grants or denies FEI Shale's motion. The final hearing on FEI Shale's motion is set for June 26, 2009. Pursuant to an agreed order, the Bankruptcy Court lifted the stay to permit the termination of the Farmout Agreement and the transfer of the balance of the Project Account (less certain reserves) to FEI Shale. (See Exhibit "C.")

5.4 Global Mediation. On March 12, 2009, the Debtors filed a Motion for Administrative Scheduling Order seeking that the Court order the primary parties in these cases to mediation. The hearing on that motion was originally set for March 24, 2009, reset for April 16, 2009, and then the Court *sua sponte* granted the motion and ordered the primary parties to mediation. HPI was opposed to the mediation, believing that a forced mediation scenario was not likely to produce a settlement between HPI, the Debtors, and the other primary parties. The mediation occurred on June 10, 2009 among HPI, Debtors, Hallwood Group, FEI Shale and the Committee. The mediation did not produce a global settlement but did produce a settlement between HPI and the Committee which terms are incorporated in this Plan. A copy of the agreement is attached hereto as Exhibit "E."

ARTICLE VI

THE PLAN OF REORGANIZATION

The Plan Proponent believes that the Plan provides the best vehicle by which Holders of Allowed Unsecured Claims can maximize the recovery on their Allowed Claims. A copy of the Plan is attached as Exhibit "A." The Plan Proponent urges you to review carefully and then vote to accept the Plan.

A. Summary of the Plan

For your convenience, the following is a summary of certain material terms of the Plan. *The Plan Proponent encourages you to read the Plan in its entirety*.

HPI is the largest creditor of the Debtors with Claims in excess of $118 million secured by Liens on substantially all of the Debtors' assets. The Bankruptcy Court has permitted HPI to take all action necessary to prepare to foreclose its Liens and take control of the Debtors' assets including the Debtors' oil and gas properties. The Debtors' remaining assets consist primarily of Causes of Action against various parties. HPI and the Committee have reached an agreement regarding the pursuit of the Causes of Action and the terms for treatment of Claims of Creditors, which terms are incorporated in this Plan. The essential terms of the Plan are as follows:

1. The formation of three trusts (Trust I, Trust II and Trust III) for the benefit of Creditors into which certain Causes of Action will be transferred so that such Causes of Action, including claims against the Debtors officers, directors and professionals and The Hallwood Group Incorporated can be pursued for the benefit of Creditors.

2. A settlement between the Debtors' Estates and HPI and its officers of all claims of the Debtors against such parties, including claims for subordination and breach of fiduciary duty. Under the terms of the settlement the litigation will be dismissed with prejudice and HPI will fulfill its obligations under the Plan including advancing the costs of operating the trusts, releasing its liens on certain Causes of Action and contributing HPI's Direct Claims to the Trust. HPI will also receive a conveyance of all of its Collateral except those Causes of Action transferred to Trust I.

3. Trade Creditors will receive the following preferred treatment as a result of the agreement reached between the Committee and HPI: from Trust I, the first $1,000,000 after payment of certain other Claims and administrative costs and then 10% of all Recoveries; from Trust II, 60% of all Recoveries after payment of administrative costs; and from Trust III, 100% of all Recoveries after repayment of any borrowings by Trust III and after payment of administrative costs.

4. Payment of 100% of Allowed Priority M&M Lien Claims as provided in the Plan.

B. The Plan's Settlement Regarding HPI

The Plan effects a settlement of any claims of the Debtors against HPI, its affiliated entities, officers and directors. The specific terms of the settlement are set forth in Section 6.01 of the Plan. As a result of the settlement, HPI will have an Allowed Secured Claim of $28 million and an Allowed Unsecured Claim of $90 million and all claims by the Debtors against HPI for subordination and breach of duty will be dismissed and released. It is HPI's position that these claims have no value which position is now supported by the findings of the Bankruptcy Court that it cannot find a "colorable claim" against HPI for inequitable conduct. Based on that finding and others, the Bankruptcy Court granted HPI's stay motion. The settlement also provides certain benefits to Creditors including the release of HPI's Liens on the Causes of Action, the transfer of HPI's Direct Claims to Trust I for benefit of all Creditors, the funding of Trusts I and II by HPI, and the preferential treatment of Trade Creditors as provided in the Plan.

C. Committee and HPI Settlement

As a result of the global mediation ordered by the Bankruptcy Court, a settlement was reached between HPI and the Committee. (See Exhibit "E.") The agreement generally provides: (i) HPI will propose a plan containing the terms for treatment as set forth in the Plan; (ii) for certain provisions regarding payment of Committee's professional's fees; (iii) for certain provisions regarding use of cash collateral in the Project Account and HPI's Operating Account; and (iv) for lift of the automatic stay to permit HPI to post its Collateral for foreclosure and take possession of the HPI Operating Account except for certain reserves.

D. Comparison of the HPI Plan and the Debtors' Plan, Discussion and Criticism of the Debtors' Plan

The Debtors have filed their own separate plan which requires a substantive consolidation of all of the assets and liabilities of the Debtors, a subordination of the secured claims of HPI, and a subordination of the claims of holders of convertible notes. Unlike the Plan proposed by HPI as Plan Proponent, any payment to the holders of general unsecured claims under the Debtors' plan depends entirely on the success of costly and protracted litigation, the Debtors' ability to raise $25 million in capital, and the future success of the Debtors' drilling operations. Although HPI does not believe that the Debtors intend to go forward with their plan in light of the Bankruptcy Court's recent ruling granting HPI's stay motion, HPI provides the following comparison of the two plans for the benefit of any creditors that may have seen the Debtors' plan or in the event the Debtors elect to go forward with the plan.

Initially, unlike the Debtors' plan which requires extensive litigation, an infusion of millions of dollars from new investors, and (literally) successfully striking oil or gas before there is any hope of recovery to unsecured creditors, HPI's Plan has the support of the Committee and is the highest and best opportunity for a real recovery to unsecured creditors. Secondly, unlike the Debtors' plan where the same officers and directors of both the Debtors and Hallwood Group are sitting on both sides of the "v" in litigation against Hallwood Group, HPI's Plan provides for the formation of a Trust and the pursuit of claims against Hallwood Group and the officers and directors of the Debtors by an independent and neutral third party. It is HPI's opinion that the pursuit of such Causes of Action by a Trustee, as opposed to the Debtors, will significantly increase the odds that recoveries will provide a material return to unsecured creditors. Further and quite significantly, under HPI's Plan, the unsecured creditors of the Debtors' estates will also receive the Recoveries from the pursuit of HPI's Direct Claims against Hallwood Group. These Direct Claims do not belong to the Debtors but belong directly to HPI. These claims include what HPI believes could be millions of dollars in damages resulting from Hallwood Group's acts to fraudulently induce HPI to make the $115 million in loans to the Debtors. This concession is HPI's alone to grant, and HPI is willing to allow other unsecured creditors to share in those Recoveries. Notably, HPI is also prepared to fund the costs of the litigation against Hallwood Group. This should be, HPI suggests, a very strong indication of HPI's belief in the potential recoveries on those claims; HPI is willing to spend its own money to pursue the Direct Claims and share the recoveries with the Debtors' other unsecured creditors.

Further, HPI's Plan does not hinge on the Debtors' ability to turn a profit. The Debtors' historic business losses are not a matter of opinion or spin. The Debtors' prepetition losses are simply a matter of fact; and a matter of math. The Debtors have spent over $575 million have assets worth, in HPI's assessment approximately $25 million. Approximately 95% of all the money the Debtors spent was lost. Generously, if the Debtors' value of their assets taken from their own filings with the Court are believed ($57.6 million), the Debtors have still lost over $517 million.

Finally, the success of HPI's Plan does not require the subordination of HPI's Senior Secured Claim. The Debtors know they cannot confirm a plan in these cases with HPI having a $118 million secured claim. There is just no way to repay a claim of that size from $25 million in assets. So, in desperation or a misguided attempt to try to gain leverage over HPI, the Debtors concocted an equitable subordination claim. The Debtors' raised this claim for the first time in the response to HPI's stay motion. Prior to that time, and at all times prepetition, in every other document, correspondence and communication including but not limited to at least ten (10) separate public

filings with the Securities and Exchange Commission by Hallwood Energy that were reviewed by Bill Guzzetti, (recall that Mr. Guzzetti is the President and Chief Operating Officer of Hallwood Energy *and* the President and Chief Operating Officer of Hallwood Group) and certified as to accuracy and completeness by then Chairman and CEO of the Debtors, Anthony Gumbiner, the Debtors had treated the $118 million in secured debt owed to HPI as just that, i.e. debt and secured. The Debtors also willingly signed complete releases in favor of HPI at various times, waiving and releasing any claims that may have existed. Once the bankruptcy cases were filed, the Debtors suddenly changed their story. If the Debtors' story is to be believed, HPI's debt was abruptly no longer debt.

In order to try to support this drastic change in position, the Debtors' position is that HPI forced them to borrow the money. The Debtors' prepetition story is that the money was much needed and greatly appreciated. The Debtors' postpetition story is that HPI forced $115 million on them. The Debtors know this subordination suit will not hold up but, in HPI's opinion, they are trying to use these unsupportable claims to buy time.

The Debtors' subordination claims are effectively a "Hail Mary" pass. The Debtors' financial picture is so far upside down that they can not possibly reorganize unless they can make their debts go away. So, conveniently, HPI's debt ought not to be debt any longer. It is actually not only HPI's debt that the Debtors seek to eliminate via subordination charges, the Debtors' plan proposes to equitably subordinate not only HPI's $115 million in debt but also all holders of convertible notes (another $47 million in debt). Obviously if they can make over $160 million of their debt vanish they might have a chance at reorganization. But the reality is there is nothing to the Debtors' subordination claims against HPI.

In the spring of 2007, the Debtors had an existing loan with an affiliate of Goldman Sachs. That loan was in default. The Debtors needed to borrow more money. HPI agreed to replace the Debtors' existing loan with a $100 million loan which paid off Goldman Sachs and gave the Debtors access to $60 million more in needed funds. HPI required as a condition of the loan that the Debtors raise additional equity of $60 million. HPI and a company controlled by Mr. Gumbiner, at that time the chairman of both Hallwood Group and the Debtors, committed to underwrite the additional $60 million in equity capital. In 2008 the Debtors borrowed an additional $15 million from HPI. There is no dispute that the loans HPI made to the Debtors were documented as loans, secured by the Debtors' assets as loans, and approved by the Debtors' boards and partners. There is no dispute that the Debtors received all the loan proceeds from HPI, and that the Debtors have made payments to HPI to repay the loans since April 2007 - the month before they filed bankruptcy. There is no dispute that the Debtors, Hallwood Group and HPI have all consistently treated and booked the amounts owed to HPI as loans.

But now the Debtors argue HPI should be subordinated because HPI "forced" them to borrow the money. But the truth is they didn't have to borrow the money; no borrower has to borrow. HPI did not and indeed could not make the Debtors borrow the money. In truth, no party is more sorry than HPI that HPI loaned the Debtors over $115 million. It goes without saying that HPI is looking at massive losses in connection with this loan. HPI does not agree that the Debtors' assets are worth

what the Debtors' say they are. However, if the Debtors' assets securing HPI's loan are worth even what the Debtors' say, around $57million, HPI will have at least a $58 million shortfall.

The Debtors seem to hinge their subordination arguments on the fact that HPI made money on the "spread" between the interest rate that the Debtors paid to HPI on the loan and the interest rate that HPI was paying its own lenders. Contrary to the Debtors claims, numerous documents indicate that the Debtors knew that HPI borrowed money from its own lenders to fund the loan to the Debtors. HPI did not have $115 million lying around. It is also true that HPI borrowed money at a lower interest rate than what the Debtors were paying HPI which was a function of HPI's better credit and is no different than how most lenders finance loans. While interesting, it is all not terribly relevant. HPI was functioning as a lender to the Debtors. Every lender makes a loan to make a profit, and HPI was no exception. HPI charged the Debtors the same interest rate the Debtors were paying on the prior loan to Goldman Sachs. Yes, HPI was able to get a lower interest rate because it was a more credit worthy borrower than the Debtors. There is nothing wrong with this and it does not make HPI's loan not a loan or any of HPI's actions improper.

HPI's Plan simply implements what happens when a debtor cannot repay the money they borrowed; the lender takes back the assets securing that loan. But HPI's Plan goes farther than that. Although HPI is under no obligation to do so, if the Plan is confirmed, HPI has agreed to create a Trust, put cash into that Trust, and fund the pursuit of Causes of Action by that Trust, including Causes of Action that no one has the current right to pursue but HPI. HPI's Plan provides a real chance for the unsecured creditors of these estates to have a material recovery on their claims.

The Debtors plan is in stark contract to HPI's Plan. The Debtors are insolvent. The Debtors' plan does nothing to alter that fact. The Debtors' plan asks the creditors to hang their hopes of any recovery not only on the (meritless) subordination of the claims of both HPI and all of the convertible not holders, but also on the future profits from the business operations of these Debtors. It is stated elsewhere in this Disclosure Statement, but it bears repeating here: under current management, *the Debtors have already lost well over $500 million*. The Debtors ask all creditors to believe that this same management will lead the Debtors to business success where before success has been lacking. HPI does not believe the Debtors' plan is feasible and suggests that creditors ought not to believe it either.

E. Acceptance and Confirmation of the Plan

1. Requirements for Confirmation. At the Confirmation Hearing, the Court will determine whether the provisions of section 1129 of the Code have been satisfied. Section 1129 of the Bankruptcy Code, as applicable here, provides as follows:

The Plan must comply with the applicable provisions of the Code, including section 1123 which specifies the mandatory contents of a plan and section 1122 which requires that Claims and Interests be placed in Classes with "substantially similar" Claims and Interests (section 1129(a)(1)).

The Plan Proponent of the Plan must comply with the applicable provisions of the Code (section 1129(a)(2)).

The Plan must have been proposed in good faith and not by any means forbidden by law (section 1129(a)(3)).

Any payment made or to be made by the Debtors, or by a person issuing securities or acquiring property under the Plan, for services or for costs and expenses in or in connection with the Case, or in connection with the Plan and incident to the Case, must be disclosed to the Court and approved or be subject to the approval of the Court as reasonable (section 1129(a)(4)).

The Debtors must disclose the identity and affiliations of any individual proposed to serve, after Confirmation of the Plan, as a director, officer, or voting trustee of the reorganized debtor, of an affiliate of the Debtors participating in the Plan with the Debtors, or of a successor to the Debtors under the Plan. The appointment to, or continuance in, such office of such individual must be consistent with the interests of the Debtors' creditors, equity holders, and with public policy. The Plan Proponent must also disclose the identity of any insider that will be employed or retained by the reorganized debtor and the nature of any compensation for such insider (section 1129(a)(5)).

The Plan must meet the "best interest of creditors" test which requires that each holder of a Claim or Interest of a Class of Claims or Interests that is impaired under the Plan either accept the Plan or receive or retain under the Plan on account of such Claim or Interest property of a value as of the Effective Date of the Plan, that is not less than the amount that such holder would receive or retain if the Debtor was liquidated on such date under Chapter 7 of the Code. If the holders of a Class of Secured Claims make an election under section 1111(b) of the Code, each holder of a Claim in such electing Class must receive or retain under the Plan on account of its Claim property of a value, as of the Effective Date of the Plan, that is not less than the value of its interest in the Debtor's interest in the property that secures its Claim (section 1129(a)(7)). To calculate what non-accepting holders would receive if the Debtor was liquidated under Chapter 7, the Court must determine the dollar amount that would be generated upon disposition of the Debtor's assets and reduce such amount by the costs of liquidation. Such costs would include the fees of a Trustee (as well as those of counsel and other professionals) and all expenses of sale.

Each Class of Claims or Interests must either accept the Plan or not be impaired under the Plan (section 1129(a)(8)). Alternatively, as discussed herein, the Plan may be confirmed over the dissent of a Class of Claims or Interests if the "cramdown" requirements of section 1129(b) of the Code are met.

Except to the extent that the holder of a particular Claim has agreed to a different treatment of such Claim, the Plan must provide that holders of Administrative Claims and Priority Claims (other than tax claims) will be paid in full in cash on the Effective Date of the Plan, and that holders of priority tax Claims will receive on account of such Claims deferred cash payments, over a period not exceeding six (6) years after the date of assessment of such tax, of a value, as of the Effective Date of the Plan, equal to the Allowed amount of such Claim (section 1129(a)(9)).

At least one impaired Class must accept the Plan, determined without including the acceptance of the Plan by any insider holding a Claim of such Class (section 1129(a)(10)).

The Plan must be "feasible". In other words, it cannot be likely that confirmation of the Plan will be followed by the liquidation, or the need for further financial reorganization, of the Debtors or any successor to the Debtors under the Plan, unless such liquidation is proposed in the Plan (section 1129(a)(11)).

All fees required to be paid under the Code have been paid or the Plan provides for such payment on its Effective Date (section 1129(a)(12)).

2. The Plan Meets All of the Requirements for Confirmation. The Plan Proponent believes that the Plan satisfies all statutory requirements of Chapter 11 of the Code and should be confirmed. More specifically:

(i) The Plan complies with all of the applicable provisions of the Code;

(ii) The Plan Proponent has complied with the Code and has proposed the Plan in good faith;

(iii) All disclosure requirements concerning payments made or to be made for services rendered in connection with the Chapter 11 case or the Plan have been, or will be met prior to or at the Confirmation Hearing; and

(iv) Administrative Claims, Priority Claims, and fees required to be paid under the Code are appropriately treated under the Plan.

ARTICLE VII

LIQUIDATION ANALYSIS

The Plan Proponent believes that the Plan affords creditors the potential for the greatest realization from the Debtors' assets, and, therefore, is in the best interests of creditors. The Plan Proponent has considered alternatives to the Plan, such as the Debtors' alternative Chapter 11 plan and a liquidation of the Debtors' assets in a Chapter 7 case. The Plan Proponent does not believe that the Debtors' plan, any alternative Chapter 11 plan, or a Chapter 7 liquidation would afford the holders of Claims a return as great as is proposed by HPI in the Plan.

Generally, under Chapter 7, a trustee would be appointed to administer the Estate, to resolve pending controversies against the Debtors and claims of the Estates against other parties, and to make distribution to Creditors. If the Cases were converted to cases under Chapter 7, significant additional Administrative Expenses would be incurred. Any distributions to holders of Claims would be substantially delayed and, in all likelihood, reduced as compared to the anticipated results of Confirmation of the Plan. A Chapter 7 trustee would be entitled to compensation in accordance with the scale set forth in § 326 of the Bankruptcy Code. A Chapter 7 trustee might also seek to retain new professionals, including attorneys and accountants, in order to resolve any disputed Claims and possibly to pursue claims of the Estates against other parties. There is a strong probability that such Chapter 7 trustee would not possess any particular knowledge of the oil and gas

industry. The trustee and any such new professionals retained by the trustee would need to expend time familiarizing themselves with the properties owned by the Debtors and the industry generally, resulting in a duplication of effort, increased expense, and delay in payment to Creditors. Under the Bankruptcy Rules, a new bar date for the filing of proofs of claim would have to be set, and additional Claims against the Estates that will soon be time-barred (because they were not filed before the applicable bar dates set in the Cases) could be asserted.

Further, however, specifically in this case, the more compelling and direct reason that the HPI Plan is preferable to a Chapter 7 liquidation is simple and straightforward; the Debtors, separately Debtor by Debtor and collectively as a group, are hopelessly insolvent. *The Debtors' liabilities to HPI alone far exceed the value of their assets and, in a Chapter 7 "straight liquidation" scenario, the unsecured creditors of these estates would receive nothing*. Two of the Debtors have no assets other than their equity interests in one of the other Debtors (Hallwood Energy Management, LLC, HG II Management, LLC); and one Debtor seemingly has no assets at all (Hallwood SWD, LLC). As for the other two "smaller" Debtors, one has assets allegedly of approximately $15 million and secured debt owed to HPI of in excess of $118 million (Hallwood Gathering, LP); and one has assets allegedly of approximately $2 million and secured debt owed to HPI of in excess of $118 million (Hallwood Petroleum, LLC). Finally, as for Hallwood Energy, the "lead" Debtor as it were, Hallwood Energy generously has assets allegedly of approximately $40 million (HPI's Collateral only) and secured debt to HPI of in excess of $118 million. On a Debtor by Debtor basis or on a consolidated basis, each Debtor and the collective Debtors are insolvent and lack any equity in their assets.

THE PLAN PROPONENT BELIEVES THAT CONFIRMATION AND IMPLEMENTATION OF THE PLAN IS PREFERABLE TO ANY OF THE ALTERNATIVES DESCRIBED HEREIN BECAUSE IT SHOULD PROVIDE GREATER RECOVERIES THAN THOSE AVAILABLE IN A CHAPTER 7 LIQUIDATION TO THE HOLDERS OF SECURED AND UNSECURED CLAIMS WHO WOULD LIKELY RECEIVE LESS IN A CHAPTER 7 LIQUIDATION. IN ADDITION, OTHER ALTERNATIVES WOULD INVOLVE DELAY, UNCERTAINTY, AND SUBSTANTIAL ADMINISTRATIVE COSTS.

ARTICLE VIII

VOTING PROCEDURES

ACCEPTANCE OR REJECTION OF THE PLAN WILL BE DETERMINED, PURSUANT TO THE BANKRUPTCY CODE, BASED UPON THE ALLOWED CLAIMS AND ALLOWED INTERESTS THAT ACTUALLY VOTE ON THE PLAN. THEREFORE, IT IS IMPORTANT THAT CLAIMANTS EXERCISE THEIR RIGHT TO VOTE TO ACCEPT OR REJECT THE PLAN.

A. Classes Entitled to Vote on the Plan

All members of Impaired Classes who hold Allowed Claims are entitled to vote to accept or reject the Plan. Section 1124 of the Bankruptcy Code generally provides that a class of claims or interests is considered to be Impaired under a plan unless the plan does not alter the legal, equitable and contractual rights of the holders of such claims or interest. For purposes of Plan solicitation, all Classes of Claims are Impaired and are, therefore, entitled to cast ballots on this Plan. Interest holders are deemed to have rejected the Plan and are therefore not entitled to vote on the Plan.

B. Persons Entitled to Vote on the Plan

Only holders of Allowed Claims and holders of Disputed Claims which have been temporarily allowed for voting purposes are entitled to vote on the Plan. For purposes of the Plan, an Allowed Claim is (i) a Claim against or Interest in a Debtor, proof of which, if filed on or before the Bar Date, which is not a Contested Claim or Contested Interest, (ii) if no proof of claim or interest was so filed, a Claim against or Interest in a Debtor that has been or hereafter is listed by a Debtor in the Schedules as liquidated in amount and not disputed or contingent, or (iii) a Claim or Interest allowed hereunder or by Final Order. An Allowed Claim or Allowed Interest does not include any Claim or Interest or portion thereof which is a Disallowed Claim or Disallowed Interest which has been subsequently withdrawn, disallowed, released or waived by the holder thereof, by this Plan, or pursuant to Final Order. Unless otherwise specifically provided in the Plan, an Allowed Claim or Allowed Interest shall not include any amount for punitive damages or penalties. Therefore, although the holders of Disputed Claims will receive ballots, these votes will not be counted unless such Claims become Allowed Claims as provided under the Plan or are temporarily allowed for voting purposes by the Court.

THE CLAIMS IN ALL CLASSES UNDER THE PLAN ARE IMPAIRED AND ARE ENTITLED TO VOTE WITH RESPECT TO ACCEPTANCE OR REJECTION OF THE PLAN.

C. Vote Required for Class Acceptance

During the Confirmation Hearing, the Bankruptcy Court will determine whether the Classes voting on the Plan have accepted the Plan by determining whether sufficient acceptances have been received from the holders of Allowed Claims actually voting in such Classes. A Class of Claims will be determined to have accepted the Plan if the holders of Allowed Claims in the Class casting votes in favor of the Plan (i) hold at least two-thirds of the total amount of the Allowed Claims of the holders in such Class who actually vote and (ii) constitute more than one-half in number of holders of the Allowed Claims in such Class who actually vote on the Plan.

As a condition to Confirmation, the Bankruptcy Code requires that each impaired Class of Claims or Interests accept the Plan, subject to the "cramdown" exception of §1129(b) described herein. To effectuate the §1129(b) exception, at least one impaired Class of Claims must accept the Plan.

D. Voting Instructions

1. Ballots and Voting. Holders of Allowed Claims entitled to vote on the Plan have been sent a Ballot, together with instructions for voting, with this Disclosure Statement. Claimants should read the Ballot carefully and follow the instructions contained therein. In voting for or against the Plan, please use only the Ballot that accompanies this Disclosure Statement.

EACH CREDITOR WILL RECEIVE A SINGLE BALLOT ONLY. IF YOU HAVE MORE THAN ONE CLAIM AGAINST ONE OF THE DEBTORS, OR YOU HAVE CLAIMS AGAINST MORE THAN ONE DEBTOR, YOU MAY REPRODUCE THIS BALLOT AS MANY TIMES AS NECESSARY TO PROPERLY VOTE YOUR CLAIMS. IF YOU HAVE ANY QUESTIONS CONCERNING THE BALLOT OR VOTING PROCEDURES, YOU SHOULD CONTACT COUNSEL FOR THE DEBTORS:

C. ASHLEY ELLIS
WRIGHT GINSBERG BRUSILOW P.C
600 SIGNATURE PLACE
14755 PRESTON ROAD
DALLAS, TEXAS 75254
(972) 788-1600
aellis@wgblawfirm.com

2. Returning Ballots and Voting Deadline. You should complete and sign each Ballot that you receive and return it in the pre-addressed envelope enclosed with each Ballot to the counsel for the Debtor in the self-addressed envelope provided, by the Voting Deadline.

THE VOTING DEADLINE IS 5:00 P.M., CENTRAL STANDARD TIME, ON _____, 2009. IN ORDER TO BE COUNTED, BALLOTS MUST BE ACTUALLY RECEIVED BY COUNSEL FOR THE DEBTOR ON OR BEFORE 5:00 P.M., CENTRAL STANDARD TIME, ON THE VOTING DEADLINE AT THE ADDRESS SET FORTH IN THE BALLOT INSTRUCTIONS WHICH ACCOMPANY THE ENCLOSED BALLOT. EXCEPT TO THE EXTENT ALLOWED BY THE BANKRUPTCY COURT, BALLOTS RECEIVED AFTER THE VOTING DEADLINE MAY NOT BE ACCEPTED OR USED IN CONNECTION WITH THE PLAN PROPONENT'S REQUEST FOR CONFIRMATION OF THE PLAN OR ANY MODIFICATION THEREOF.

3. Incomplete or Irregular Ballots. Ballots which fail to designate the Class to which they apply shall be counted in the appropriate Class as determined by the Plan Proponent, subject only to contrary determinations by the Bankruptcy Court.

4. Changing Votes. Bankruptcy Rule 3018(a) permits a Claimant, for cause, to move the Bankruptcy Court to permit such claimant to change or withdraw its acceptance or rejection of a plan of reorganization.

E. Contested and Unliquidated Claims

Contested Claims are not entitled to vote to accept or reject the Plan. If you are the holder of a Contested Claim, you may ask the Bankruptcy Court pursuant to Bankruptcy Rule 3018 to have your Claim temporarily Allowed for the purpose of voting.

F. Possible Reclassification of Creditors and Interest Holders

The Plan Proponent is required pursuant to §1122 of the Bankruptcy Code to place Claims and Interests into Classes that contain substantially similar Claims or Interests. While the Plan Proponent believes that all Claims and Interests are classified in the Plan in compliance with §1122, it is possible that a Claimant or Interest holder may challenge the classification of its Claim or Interest. If the Plan Proponent is required to reclassify any Claims or Interests of any Claimants or Interest holders under the Plan, the Plan Proponent, to the extent permitted by the Bankruptcy Court, intends to continue to use the acceptances received from such Claimants or Interest holders pursuant to the solicitation of acceptances using this Disclosure Statement for the purpose of obtaining the approval of the Class or Classes of which such Claimants or Interest holders are ultimately deemed to be a member. Any reclassification of Claimants or Interest holders should affect the Class in which such Claimants or Interest holders were initially a member, or any other Class under the Plan, by changing the composition of such Class and the required vote thereof for approval of the Plan.

ARTICLE IX

CRAMDOWN OR MODIFICATION OF THE PLAN

A. "Cramdown:" Request for Relief under Section 1129(b)

In the event any Impaired Class of Claims shall fail to accept the Plan in accordance with § 1129(a) of the Bankruptcy Code, the Plan Proponent shall request the Bankruptcy Court to confirm the Plan in accordance with the provisions of § 1129(b) of the Bankruptcy Code.

The Court may confirm a plan, even if it is not accepted by all impaired Classes, if a plan has been accepted by at least one impaired Class of Claims and the plan meets the "cramdown" provisions set forth in § 1129(b) of the Code. The "cramdown" provisions require that the Court find that a plan "does not discriminate unfairly" and is "fair and equitable" with respect to each non-accepting impaired Class. In the event that all impaired Classes do not vote to accept the Plan, the Plan Proponent will request that the Bankruptcy Court nonetheless confirm the Plan pursuant to the provisions of § 1129(b) of the Code.

The Court may find that the Plan is "fair and equitable" with respect to a Class of non-accepting impaired Interests only if (a) the holder of an Interest will receive or retain under the Plan property of a value as of the Plan's Effective Date equal to the greatest of any fixed liquidation preference or redemption price or the value of such Interest or (b) the holder of any Interest that is junior to such Interest will not receive or retain any property under the Plan.

The Court may find that the Plan is "fair and equitable" with respect to a Class of non-accepting impaired Unsecured Claims only if (a) each impaired unsecured Creditor receives or

retains under the Plan property of a value as of the Effective Date of such Plan equal to the amount of its Allowed Claim, or (b) the holder of any Claim or Interest that is junior to the Claims of the dissenting Class will not receive or retain any property under the Plan.

The Court may find that the Plan is "fair and equitable" with respect to a Class of non-accepting Secured Claims, only if, under the Plan, (a) the holder of each Secured Claim in such Class retains such holder's lien and receives deferred cash payments totaling at least the Allowed amount of such Secured Claim and having a value, as of the Effective Date of the Plan, equal to or in excess of the value of such holder's interest in the estate's interest in the collateral for the Secured Claim, (b) the collateral for such Secured Claim is sold, the lien securing such Claims attached to the proceeds, and such liens on proceeds are afforded the treatment described under clause (a) or (c) of this sentence, or (c) the holders of such Secured Claims realize the "indubitable equivalent" of their claims.

If all of the provisions of section 1129 are met, the Court may enter an order confirming the Plan.

B. The Plan Meets the "Best Interest of Creditors" Test

The "best interest of creditors" test requires that the Court find that the Plan provides to each non-accepting holder of a Claim or Interest treated under the Plan a recovery which has a present value at least equal to the present value of the distribution that such person would receive from the Debtor if the Debtor were liquidated under Chapter 7 of the Code. An analysis of the likely recoveries and affect on Creditors in the event of liquidation under Chapter 7 of the Code is contained hereinabove.

C. The Plan is Feasible

The Code requires that, as a condition to Confirmation of a plan, the Court find that Confirmation is not likely to be followed by a liquidation or a need for further financial reorganization except as proposed in that plan. Initially, the Plan provides the mechanism by which the Trusts will pay all Allowed Priority Claims, Administrative Claims, Fee Claims, Administrative Tax Claims, and Administrative Convenience Claims: the Trust will be funded by the Net Proceeds and Recoveries from the Trust Assets being (i) the balance of any monies in the Project Account; (ii) the Causes of Action; and (iii) the Trust Shares. Other than confirmation of the Plan itself, there is no contingency that must be satisfied for the Trusts to be formed and the Trust Assets transferred into it.

The Net Proceeds and Net Recoveries from the Causes of Action will be used to satisfy the Allowed Claims of all Unsecured Creditors in accordance with the terms of the Plan as proposed and the priority scheme set forth in the Code. HPI cannot predict with certainty the Recoveries on any particular Cause of Action or whether Recoveries will be sufficient to pay all creditors of these Debtors in full or provide a significant return to them. However, HPI asserts that there is no value in the Debtors' estates over and above the HPI Senior Secured Claim whether HPI's Plan is confirmed or not. The fact that the Debtors liabilities greatly exceed their assets is just that, a fact.

Under HPI's Plan, Creditors are not asked to pin their hopes for payment on future business achievements or successes of these Debtors which, given the Debtors' historical losses would be unrealistic. Creditors are not asked to rely on an infusion of capital from some unidentified source, or any other visionary scheme from these Debtors who have already lost over $550 million. Under the HPI Plan, the Trust will be funded and Creditors holding Allowed Unsecured Claims will be paid from the Net Proceeds and Recoveries of the Trust activities; the Plan is feasible.

D. The Plan Meets the Cramdown Standard With Respect to Any Impaired Class of Claims Rejecting the Plan

The Plan satisfies the provisions for cramdown under §1129(b)(2) of the Code. Secured Creditors are retaining their liens and receiving the value of their interest in the Debtors' property totaling the allowed amount of their Secured Claims. Interest Holders are not receiving or retaining any property under the Plan on account of their Interests unless and until all senior Creditors are paid in full. In the event an impaired Class rejects the Plan, the Plan shall be deemed a motion for cramdown of such Class under §1129(b)(2) of the Code.

E. Modification or Revocation of the Plan; Severability

Subject to the restrictions on modifications set forth in §1127 of the Bankruptcy Code and any applicable notice requirements, the Plan Proponent reserves the right to alter, amend or modify the Plan before its substantial consummation. The Plan Proponent also reserves the right to withdraw the Plan prior to the Confirmation Date. If the Plan Proponent withdraws the Plan, or if Confirmation does not occur, then the Plan shall be null and void in all respects, and nothing contained in the Plan will: (1) constitute a waiver or release of any Claims or rights against, or any Interest in, the Debtors by HPI; or (2) prejudice in any manner the rights of HPI.

If, prior to Confirmation, any term or provision of the Plan is held by the Bankruptcy Court to be invalid, void or unenforceable, the Bankruptcy Court, at the request of the Plan Proponent, has the power to alter and interpret such term or provision to make it valid or enforceable to the maximum extent practicable, consistent with the original purpose of the term or provision held to be invalid, void or unenforceable, and such term or provision will then be applicable as altered or interpreted. Notwithstanding any such holding, alteration or interpretation, the remainder of the terms and provisions of the Plan will remain in full force and effect and will in no way be affected, impaired or invalidated by such holding, alteration or interpretation.

ARTICLE X

RISK FACTORS

A. Factors Relating to Chapter 11 and the Plan

The following is intended as a summary of certain risks associated with the Plan, but is not exhaustive and must be supplemented by the analysis and evaluation of the Plan and this Disclosure Statement made by each Claimant as a whole in consultation with such Claimant's own advisors.

It is unlikely, although possible, that there may be no appreciable Net Recoveries from the Causes of Action transferred to the Trust. The fact remains, however, that the Debtors are hopelessly insolvent; in order for Creditors to be paid, one or more of the Causes of Action must be pursued. This risk, however, is not exclusive to the Plan. The value of the Debtors' estates over and above the Secured Claims against these estates is tied to the Causes of Action whether the Plan is confirmed or not. HPI believes that the Plan is feasible, and the risk that no Recoveries will be realized will be minimal.

B. Insufficient Acceptances

The Plan may not be confirmed without sufficient accepting votes. Each impaired Class of Claims and Interests receiving a distribution under the Plan is given the opportunity to vote to accept or reject the Plan. The Plan will be accepted by a Class of impaired Claims if the Plan is accepted by Claimants in such Class actually voting on the Plan who hold *at least* two-thirds (2/3) in amount and *more than* one-half (½) in number of the total Allowed Claims of that Class which actually vote. The Plan will be accepted by a Class of impaired Interests if it is accepted by holders of Interests in such Class actually voting on the Plan who hold *at least* two-thirds (2/3) in amount of the total Allowed Interests of the Class which actually vote. However, an Interest Holder is deemed to have rejected the Plan and is therefore not entitled to vote on the Plan. Only those members of a Class who vote to accept or reject the Plan will be counted for voting purposes.

If any impaired Class of Claims under the Plan fails to provide acceptance levels sufficient to meet the minimum Class vote requirements but at least one impaired Class of Claims accepts the Plan, then, subject to the provisions of the Plan, HPI intends to request confirmation of the Plan under Section 1129(b) of the Bankruptcy Code.

ARTICLE XI

CERTAIN FEDERAL INCOME TAX CONSEQUENCES OF THE PLAN

The following discussion summarizes certain possible federal income tax consequences of the Plan to the Debtors, and to the holders of Claims and Interests. It is based on the Internal Revenue Code of 1986, as amended (the "Code"), Treasury Regulations, and administrative and judicial interpretations thereof which are now in effect, but which could change, even retroactively, at any time. This discussion does not address all aspects of federal, state and local tax laws that could impact the various classes of Claimants, the holders of Interests or the Debtors.

NO RULING HAS BEEN SOUGHT OR OBTAINED FROM THE IRS WITH RESPECT TO ANY OF THE TAX ASPECTS OF THE PLAN AND NO OPINION OF COUNSEL HAS BEEN OBTAINED BY THE PLAN Proponent WITH RESPECT THERETO. NO REPRESENTATIONS OR ASSURANCES ARE BEING MADE WITH RESPECT TO THE FEDERAL INCOME TAX CONSEQUENCES AS DESCRIBED HEREIN. CERTAIN TYPES OF CLAIMANTS AND INTEREST HOLDERS MAY BE SUBJECT TO SPECIAL RULES NOT ADDRESSED IN THIS SUMMARY OF FEDERAL

INCOME TAX CONSEQUENCES. FURTHER, STATE, LOCAL, OR FOREIGN TAX CONSIDERATIONS MAY APPLY TO A HOLDER OF A CLAIM OR INTEREST WHICH ARE NOT ADDRESSED HEREIN. BECAUSE THE TAX CONSEQUENCES OF THE PLAN ARE COMPLEX AND MAY VARY BASED ON INDIVIDUAL CIRCUMSTANCES, EACH HOLDER OF A CLAIM OR INTEREST AFFECTED BY THE PLAN MUST CONSULT, AND RELY UPON, HIS OR HER OWN TAX ADVISOR REGARDING THE SPECIFIC TAX CONSEQUENCES OF THE PLAN WITH RESPECT TO THAT HOLDER'S CLAIM OR INTEREST. THIS INFORMATION MAY NOT BE USED OR QUOTED IN WHOLE OR IN PART IN CONNECTION WITH THE OFFERING FOR SALE OF SECURITIES.

11.1 Tax Consequences to the Debtors. Under the IRC, a taxpayer generally must include in gross income the amount of any discharge of indebtedness income realized during the taxable year. Section 108(a)(1)(A) of the IRC provides an exception to this general rule, however, in the case of a taxpayer that is under the jurisdiction of a bankruptcy court in a case brought under the Bankruptcy Code where the discharge of indebtedness is granted by the court or is pursuant to a Plan approved by the court, provided that the amount of discharged indebtedness that would otherwise be required to be included in income is applied to reduce certain tax attributes of the taxpayer. Section 108(e)(2) of the IRC provides that a taxpayer shall not realize income from the discharge of indebtedness to the extent that satisfaction of the liability would have given rise to a deduction. As a result of §§ 108(a)(1)(A) and 108(e)(2) of the IRC, the Debtors do not anticipate that any of them will recognize any taxable income from the discharge of indebtedness through the Chapter 11 Cases. Reductions in tax attributes (net operating loss carryover) will occur to the extent of cancellation of indebtedness income not recognized due to the above.

Under § 1141 of the Bankruptcy Code, confirmation of the Plan will discharge the Debtors from all debts except as provided for in the Plan. Implementation of the Plan, including the liquidation and ultimate dissolution of the Debtors may result in discharge of indebtedness to the Debtors as a matter of tax law to the extent of any unsatisfied portion of such Claims. Any such discharge of indebtedness should not be included in gross income of the Debtor, however, because of the exceptions to such inclusion discussed above.

11.2 Tax Consequences to Creditors. A Creditor who receives cash or other consideration in satisfaction of any Claim may recognize ordinary income. The impact of such ordinary income, as well as the tax year for which the income shall be recognized, shall depend upon the individual circumstances of each Claimant, including the nature and manner of organization of the Claimant, the applicable tax bracket for the Claimant, and the taxable year of the Claimant. Each Creditor is urged to consult with its tax advisor regarding the tax implications of any payments or distributions under the Plan.

In general, the principal federal income tax consequences of the Plan to holders of Claims will be (a) recognition of loss or a bad debt deduction to the extent that the total payments received under the Plan with respect to the Claim are less than the adjusted basis of the holder in such Claim, or (b) recognition of taxable income by the holder of the Claim to the extent of the excess of the

amount of any payments made under the Plan in respect of the Claim over the holder's adjusted basis therein.

Common examples of holders of Claims who may recognize taxable income upon receipt of payments under the Plan include (a) former employees with Claims for services rendered while serving as employees of a Debtor, (b) trade creditors whose Claims represent an item not previously reported in income (including Claims for lost income upon rejection of leases or other contracts with a Debtor), (c) holders of Claims who had previously claimed a bad debt deduction with respect to their Claims in excess of their ultimate economic loss, and (d) holders of Claims that include amounts of pre-petition interest that had not previously been reported in income. Common examples of Claims who may recognize a loss or deduction for tax purposes as a result of implementation of the Plan, provided that such holders are not paid in full, include holders of Claims that arose out of cash actually loaned or advanced to a Debtor, and holders of Claims consisting of items that were previously included in income of such holders on the accrual method of accounting, to the extent, in both cases, that the economic loss to such holders has not been allowed as a tax deduction in a prior year.

The amount and character or any resulting income or loss recognized for federal income tax consequences to a holder of any Claim as a result of implementation of the Plan will, however, depend on many factors. The most significant of these factors include (a) the nature and origin of the Claim, (b) whether the holder is a corporation (c) the extent to which the Plan provides for payment of the particular Claim, (d) the extent to which any payment made is allocable to pre-petition interest which is part of such Claim, and (e) the prior tax reporting positions taken by the holder with respect to the item that constitutes the Claim. As to the last factor, relevant tax reporting positions include whether the holder had to report under its method of accounting any portion of the Claim (including accrued and unpaid interest) as income prior to receipt and whether the holder previously claimed a bad debt or worthlessness deduction with respect to the Claim, which would affect the adjusted basis of the holder in the Claim.

General rules for the deduction of bad debts are provided in IRC § 166 as follows:

If either (a) the creditor is a corporation, or (b) the debt is a business bad debt in the hands of the creditor, and the creditor demonstrates that the debt is collectable only in part, a deduction for partial worthlessness of the debt will be allowed to the extent that the debt is charged off in the accounting records of the creditor.

For a creditor not described in the previous paragraph, a bad debt deduction is allowable only in the year that the debt becomes wholly worthless.

If the creditor is not a corporation and the debt is a nonbusiness bad debt, the bad debt deduction is treated as a short-term capital loss, which can offset only capital gain income and a limited amount of ordinary income.

For purposes of IRC § 166, a "nonbusiness debt" means a debt other than (i) a debt created or acquired in connection with the creditor's trade or business, or (ii) a debt the loss from the worthlessness of which was incurred during the operation of the creditor's trade or business.

The time as of which a debt becomes worthless (or partially worthless), and therefore the tax year in which a creditor may claim a bad debt deduction, is a question of fact. Pursuant to Income Tax Regulations ("Regs.") § 1.166-2(c), as a general rule, bankruptcy is an indication of the worthlessness of at least a part of an unsecured, non-priority debt. In bankruptcy cases, a debt may become worthless before settlement in some instances, and only when a settlement in bankruptcy has been reached in other instances. The mere fact that bankruptcy proceedings instituted against the debtor are terminated in a later year, thereby confirming the conclusion that the debt is worthless (or partially worthless), does not necessarily shift the deduction to such later year. Thus, even though the precise amount that holders of General Unsecured Claims or other Claims will receive under the Plan may not be known until the final distribution date, the determination of the precise amount that will be paid under the Plan with respect to a Claim, or that no amount will be paid, does not necessarily establish that any resulting bad debt deduction is properly allowable in the Creditor's tax year in which the final distribution is made, rather than in an earlier year. Accordingly, to the extent that a Creditor may claim a bad debt deduction which it has not previously claimed, it is possible that the Creditor will be required to amend its return for a prior year and claim the deduction in that year, rather than in the year in which the final distribution is made. Creditors should consult with their individual tax advisors with respect to this issue.

The extent to which gain or loss may be recognized by a holder of a Claim upon implementation of the Plan may be significantly affected by any bad debt deduction that may have been claimed by the holder in a prior year with respect to the debt on which the Claim is based. If the holder took a bad debt deduction in a prior year which is recovered in whole or part through a payment made to the holder pursuant to the Plan, the holder will generally be required to include in income the amount recovered in the year the holder receives the payment. An exception to this rule permits exclusion of a recovery of a prior bad debt deduction to the extent that the earlier bad debt deduction did not produce a tax benefit to the holder.

THE FOREGOING IS INTENDED TO BE A SUMMARY ONLY AND NOT A SUBSTITUTE FOR CAREFUL TAX PLANNING OR CONSULTATION WITH A TAX ADVISOR. THE FEDERAL, STATE, LOCAL, AND FOREIGN TAX CONSEQUENCES OF THE PLAN ARE COMPLEX AND, IN SOME CASES, UNCERTAIN. SUCH CONSEQUENCES MAY ALSO VARY BASED UPON THE INDIVIDUAL CIRCUMSTANCES OF EACH HOLDER OF A CLAIM OR INTEREST. ACCORDINGLY, EACH HOLDER OF A CLAIM OR INTEREST IS STRONGLY URGED TO CONSULT WITH HIS OR HER OWN TAX ADVISOR REGARDING THE FEDERAL, STATE, LOCAL, AND FOREIGN TAX CONSEQUENCES OF THE PLAN.

ARTICLE XII

RECOMMENDATION OF THE PLAN PROPONENT

The Plan Proponent believes the Plan is in the best interests of all Creditors. Accordingly, the Plan Proponent recommends that you vote for acceptance of the Plan and hereby solicits your acceptance of the Plan. **THE COMMITTEE ALSO SUPPORTS THE PLAN AND RECOMMENDS YOU VOTE IN FAVOR OF THE PLAN.**

DATED: July 14, 2009

HALL PHOENIX/INWOOD, LTD.

By: Phoenix Inwood Corporation

By: ***/s/ Donald Braun***
Donald Braun, President

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