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DUANE MORRIS

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October 10, 2013

VIA E-MAIL AND FEDEX

Kimberly A. Rankin, Director
Bureau of Company Licensing and Financial Analysis
Office of Corporate & Financial Regulation
Pennsylvania Insurance Department
Commonwealth of Pennsylvania
1345 Strawberry Square
Harrisburg, PA 17120

Re: Form A Application (the "Application") of Gregory M. Shepard ("Shepard")
to Acquire Control of Donegal Group Inc. ("DGI")

Dear Ms. Rankin:

As co-counsel to DGI with Bob Pratter with respect to the Application, we are responding to the September 27, 2013 letter of J. Victor Peterson, Esq. to you requesting, on behalf of Shepard, that the Department schedule a public hearing on the Application.

Mr. Peterson's request is both premature and invalid for the reasons we have set forth in our prior correspondence, most recently by letter dated September 24, 2013, a copy of which we attach for your convenience. As set forth in our prior correspondence, the Application does not comply in a number of material respects with the requirements of Section 1402 et seq. of the Pennsylvania Insurance Holding Companies Act (the "Act") or the regulations the Department has issued pursuant to the Act (the "Regulations").

Moreover, by letter dated October 7, 2013, from Shepard to DGI and Donegal Mutual Insurance Company, Shepard seeks to continue his efforts to cause the merger or sale of DGI and its affiliates to an unidentified insurance company. Shepard's latest letter again

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Kimberly A. Rankin, Director

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demonstrates the inconsistency in Shepard's position before the Department. Shepard's letter outlines, albeit in vague terms, an entirely different type of transaction from the one described in the current Application, which negates the very purpose of holding a hearing on the present Application.

Based upon the foregoing, DGI respectfully requests that the Department deny the hearing request and dismiss the current Application for failure to comply with the Act and the Regulations .

Respectfully submitted,



Frederick W. Dreher, Esq.

FWD:am

cc: Donald H. Nikolaus
Robert L. Pratter, Esq.
Stephen J. Johnson

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September 24, 2013

VIA E MAIL AND FIRST CLASS MAIL

Stephen J. Johnson, Deputy Insurance Commissioner
Commonwealth of Pennsylvania
1345 Strawberry Square
13th Floor
Harrisburg, PA 17120

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Re: Form A Statement Dated March 20, 2013 Regarding the Acquisition of Control of Atlantic States Insurance Company, a Pennsylvania insurance company and wholly owned subsidiary of Donegal Group Inc., by Gregory Mark Shepard ("Shepard") (the "Form A")

Dear Mr. Johnson:

We have received a copy of Victor Peterson's letter dated September 12, 2013 to Kimberly A. Rankin of the Pennsylvania Insurance Department (the "Department") on behalf of Shepard (the "September 12, 2013 letter"), which comprises Shepard's responses to the Department's requests for additional information from Shepard in its letter to Mr. Peterson dated August 23, 2013. On behalf of our client Donegal Group Inc. ("DGI"), we respectfully believe that Mr. Peterson's latest response to the Department does not answer the key questions the Department has asked, and continues to demonstrate the deficiencies in the Form A and that Shepard does not have the required competence, experience and integrity to earn the Department's approval of the Form A.

In particular, Question 8 of the Department's letter requested information on the "rationale for [Shepard's] decision to walk away from Illinois Healthcare instead of managing the company through a run-of process." Shepard's response is telling in that his response is materially incomplete, not completely candid, and once again demonstrates why DGI urges disapproval of the Form A.

In his September 12, 2013 letter, Mr. Peterson, on behalf of Shepard, stated, in pertinent part, that:

On or about May 1, 2000, Illinois HealthCare filed its 1st quarter 2000 quarterly statement showing that its capital and surplus had declined to \$916,402. Approximately 10 days later, Illinois HealthCare received a letter from the IDOI stating that Illinois HealthCare must increase its capital and surplus to more than \$1,500,000 by June 30, 2000, or it would be placed into liquidation.

* * *

On June 30, 2000, Mr. Shepard (i.e., Gregory Shepard) was the sole owner of Illinois HealthCare, and he owed \$19,371,100 to Commerce Bank, \$21,262,000 to AUIC, and \$600,000 to his father's trust for a total of \$41,233,100, which prevented him from borrowing any additional funds to contribute to Illinois HealthCare.

September 12, 2013 letter at 4. In short, Mr. Peterson has stated that, because of Shepard's outstanding loans, Shepard could not borrow the additional \$600,000 he needed to increase Illinois HealthCare's capital and surplus to more than \$1,500,000 and thereby avoid liquidation.

However, what Mr. Peterson and Shepard have omitted is that the entirety of the Commerce Bank loan and approximately half (if not more) of the AUIC loan were loans Shepard secured to purchase 20% of the common stock of Meridian Insurance Group, Inc. ("MIGI") in his unsuccessful **personal** attempt to acquire control of MIGI. See the Management's Discussion and Analysis in the AUIC Annual Statement f/y/e December 31, 2000 annexed hereto as Exhibit A. In other words, Shepard purchased MIGI stock for his personal benefit with loans, including a loan from AUIC, that deprived him of the borrowing capacity that could have otherwise been utilized to increase the capital and surplus of Illinois HealthCare for the benefit of its policyholders and thereby stave off Illinois HealthCare's insolvency and liquidation. Shepard's elevation of his personal interests over his duties as an officer, director and control person to Illinois HealthCare and its policyholders is underscored by the fact that the Illinois Department of Insurance only wanted Shepard to increase Illinois HealthCare's capital and surplus by \$600,000 to avoid its insolvency and liquidation. Instead, Shepard continued to hold his MIGI common stock for his personal benefit rather than decreasing his MIGI ownership so he would have the borrowing capacity to raise only \$600,000 for the benefit of Illinois HealthCare's policyholders. ~~Shepard's preferential conduct is further compromised by the fact that AUIC was not an unrelated third party like Commerce Bank, but instead a closely-held affiliate in which he was the 50% owner and president.~~

Surely, by selling some of the MIGI common stock and repaying part of the AUIC loan, Shepard could have freed up \$600,000 to avoid Illinois HealthCare's insolvency and liquidation and thereby protect Illinois HealthCare's policyholders.

Stephen J. Johnson, Deputy Insurance Commissioner
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We also note that Mr. Peterson, on behalf of Shepard, continues to evade the Department's now thrice-made request for an explanation of Shepard's contradictory representations that he has no future plans to sell, merge or change the operations of DGI and his oft-stated public statements urging DGI's merger with or sale to a larger insurer so that Shepard can realize a profit on his DGI holdings. (See the first full paragraph on page 5 of the September 12, 2013 letter that merely refers to prior correspondence that never answered the Department's question.)

Mr. Peterson's response to DGI's request that Shepard file current, updated financial statements is patently inadequate. Mr. Peterson asserts that updated financial statements are "not called for in the regulations and goes beyond the scope of the Form A process." September 12, 2013 letter at 5. This is incorrect. 40 P.S. § 991.1402(d) states that "if any material change occurs in the facts set forth in the statement . . . an amendment setting forth such change, together with copies of all documents and other material relevant to such change, shall be filed with the department and sent to such insurer within two (2) business days after the person learns of such change." 40 P.S. § 991.1402(b)(3) requires the applicant to furnish five years of audited financial statements "and similar unaudited information as of a date not earlier than ninety (90) days prior to the filing of the statement." Shepard attempted to circumvent these requirements after the Tender Offer expired by sending a letter to the Department through his counsel purporting to show deletions and additions to the Form A filed on March 20, 2013. The Department, however, has required Shepard to file an amended Form A seeking Department approval of a different transaction consisting of open market and direct purchases of DGI Class B Shares. The amended Form A was only recently filed along with the September 12, 2013 letter. Given the extended time – now more than six months – which has elapsed since the first Form A was filed, the importance of having current financial information, and the fact that the unaudited financial statements dated March 15, 2013 are stale and do not comply with the 90 day requirement, Mr. Peterson's legal argument is incorrect and the Department should require Shepard to file updated financial information in compliance with 40 P.S. § 991.1402 (b)(3).

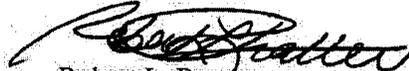
In closing the September 12, 2013 letter, Mr. Peterson states that "DGI needs dissenting shareholders." September 12, 2013 letter at 5. Shepard's desire to be a dissenting shareholder is clearly irrelevant to the Form A process. The relevant fact is that Shepard has utterly failed to prove that he is entitled to be a "control" shareholder within the meaning of the Insurance Holding Companies Law. That is the only issue before the Department, and DGI respectfully

Stephen J. Johnson, Deputy Insurance Commissioner
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requests that the Department deny Shepard's Form A for the reasons DGI has given for the past six months in this matter.

Respectfully submitted,


Robert L. Praiter

RLP/lmb
Enclosure

cc: Kimberly A. Rankin
Jodi Frantz, Esquire
J. Victor Peterson, Esquire

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EXHIBIT "A"



ANNUAL STATEMENT
For the Year Ended December 31, 2000
OF THE CONDITION AND AFFAIRS OF THE
American Union Insurance Company

(2 PAGES)

NAIC Group Code 0193, NAIC Company Code 25828, Employer's ID Number 37-055663D
Organized under the Laws of the State of Illinois using as the Port of Entry
Incorporated 08/12/1918 Commenced Business 10/03/1916
Statutory Home Office 2205 East Empire Street, Suite A, Bloomington, IL 61704
Main Administrative Office 2205 East Empire Street, Suite A, Bloomington, IL 61704
Mail Address 2205 East Empire Street, Suite A, Bloomington, IL 61704
Primary Location of Books and Records 2205 East Empire Street, Suite A, Bloomington, IL 61704
Annual Statement Contact Courtney Dawn Book, Courtney@americanunion.com

OFFICERS

President Gregory Mark Shepard
Secretary William Mark Dalton
Treasurer Tracy Morgan Shepard

VICE PRESIDENTS

Tracy Morgan Shepard, Frederic Henry Backsmeyer, William Mark Dalton

DIRECTORS OR TRUSTEES

Gregory Mark Shepard, Patrick Francis Busch, Mark Allen Weaver, Tracy Morgan Shepard, Merrick Condit Hayes

State of Illinois
County of McLean ss

The officers of this Company, being duly sworn, each depose and say that they are the described officers of the said Insurer; and that on the thirty-first day of December last, all of the herein described assets were the absolute property of the said Insurer, free and clear from any liens or claims thereon, except as herein stated, and that this annual statement, together with related exhibits, schedules and explanations therein contained, annexed or referred to are a full and true statement of all the assets and liabilities and of the condition and affairs of the said Insurer as of the thirty-first day of December last, and of its income and deductions therefrom for the year ended on that date, and have been completed in accordance with the NAIC annual statement instructions and accounting practices and procedures manuals except to the extent that: (1) state law may differ, or, (2) that state rules or regulations require differences in reporting not related to accounting practices and procedures, according to the best of their information, knowledge and belief, respectively.

Gregory Mark Shepard
(Printed Name)
President

William Mark Dalton
(Printed Name)
Secretary

Tracy Morgan Shepard
(Printed Name)
Treasurer

- a. Is this an original filing?
b. If no, 1. State the amendment number
2. Date filed
3. Number of pages attached

Yes [X] No []

Subscribed and sworn to before me this 9th day of March, 2001

Handwritten initials and date



Management's Discussion and Analysis

American Union Insurance Company "AUIC" is an Illinois stock property & casualty company formed in June of 1916 by L. F. Shepard of Normal, Illinois. AUIC is owned 50% by Gregory M. Shepard and 50% by Tracy M. Shepard who are brothers and grandsons of the founder.

On January 1, 2000 Gregory M. Shepard, President of AUIC owned approximately 20% of Meridian Insurance Group, Inc. "MIGI" of Indianapolis, Indiana. Shepard had acquired those shares with his own personal funds and by two loans. One of Shepard's loans was dated June 30, 1998 from Commerce Bank, N.A. for \$18,371,100 and one loan was from AUIC dated June 30, 1999 with a balance of \$7,589,149.89 as of December 31, 1999 and \$8,975,116.26 as of December 31, 2000.

During the first 2 quarters of 2000 Illinois HealthCare Insurance Company "IHIC" an affiliated Illinois stock life, accident & health insurance company with HMO authority incurred 2 losses totaling in excess of 2 million dollars which resulted in IHIC being placed into liquidation on June 30, 2000. IHIC was owned 100% by Greg Shepard. Greg Shepard as of June 30, 2000 had a loan from AUIC of \$12,017,304.43 for funding IHIC. As of December 31, 2000 the balance on that loan was \$12,528,908.21.

Throughout the year AUIC made a number of attempts to acquire control of MIGI and its property and casualty subsidiaries and affiliates. On August 31st AUIC through a wholly owned acquisition subsidiary made a tender offer to acquire the 80% not owned by Greg Shepard. On October 25th MIGI agreed to be acquired by State Auto Mutual Insurance Company of Columbus, OH.

The Illinois Department of Insurance conducted a financial exam of AUIC from 1996 to 1999 during the year. The financial exam also looked at the affairs of AUIC up and through year end 2000.

On March 8, 2001 AUIC notified the Illinois Department of Insurance of its intentions to refocus its limited amount of direct auto business to a new affiliate to be named Direct Auto Insurance Company. Direct Auto is expected to be licensed as an Illinois stock property & casualty insurance company in 2001. Direct Auto will be owned 100% by Tracy Shepard. After AUIC's business in Illinois and Missouri is closed out before year end 2001, AUIC desires to surrender its Certificate of Authority. AUIC would then operate as an Illinois business corporation with all of its assets invested in 21st Century Insurance Group "TW". TW is a California business corporation which owns two California direct marketers of auto and homeowners insurance. Greg Shepard has served on the Board of Directors of TW since 1995. TW trades on the NYSE. TW's property and casualty insurance company subsidiaries are currently in the process of applying for admission to Illinois and Missouri.

The State Auto acquisition of MIGI is expected to close on May 31, 2001 or June 30, 2001. Greg Shepard intends to pay off his Commerce Bank loan, his two loans to AUIC and several other loans utilizing most of his MIGI proceeds of \$47,652,000. AUIC in turn intends to pay off its \$10,000,000 loan from Commerce Bank.

On March 8th, Greg Shepard notified the Illinois Department of Insurance of his desires to form a new Illinois stock life insurance company for the purpose of selling a limited amount of annuities similar to previous efforts undertaken by American Union Health Insurance Company and American Union Life Insurance Company. Shepard intends to fund the new company with MIGI proceeds after his stock loans are paid off.