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November 17, 2011

Via Overnight Delivery

Hon. Michael F. Consedine
Commissioner of Insurance
Pennsylvania Insurance Department
1345 Strawberry Square
Harrisburg, PA 17120

Re: Proposed Merger of Harleysville Mutual Insurance Company with and into Nationwide Mutual Insurance Company

Dear Commissioner Consedine:

I am writing this letter in response to the letter addressed to you, dated October 12, 2011 (the "October 12 Letter"), from Christopher C. Mansfield ("Mr. Mansfield") of Liberty Mutual Holding Company, Inc. ("Liberty Mutual"). We dispute virtually all of the contentions made by Mr. Mansfield on behalf of Liberty Mutual and its affiliate Liberty Real Estate Holdings LLC ("Liberty Holdings") with respect to the proposed merger (the "Harleysville Mutual Merger") of Harleysville Mutual Insurance Company ("Harleysville Mutual") with and into Nationwide Mutual Insurance Company ("Nationwide").

A. Preliminary Statement

The Harleysville Mutual Merger for which we are seeking the approval of the Pennsylvania Insurance Department (the "Department") is a fair and compelling transaction that benefits all of the stakeholders of Harleysville Mutual and satisfies the standards set forth in Section 991.1402 of Title 40 of the Pennsylvania Statutes. The principal reason that a business or individual becomes a policyholder of a mutual insurance company is to protect their assets

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consistent with their economic means. By virtue of the Harleysville Mutual Merger, the Harleysville Mutual policyholders will become policyholders in Nationwide, an insurance company with an approximate \$13 billion in group surplus, an A.M. Best rating of A+ and a significantly larger and more diverse product portfolio, all of which will serve to significantly increase the protection afforded to the insured assets of Harleysville Mutual policyholders and thereby enhance the most fundamental benefit derived from mutual insurance company membership.

In connection with the Harleysville Mutual Merger, a wholly owned subsidiary of Nationwide will merge with and into Harleysville Group Inc. ("HGI"), 54% of which is owned by Harleysville Mutual, and the shares of common stock of HGI held by the public will be converted into the right to receive \$60 per share. In contrast, the publicly traded stock of HGI is a traditional investment on which the shareholder is expecting an investment return. The expectations of HGI public shareholders are satisfied through Nationwide's agreement to purchase their stock at \$60 per share.

There is nothing unusual about either of these two transactions. The consideration for mutual-to-mutual mergers over the last 15 years has been, as it is here, providing the policyholders of the non-surviving mutual insurance company with a better rated company, a greater surplus, a broader range of products and a better risk diversification. In fact, especially in these times of increasing catastrophic loss events with more and more tornados, hurricanes, earthquakes, torrential rains, flooding and snow storms, two of the most important considerations for policyholders are their insurance company's rating and its surplus. The usual

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and customary consideration for the shareholders is cash as it is here. Accordingly, there is nothing unusual about the two transactions and, in fact, they fit seamlessly together.

B. The Merger Transactions

As you will see from the Form A filed by Nationwide seeking the Department's approval, the proposed transactions involve two separate but mutually conditioned merger transactions:

- (1) A merger of Harleysville Mutual with and into Nationwide Mutual with the Harleysville Mutual policyholders/members becoming Nationwide Mutual policyholders/members with all the rights and benefits of Nationwide Mutual's existing policyholders/members;
- (2) Immediately thereafter, a merger of Nationals Sub, Inc., a wholly owned subsidiary of Nationwide, with and into HGI with HGI surviving as the wholly owned subsidiary of Nationwide (the "HGI Merger"), with the provision for a payment by Nationwide of cash consideration of \$60.00 per share only to each of the public stockholders of HGI (*i.e.*, no payment to any of the parties to the transactions, namely, HGI and its subsidiaries, Harleysville Mutual and its subsidiaries and Nationwide and its subsidiaries).

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The Harleysville Mutual members are the persons entitled to vote with respect to the Harleysville Mutual Merger and the stockholders of HGI are the persons entitled to vote with respect to the HGI Merger. Harleysville Mutual is the owner of approximately 54% of the HGI common stock, and entered into a Voting Agreement with Nationwide under which Harleysville Mutual agreed to vote its shares of HGI common stock in favor of the HGI Merger.

We believe it is important to understand that the Harleysville Mutual Merger and the HGI Merger are two separate transactions with very different constituencies, which were entered into based on separate considerations and separate determinations. The commonality is that both transactions are with Nationwide, an unaffiliated third party seeking to acquire Harleysville as a whole, and are mutually conditioned upon one another, *i.e.*, if one of the two transactions is not approved, the other one will not be consummated as well. However, as described in more detail below, the determinations made to proceed with each proposed merger transaction involved different decision-makers, different advisors and different standards of care and considerations.

C. The Harleysville Mutual Merger

The Harleysville Mutual Merger is a mutual-to-mutual merger where the current policyholders/members of Harleysville Mutual will become policyholders/members of Nationwide. Harleysville Mutual members, in their roles as policyholders, will continue to be insured under their policies of insurance with Nationwide, and will continue to hold the rights of members of a non-stock mutual insurance company, including the right to vote on certain fundamental events and the right to receive dividends when declared. Because of the mutual-to-

mutual nature of the Harleysville Mutual Merger, no policyholder distribution will occur. In the October 12 Letter, Liberty Mutual concedes that “it is not unusual for no such consideration to be paid to members¹ [of a mutual insurance company] in connection with a traditional merger of two mutual insurance companies.” October 12 Letter at 2 (footnote added). In fact, with the sole exception of the Allied Insurance/Nationwide merger which involved a dividend to Allied Insurance’s policyholders under factually different circumstances, Harleysville Mutual is unaware of any other merger of two mutual insurance companies in the last 15 years involving the payment of any consideration to the members of the non-surviving mutual insurance company.

Moreover, despite Liberty Mutual’s contention to the contrary, there is nothing unusual about the Harleysville Mutual Merger. To the contrary, as a result of this merger:

- Harleysville Mutual’s policyholders will become policyholders in Nationwide, which has an A.M. Best rating of A+ and which will have a combined pro forma group surplus of approximately \$13 billion;
- Harleysville Mutual’s policyholders will have a more diverse set of financial products and services, including Nationwide’s long-term savings and retirement products;
- Harleysville Mutual’s policyholders will have access to a national independent agency distribution network; and

¹ The terms “members” and “policyholders” were used interchangeably in Liberty Mutual’s October 12 Letter.

- Harleystville Mutual's members will continue as members of a non-stock mutual insurance company with similar membership rights.

Thus, the Harleystville Mutual Merger will bestow significant benefits on the Harleystville Mutual policyholders/members.

Liberty Mutual incorrectly suggests that the Harleystville Mutual Merger is a so-called "going private" transaction for HGI, "result[ing] in an inherent conflict of interest between the interests of the members of Harleystville Mutual and the public stockholders of HGI." October 12 Letter at 2 (footnote omitted). For starters, this is not a so-called "going private" transaction. Harleystville Mutual's policyholders are not being squeezed out of existence by Harleystville Mutual or HGI. Nor will Harleystville Mutual purchase the shares held by the public in HGI. Either of these events could constitute a "going private" transaction, but neither of them will occur here. Instead, in two arm's length transactions with Nationwide, the Harleystville Mutual policyholders will become Nationwide policyholders and Nationwide will acquire the public's interest in HGI as a result of the HGI merger.²

Moreover, Liberty Mutual's assertions of conflict of interest are similarly misplaced. The Harleystville Mutual and HGI Boards are comprised of reputable and respected directors who set up processes and procedures to ensure that all interests were identified and represented:

² Rule 13e-3 of the Securities Exchange Act of 1934 governs "going private" transactions. As Rule 13e-3 makes clear, it governs transactions between issuers and their affiliates which result in the public selling all of their shares in the issuer to an affiliate of the issuer. It is undisputed that Nationwide is not an affiliate of either Harleystville Mutual or HGI.

- A special committee comprised of two Harleysville Mutual directors, who were not directors of HGI (the “Harleysville Mutual Special Committee”), favorably recommended the Harleysville Mutual Merger to the entire Harleysville Mutual Board;
- Griffin Financial Group, LLC (“Griffin”) was retained solely by Harleysville Mutual’s Board to advise Harleysville Mutual’s Board with respect to the Harleysville Mutual Merger;
- Griffin rendered a fairness opinion that the Harleysville Mutual Merger was fair, from a financial point of view, to Harleysville Mutual;
- The law firm of Stevens & Lee was retained solely by Harleysville Mutual’s Board to advise Harleysville Mutual’s Board on its fiduciary duties;
- Stevens & Lee rendered a comprehensive opinion to the Harleysville Mutual Board that the directors would not be violating their fiduciary duties by entering into the Harleysville Mutual Merger;
- A special committee comprised of two HGI directors, who were not directors of Harleysville Mutual (the “HGI Special Committee”), favorably recommended the HGI Merger and buyout of the HGI public stockholders to the entire HGI Board;

- Keefe, Bruyette & Woods, Inc. (“KBW”) was retained solely by HGI’s Board to advise HGI’s Board with respect to the consideration to be received by the public stockholders of HGI; and
- KBW rendered a fairness opinion that the consideration to be received by HGI’s public stockholders in the HGI Merger was fair, from a financial point of view, to the holders of such shares.

Given the foregoing, any potential conflict of interest arising because of the negotiations or structure of the Harleysville Mutual Merger were dealt with consistent with the recognized standards of corporate governance. The fact that the public stockholders of HGI will receive cash consideration in the separate HGI Merger, while the Harleysville Mutual policyholders receive traditional mutual-to-mutual consideration, does not mean that the Harleysville Mutual policyholders have been treated unfairly. On the contrary, the Harleysville Mutual policyholders will remain as part of the combined organization for the long-term, and continue to receive insurance coverage from a well capitalized A+ rated carrier and the same or greater “bundle of rights” they possessed with respect to Harleysville Mutual, but with a stronger organization, while the HGI public stockholders are being cashed out of their investment in a publicly traded company and their interests will terminate. The Harleysville Mutual policyholders and the HGI public shareholders are receiving different, but completely traditional consideration. The difference in consideration is a direct and appropriate result of the differences in their interests as policyholders and shareholders.

Accordingly, Liberty Mutual is simply wrong when it suggests that there has been an enrichment of HGI's public stockholders at the expense of Harleysville Mutual's policyholders. Moreover, Liberty Mutual's focus on the supposedly "disturbing" fact that Harleysville Mutual's Board and senior management "includes a number of individuals who have held high ranking positions within Pennsylvania's government, including, among others, a former Commissioner of Insurance and a former Lieutenant Governor" borders on the defamatory. Rather than being "disturbing," this fact – the respected and reputable members of Harleysville Mutual's Board and senior management – insured that everything was correctly and appropriately handled throughout this transaction.

D. The Duties Of The Harleysville Mutual Directors Under The Pennsylvania Business Corporation Law³

Harleysville Mutual is a Pennsylvania corporation. Accordingly, the duties of a director of a Pennsylvania corporation are governed by the Pennsylvania Business Corporation Law (the "PBCL").

Under Section 1712(a) of the PBCL, each "director of a [Pennsylvania] business corporation shall stand in a fiduciary relation to the corporation and shall perform his duties as a director, including his duties as a member of any committee of the board upon which he may

³ Section 2101(c) of the PBCL provides that the PBCL shall be generally applicable to all nonstock corporations and that references to "shares" and "shareholder" shall mean "memberships" and "member," respectively, with respect to a mutual insurance company like Harleysville Mutual. 15 Pa.C.S. § 2101(c). Accordingly, the provisions of the PBCL that are applicable to stock corporations are applicable to Harleysville Mutual.

serve, in good faith, in a manner he reasonably believes to be in the best interests of the **corporation** . . .” 15 Pa.C.S. § 1712(a) (emphasis added). In conjunction with Section 1712(a), Section 1717 of the PBCL provides that the “duty of the board of directors, committees of the board and individual directors under section 1712 . . . is solely to the business corporation . . .” 15 Pa.C.S. § 1717. Accordingly, based upon Sections 1712(a) and 1717 of the PBCL, the Harleysville Mutual individual directors, Special Committee and Board owed their fiduciary duties **only** to Harleysville Mutual and all of its constituencies and not to any one constituency.

This last point is underscored by Section 1715 of the PBCL. Thus, Section 1715(a) provides that, “[i]n discharging the duties of their respective positions, the board of directors, committees of the board and individual directors of a business corporation may, in considering the best interests of the corporation, consider to the extent they deem appropriate”: (1) the interests of policyholders, employees, suppliers, customers, independent agents and the communities in which they have offices; (2) the long-term as well as short-term interests of the corporation; (3) the resources, intent and conduct of any person seeking to acquire control of the corporation; and (4) any other pertinent factors. 15 Pa.C.S. § 1715(a). Moreover, Section 1715(b) of the PBCL makes indelibly clear that none of “the interests of any particular group affected by [any] action” shall be “a dominant or controlling interest or factor” in the decisions of the individual directors, special committees or board of directors. 15 Pa.C.S. § 1715(b). This means that, in considering the Harleysville Mutual Merger, the duty of the Harleysville Mutual Special Committee and the Board was to decide what was in the best interests of Harleysville Mutual itself and all of its constituencies.

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The Harleysville Mutual Special Committee, a special committee comprised of two Harleysville Mutual directors who were not directors of HGI, was organized to evaluate the Harleysville Mutual Merger and make a recommendation to the entire Harleysville Mutual Board. In turn, pursuant to Section 1712(a) of the PBCL, in performing their duties, the directors of Harleysville Mutual were “entitled to rely in good faith” on the opinions and reports of special committees, such as the Harleysville Mutual Special Committee, and experts, such as Griffin and Stevens & Lee. 15 Pa.C.S. § 1712(a)(2) and (3).

Moreover, pursuant to Section 1715(d) of the PBCL, any act of the Harleysville Mutual individual directors, Special Committee or Board as a whole is presumed to be in the best interests of Harleysville Mutual absent a breach of fiduciary duty to Harleysville Mutual, lack of good faith or self-dealing. Section 1715(d) of the PBCL also provides that, if a majority of disinterested directors assent to an acquisition of control, the directors are presumed to have satisfied their fiduciary duties to the corporation “unless it is proven by clear and convincing evidence that the disinterested directors did not assent to such act in good faith after reasonable investigation.” 15 Pa.C.S. § 1715(d)(2).⁴

⁴ The definition of “disinterested director” for purposes of Section 1715(d) of the PBCL is set forth in Section 1715(e). 15 Pa.C.S. § 1715(e). That section provides that a director is “disinterested” even if he or she receives a distribution made to all owners of shares of a class or series of stock, director’s fees or other compensation as a director or an interest in retaining his status as a director. 15 Pa.C.S. § 1715(e). The requirements of Section 1715(e) of the PBCL were scrupulously followed by the Harleysville Mutual Board in its determination of whether to approve the Harleysville Mutual Merger. Specifically, Michael L. Browne, the CEO of Harleysville who was offered an ongoing Retention Agreement by Nationwide (entry into which is a condition to the closing), and Ellen Dunn, a Harleysville Mutual Board member whose law firm provides legal
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As discussed in Sections C and E, both the Harleysville Mutual Special Committee and the Harleysville Mutual Board satisfied their fiduciary duties in approving the Harleysville Mutual Merger by acting in the best interests of Harleysville Mutual and all of its constituencies.

E. The Harleysville Mutual Special Committee And Harleysville Mutual Board Satisfied Their Fiduciary Duties In Approving The Merger Agreement with No Superior Proposal Fiduciary Duty Out

The October 12 Letter contends that, because the Harleysville Mutual Board had no contractual right to accept a so-called “Superior Proposal” – unlike the HGI Board – the Harleysville Mutual Board would not be able to consider an alternative transaction. October 12 Letter at 3. First, in deciding what was in the best interests of Harleysville Mutual, the Harleysville Mutual Board was entitled to, and did, consider various constituencies of Harleysville Mutual and how the proposed transaction would impact or affect them. As Stevens & Lee opined to the Harleysville Mutual Board and as Section 1715(b) of the PBCL definitively provides, the interests of its policyholders/members are neither dominant nor controlling. Therefore, the Harleysville Mutual Special Committee and Board were entitled to decide what was in the best interests of Harleysville Mutual and all of its constituencies in their entirety.

Second, in determining whether to approve the Harleysville Mutual Merger, the Harleysville Mutual Special Committee and Board did not focus solely on whether consideration

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services to Nationwide, disclosed their separate interests to the Harleysville Mutual Board and did not participate in the Harleysville Mutual Board’s approval votes. However, all of the remaining Harleysville Mutual directors – not just the two members of the Harleysville Mutual Special Committee – were “disinterested” when they approved the Harleysville Mutual Merger.

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was offered to be paid to the Harleysville Mutual policyholders. Such a focus would, simply put, have been myopic. In order to determine what was best for Harleysville Mutual, one would have to consider, as the Special Committee and Board did, the nature of the mutual insurance company acquiring Harleysville Mutual, the A.M. Best rating of such acquiror, the fit of the independent agent structure of such acquiror with the independent agent structure of Harleysville Mutual, the surplus of the combined companies, the products to be offered by the combined companies, the preservation of the jobs of the Harleysville Mutual employees, the fit of the cultures of the combined companies and the impact of the merger on the communities where Harleysville Mutual is located. In sum, the Harleysville Mutual Board was entitled to, and did, determine that these considerations ought to prevail over the single factor on which the October 12 Letter focuses, namely, the cash consideration payable to HGI's public shareholders. The Harleysville Mutual Board determined at the end of this process, with counsel from its advisors, that it did not have the same need for a Superior Proposal fiduciary duty "out" following execution of the Merger Agreement as was required for HGI. Accordingly, the premise of the October 12 Letter is factually incorrect.

Very truly yours,



Robert A. Kauffman

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