

ROBERT L. PRATTER
DIRECT DIAL: 215 979 1173
PERSONAL FAX: 215 754 4845
E-MAIL: rlpratter@duanemorris.com

www.duanemorris.com

May 9, 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

RECEIVED
Corporate & Financial Regulation

MAY 13 2013

Pennsylvania
Insurance Department

NEW YORK
LONDON
SINGAPORE
PHILADELPHIA
CHICAGO
WASHINGTON, DC
SAN FRANCISCO
PALO ALTO
SAN DIEGO
BOSTON
HOUSTON
LOS ANGELES
HANOI
HO CHI MINH CITY
ATLANTA
BALTIMORE
WILMINGTON
MIAMI
PITTSBURGH
NEWARK
LAS VEGAS
CHERRY HILL
BOCA RATON
LAKE TAHOE

MEXICO CITY
ALLIANCE WITH
MIRANDA & ESTAVILLO

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 (the "Form A")

Dear Mr. Johnson:

We are writing to you as counsel to Donegal Group Inc. ("DGI") and its wholly owned, Pennsylvania domiciled insurance subsidiary, Atlantic States Insurance Company ("Atlantic States"), which are the subject of the Form A filed by Gregory Mark Shepard ("Shepard"). By Notice published on April 13, 2013 in 43 Pennsylvania Bulletin 2120, the Pennsylvania Insurance Department (the "Department") gave public notice of the Form A and established a 60 day public comment period on the Form A that, unless extended, expires on June 12, 2013. The Department also by letter dated April 17, 2013 to Shepard's counsel, which letter the Department posted on its public website, requested that Shepard provide additional information in support of his Form A.

By our letter dated April 9, 2013 to the Department, a copy of which we attach for your convenience, we noted that the Form A did not meet the requirements of Pennsylvania law in 40 P.S. § 991.1401 et seq. and 31 Pa. Code Chapter 25. In particular, the Form A was deficient because Shepard did not send to DGI and Atlantic States a complete copy of the Form A. We further objected to and requested that the Department deny Shepard's request for confidentiality of Exhibits H-M to the Form A for the reasons set forth in our April 9, 2013 letter. We also requested that the Department order Shepard to produce the withheld exhibits forthwith to DGI and Atlantic States. As of the date of this letter, we have not received copies of Exhibits H-M and we reiterate DGI's and Atlantic States' objection to confidentiality and again request that

Stephen J. Johnson, Deputy Insurance Commissioner
May 9, 2013
Page 2

Shepard or the Department presently deliver to us Exhibits H-M for the reasons set forth in our letter of April 9, 2013, which is incorporated by reference herein.

On April 30, 2013, the Department notified us that Shepard's counsel had replied to the Department's April 17, 2013 letter by letter dated April 25, 2013, a copy of which letter the Department provided to us on April 30, 2013. In the letter dated April 25, 2013, Shepard requested that the Department schedule a public hearing on the Form A no later than May 15, 2013.

DGI and Atlantic States have previously requested a public hearing on the Form A in which they can fully participate. However, we oppose Shepard's suggested hearing schedule because it violates 40 P.S. § 991.1402(f)(2), which requires 30 days' prior notice of any hearing to be given to "the issuer whose stock is proposed to be acquired," in this case DGI. In addition, holding a hearing before the expiration of the public comment period is contrary to the establishment of the 60 day public comment period itself.

Moreover, DGI and Atlantic States further note that, in addition to Exhibits H-M that have not been furnished to DGI and Atlantic States, Shepard has not provided the additional information the Department had specifically requested in its letter dated April 17, 2013 in the following respects (for the Department's convenience, we refer to the numbered paragraphs of the Department's April 17, 2013 letter to Shepard):

1. Shepard has not provided a specific description of the source of funds to be used for his purchase of Class B Shares, and has not specifically indicated which investments he will sell and their current fair market value. Instead, Shepard has provided a superficial and non-responsive answer that fails to address the Department's question and cannot be relied upon in determining whether Shepard has adequate and readily available funds to purchase the Class B Shares he seeks to acquire in his tender offer. At the threshold, can Shepard freely sell the unidentified stock, or is it subject to a lien, pledge, restrictive legend or other legal restriction or condition that must be satisfied before he can sell the stock? Is Shepard a "statutory underwriter" under the federal securities laws with respect to the mystery stock? Even if Shepard can sell the stock without any restriction or condition precedent, Shepard's representation that the unidentified stock was selling at \$32.71 per share at the close of business on April 24, 2013 is irrelevant. What will it be selling for on the day down the road when Shepard will be required to purchase the Class B Shares, assuming his Form A is ultimately approved by, inter alia, the insurance regulators in six states, the Federal Reserve Board, and the tender offer has met the other conditions precedent Shepard has erected to its completion? What is the 52-week low for this stock? If this stock is selling for \$22.71 when Shepard must pay for the Class B Shares, what sources of truly liquid funds will be used by him to make up the difference? If Shepard holds this stock in a margin account and he sells it, what will he owe his broker? What is Shepard's basis in this stock and, therefore, at \$22.71 and \$32.71, or any other actual selling price what will be his tax burden? The indisputable fact is that there is no way of

Stephen J. Johnson, Deputy Insurance Commissioner
May 9, 2013
Page 3

knowing from Shepard's answer whether he will be able to purchase 925,000 Class B Shares with the net proceeds from the sale of his unidentified stock. The only conclusion that one can draw from Shepard's response is that it raises more questions than it answers in terms of the Department's legitimate inquiry.

2. See Response 3, *infra*.

3. Shepard's response to this question is manifestly misleading. Mr. Shepard has made numerous statements over the past six months which evidence his present plan to do everything he can to compel or influence the DGI Board to sell or merge DGI and its insurance subsidiaries to or with a larger insurance company. This, as Shepard readily admitted, was the very reason for his 2013 stockholder proposal, which immediately preceded his tender offer and which sought stockholder approval for his plan to have DGI sold or merged into another insurer.

"[N]o amount of rate increases, fortuitous avoidance of catastrophic storms, or other operational improvements can unleash realization of the Company's shares' true value as would a merger or sale of the Company to another insurer. Therefore, I believe that the greatest value to the shareholders will be realized through a merger or sale of the Company" [Quoted in Shepard's Tender Offer Statement filed March 20, 2013 ("TO") at 22-23].

Likewise, Shepard's "no present plans or purposes" statement is contradicted by several other statements in his tender offer:

"Offeror believes the Company's shares trade at a substantial discount to their realizable value if combined with another mutual insurer" [TO at (i)].

* * *

"The purpose of the Offer is to enable Offeror to increase his voting securities from 9.99% of the Company to 22.7% because he believes the Company's shares trade at a substantial discount to their realizable value if combined with another mutual insurer"[TO at 1].

It is crystal clear from the foregoing statements that, after paying a 42% premium for the Class B Shares (TO at 24; TO Ex.-99.(A)(1)(G) at 1), the only way Shepard could cover his costs and make a profit would be through the sale or merger of DGI with another insurance company.

To cloak his true intent with a mere "belie[f] that Donegal and Donegal Mutual are extremely valuable in the hands of a larger mutual property and casualty company" cannot disguise his real purpose and current plan. As Shepard readily admits, if his tender offer were successful, he would have "an over eighty million (\$80,000,000) investment in Donegal" and

Stephen J. Johnson, Deputy Insurance Commissioner
May 9, 2013
Page 4

nearly \$30,000,000 would have been invested at \$30 per share by paying a 42% premium. Does anyone really believe that given Shepard's often - announced desires to cash-out his position through a sale or merger with another company that he will actually sit passively on the sideline while DGI adheres to its long-term business strategy that it has pursued successfully for 27 years? The common sense answer to this question belies and refutes Shepard's "no present plans or purposes" pose. In addition, Shepard has not provided any information on the impact on competition in Pennsylvania associated with his future plans.

We also direct your attention to Mr. Shepard's prior record of control, management of, interference with and efforts to merge or sell other insurance companies. We have attached the letter dated April 4, 2006 to Deputy Insurance Commissioner Stephen J. Johnson from David H. Pittinsky on behalf of DGI that summarizes Mr. Shepard's aggressive history with insurance companies, which indicates that his current Form A statements about his future plans for DGI, its subsidiaries and affiliates are false, incomplete and misleading. (We have omitted the voluminous exhibits to the letter which the Department already has, but will furnish them to you if you want additional copies.)

Furthermore, pursuant to the definition of "control" contained in 40 P.S. § 991.1401, there can be more than one "control person." By virtue of his present ownership of Class A and Class B shares and the additional Class B shares he seeks to acquire, his statements about his desire to change the future direction of DGI, its subsidiaries and affiliates and his other actions, Shepard is undeniably a "control person".

6. The reply to Item 6 is non-responsive and inadequate because it does not provide the instrument in compliance with 40 P.S. §§ 991.1402(b)11.1 and 11.2.

7. Shepard has been involved in insurance operations. For example, Shepard was the chief executive officer, chairman and sole shareholder of Illinois HealthCare Insurance Co. ("IHIC"), an Illinois stock life, accident and health insurance company which was liquidated upon a finding of insolvency by the Illinois Division of Insurance in June 2000 leaving 26,000 policyholders without IHIC coverage and requiring guaranty funds in three states to cover their health claims. DGI and Atlantic States therefore question whether Shepard's response to this Item is complete or accurate.

8. Shepard has not provided a listing of his non-insurance affiliates. If and when he provides such listing, DGI and Atlantic States request a true and correct copy be provided to them and posted on the Department's public website so that our clients and the public can evaluate the information and provide comments upon it.

9. Shepard has not provided to DGI and Atlantic States a copy of his response to the Iowa Insurance Department's letter of March 27, 2013 that is posted on the Department's public website. DGI and Atlantic States request a true and correct copy of Shepard's response and that the Department post Shepard's response on the Department's public website.

Stephen J. Johnson, Deputy Insurance Commissioner

May 9, 2013

Page 5

10. Shepard's baseless comments about Mr. Nikolaus are without merit and deserve no attention. First and foremost, Mr. Nikolaus has the right to choose to sell or refrain from selling his Class B Shares to any person and for any price. Second, it is Shepard's insistence on a Minimum Tender Condition of 925,000 Class B Shares – not Mr. Nikolaus' decision to decline to tender his Class B Shares – which constitutes an impediment to Shepard's amended tender offer.

Moreover, DGI's amended 14D-9 filed with the SEC on May 2, 2013, which we have previously furnished to the Department, identifies three additional conditions that the DGI Board and the DGI Special Committee, comprised of five independent directors unaffiliated with Donegal Mutual, believe cannot be satisfied by the amended tender offer's May 20, 2013 expiration date or within a reasonable time after the May 20, 2013 expiration date: (1) the FRB Condition; (2) the Insurance Regulatory Approval Condition; and (3) the HSR Condition. Significantly, as explained in DGI's amended 14D-9, Shepard cannot waive any of these conditions because each one is by law an indispensable legal condition precedent to the consummation of Shepard's amended tender offer.

11. Shepard's response is inadequate because it does not identify the specific information, document, report or other material in Exhibits H-M that he contends are entitled to confidential treatment under Pennsylvania law and the basis upon which he makes his confidentiality request. The self-serving statement that their release would be "harmful" to Shepard is insufficient on its face. We also refer you to our letter dated April 9, 2013 specifying the reasons why Shepard's request for confidentiality should be denied and Exhibits H-M should be immediately produced to DGI and Atlantic States.

Based upon the foregoing, DGI and Atlantic States believe that the Form A is incomplete on its face. Moreover, DGI, Atlantic States and the public have been denied essential information with respect to the Form A to which they are legally entitled and which is necessary for preparation of public comments and full participation in the ongoing review of the Form A, including public hearings. Unless DGI and Atlantic States receive all of the information to which they are legally entitled, their statutory and constitutional rights in this matter are being abridged.

DGI and Atlantic States further suggest that, before any public hearings are scheduled and the Department rules on the Form A: (i) Mr. Shepard first submit a complete Form A and provide complete, satisfactory answers to the Department's requests for additional information; (ii) either Mr. Shepard or the Department provide our clients with true and correct copies of Exhibits H-M and all other information that Shepard has submitted to the Department with respect to the Form A; and (iii) the public comment period, and any extension thereof, run to its completion.

Duane Morris

Stephen J. Johnson, Deputy Insurance Commissioner
May 9, 2013
Page 6

DGI and Atlantic States thank you for your careful attention to this submission and our prior letters to the Department that identify the multiple ways in which Shepard's Form A does not comply with Pennsylvania law. We also stand ready to answer any questions you have or to meet with you and other Department representatives as may be appropriate.

Sincerely,



Robert L. Pratter

RLP/lmb
Enclosures

cc: Michael F. Consedine, Insurance Commissioner
Robert E. Brackbill, Jr.
Jodi Frantz, Esquire

DM3\2536175.1

LAW OFFICES
BALLARD SPAHR ANDREWS & INGERSOLL, LLP

1738 MARKET STREET, 81ST FLOOR
PHILADELPHIA, PENNSYLVANIA 19103-7599
215-695-8600
FAX: 215-864-8888
LAWYERS@BALLARDSPAHR.COM

BALTIMORE, MD
CAMDEN, NJ
DENVER, CO
SALT LAKE CITY, UT
VOORHEES, NJ
WASHINGTON, DC

DAVID H. PITTINSKY
DIRECT DIAL: 215-864-8117
PERSONAL FAX: 215-864-8767
PITTINSKY@BALLARDSPAHR.COM

April 4, 2006

By Federal Express

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

Re: Donegal Group Inc. ("DGI")

Dear Mr. Johnson:

As the facts set forth below indelibly demonstrate, Gregory Shepard ("Shepard") has an eight year history of stating that he is investing in insurance companies only for "investment purposes" and then:

- making illusory tender offers for the stock of such companies
- seeking to buy such companies with their own assets
- bringing baseless litigation against such companies and their boards of directors for failing to support his illusory offers
- being sanctioned by regulators for violating securities laws
- seeking to interfere in the business affairs of such companies

In addition, Shepard was the Chairman, CEO and majority shareholder of an insurance company liquidated by regulators, which left 26,000 policyholders without any coverage.

Stephen J. Johnson
April 4, 2006
Page 2

Given Shepard's pattern of conduct, DGI believes that Shepard's past is DGI's prologue. The Department should not be misled by Shepard's statement that he is seeking to invest in DGI solely for investment purposes. The fact that he has lacked control in the past has never deterred him from interfering in, and seeking to control, the insurance companies in which he has invested. Accordingly, the Department should, at a minimum, prohibit Shepard from acquiring any additional shares of DGI common stock until he has filed a sworn Form A with the Department.¹ This is the only way to protect DGI from Shepard's penchant for wreaking havoc on the insurance companies in which he invests.

A. Meridian Insurance Group, Inc. ("MIGI")

1. On December 27, 1996, Union Automobile Insurance Company ("Union Auto") filed a Schedule 13G with the SEC reporting that two of its wholly owned subsidiaries, American Union Life Insurance Company ("AULIC") and Prairie State Farmers Insurance Company ("Prairie") had acquired 387,000² shares and 290,000 shares, respectively, of MIGI common stock. A copy of the Union Auto 13G is contained in DGI's Appendix as Exhibit 1. The Union Auto 13G was signed by Shepard as Union Auto's President.

2. Union Auto was a wholly owned subsidiary of American Union Financial Corp. ("AUFIC"). Shepard and his brother Tracy Shepard each owned 50% of AUFIC. See ¶ 3,

¹ DGI reserves the right to request a Section 1402(f)(2) hearing within ten days following the Department's production to DGI of Shepard's request to acquire additional DGI common stock and his disclaimer of control in connection therewith.

² Since the Union Auto 13G reported that Union Auto owned 677,000 shares indirectly through AULIC and Prairie, the 468,000 share figure reported for AULIC was incorrect. This mistake was corrected in a later filing. See ¶ 4, *infra*.

Stephen J. Johnson
April 4, 2006
Page 3

infra. The 677,000 shares of MIGI common stock purchased by AUFC's second tier subsidiaries represented 9.9% of MIGI's common stock. Ex. 1 at 2.

3. On April 13, 1997, AUFC, Shepard, his brother Tracy Shepard, Direct Auto Insurance Company ("Direct Auto"), AULIC and Direct Auto Indemnity Company ("Direct Indemnity") filed Amendment No. 2 to Union Auto's 13G. A copy of the AUFC 13G Amendment is contained in DGI's Appendix as Exhibit 2. AUFC's 13G Amendment reported that Shepard and his brother each owned 50% of AUFC, that AUFC owned 100% of Direct Auto (which formerly had been Union Auto) and that Direct Auto owned 100% of AULIC and Direct Indemnity (which formerly had been Prairie). Ex. 2 at 10.

4. Moreover, AUFC's 13G Amendment reported that Shepard owned 677,100 shares of MIGI common stock through his subsidiaries: (a) 387,100 shares through AULIC; and (b) 290,000 shares through Direct Auto (formerly Prairie). Ex. 2 at 2-3, 5-6, 8.

5. On August 11, 1997, AUFC, Shepard, his brother Tracy Shepard, Direct Auto, AULIC and Direct Indemnity filed a Schedule 13G with the SEC to report that they collectively owned 679,600 shares or 10.02% of MIGI common stock. A copy of the AUFC 13G is contained in DGI's Appendix as Exhibit 3.

6. On February 13, 1998, AUFC, Shepard, his brother Tracy Shepard, Direct Auto, AULIC and Direct Indemnity filed Amendment No. 3 to Union Auto's 13G to report that they had increased their collective ownership of MIGI common stock to 851,800 shares or 12.8%. A copy of the AUFC 13G Amendment is contained in DGI's Appendix as Exhibit 4.

Stephen J. Johnson
April 4, 2006
Page 4

7. On July 10, 1998, Shepard filed a Schedule 13G with the SEC to report that he had acquired: (a) 64,290 shares of MIGI common stock from AUFC; (b) 680,400 shares of MIGI common stock from AULIC; and (c) 222,210 shares of MIGI common stock from Direct Indemnity. A copy of the Shepard 13G is contained in DGI's Appendix as Exhibit 5.

8. As a result of Shepard's purchases of MIGI common stock from his own companies, he reported that he owned 966,900 shares or 14.6% of MIGI common stock. Ex. 5 at 1-2, 5.

9. On August 31, 1998, Shepard filed a Schedule 13D with the SEC. A copy of the Shepard 13D is contained in DGI's Appendix as Exhibit 6. In his 13D, Shepard reported that he then owned 995,000 shares or 14.98% of MIGI common stock. Ex. 6 at 2.

10. More importantly and as a portent of the ominous events soon to follow, Shepard stated in his 13D that, although he had acquired the MIGI shares "for the purpose of investment," he reserved the right to pursue an acquisition of MIGI. Ex. 6 at 3-4.

11. On April 1, 1999, Shepard filed Amendment No. 2 to his 13D to report that he owned 1,094,500 shares or 15.08% of MIGI common stock. A copy of the Shepard 13D Amendment is contained in DGI's Appendix as Exhibit 7.

12. Moreover, Shepard also reported that, on March 31, 1999, his company AUFC had announced a tender offer to commence on April 2, 1999 to purchase up to an

Stephen J. Johnson
April 4, 2006
Page 5

additional 350,000 shares or 4.82% of MIGI common stock through a "Dutch auction."³ Ex. 7 at 3.

13. On May 19, 1999 and June 21, 1999, Shepard and his company AUFC filed Amendments Nos. 3 and 4 to his Schedule 13D to report that AUFC had purchased 177,500 shares and Shepard had received a stock dividend of 99,700 shares, respectively, of MIGI common stock. Copies of the two Shepard 13D Amendments are contained in DGI's Appendix as Exhibits 8 and 9.

14. On June 30, 1999, Shepard and AUFC filed Amendment No. 5 to his Schedule 13D to report that Shepard had purchased the 177,500 shares of MIGI common stock recently acquired by AUFC. A copy of the Shepard 13D Amendment is contained in DGI's Appendix as Exhibit 10.

15. As a result of his acquisition, Shepard reported that he then owned 1,371,700 shares or 18.90% of MIGI common stock. Ex. 10 at 2, 5.

16. In order to finance his acquisition, Shepard entered into a loan agreement and promissory note with his own company AUFC. Ex. 10 at 10-14.

17. On August 30, 2000, Shepard filed Amendment No. 7 to his Schedule 13D to report at pages 2-4 thereof that he then owned 1,588,400 shares or 20.23% of MIGI common

³ Shepard's illegal acquisition of MIGI common stock on the open market during his "Dutch auction" tender offer was later the subject of an SEC Cease and Desist Order. See ¶ 32, *infra*.

Stephen J. Johnson
April 4, 2006
Page 6

stock and that he intended to seek ownership and control of MIGI through a tender offer for all of its outstanding common stock at a price of \$20 per share. A copy of the Shepard 13D Amendment is contained in DGI's Appendix as Exhibit 11.

18. On August 30, 2000, Shepard filed a Schedule TO with the SEC using Meridian Insurance Group Acquisition Corp. ("MIGAC") as the vehicle to make his tender offer for all of the outstanding shares of MIGI common stock at a price of \$20 per share. A copy of the MIGAC Offer to Purchase is contained in DGI's Appendix as Exhibit 12.

19. At the time of his offer, MIGI had 7,852,411 shares of common stock outstanding and 3,811,500 of them were owned by Meridian Mutual Insurance Company ("Meridian Mutual") and 1,588,400 of them were owned by Shepard. Ex. 11 at 2; Ex. 12 at 2. Accordingly, Shepard's tender offer was offering to purchase the 6,264,011 shares of MIGI common stock which he did not own for a price of \$20 per share.

20. On September 11, 2000, MIGI filed a Schedule 14D-9 with the SEC to report the position it was taking vis-à-vis MIGI's shareholders with respect to the Shepard tender offer. A copy of the MIGI 14D-9 is contained in DGI's Appendix as Exhibit 13.

21. In its 14D-9, MIGI recommended that the MIGI shareholders refrain from tendering any shares in response to the Shepard tender offer, *inter alia*, because:

(a) its independent investment banker had rendered an opinion that the \$20 per share price was inadequate (Ex. 13 at 4);

Stephen J. Johnson
April 4, 2006
Page 7

(b) Meridian Mutual owned 48.5% of MIGI common stock and MIGI's directors and officers owned an additional 2% of MIGI common stock (Ex. 13 at 4);

(c) Since Shepard's offer was subject to a requirement that at least 50.1% of MIGI's voting securities must have been tendered and not withdrawn and since Meridian Mutual (48.5%) and MIGI's directors and officers (2%) had determined not to tender, the 50.1% requirement could not be satisfied and the offer could not be completed (Ex. 13 at 4);

(d) Shepard could not raise the financing to complete the offer even if 50.1% of MIGI's voting securities were tendered and not withdrawn (Ex. 13 at 5); and

(e) of Shepard's involvement in the insolvency of Illinois Healthcare Insurance Company ("Illinois HealthCare"), which was liquidated by the Illinois Department of Insurance on June 30, 2000 (Ex. 13 at 5-6).⁴

22. Given the facts set forth in subparagraphs 21(b)(c) and (d) hereof, the MIGI Board concluded that Shepard's tender offer was "illusory." Ex. 13 at 4-5.

23. On September 18, 2000, Shepard filed Amendment No. 2 to his Schedule TO using MIGAC as the vehicle to make his tender offer for MIGI common stock. A copy of the MIGAC Supplement to Offer to Purchase is contained in DGI's Appendix as Exhibit 14.

24. Pursuant to the Supplement, Shepard increased his tender offer price from \$20 per share to \$25 per share. However, instead of offering to purchase all 6,264,011 shares of

⁴ See ¶¶ 40-42, *infra*.

Stephen J. Johnson
April 4, 2006
Page 8

MIGI common stock which he did not own for the \$25 per share price, he offered only to purchase 2,985,769 shares of MIGI common stock for the new price. Ex. 14 at i and 5. Moreover, Shepard did not alter the condition, which could not be satisfied, requiring 50.1% of the MIGI voting securities to be tendered and not withdrawn before he was obligated to consummate his offer. Ex. 14 at i.

25. On September 22, 2000, MIGI filed Amendment No. 2 to its 14D-9 to report the position it was taking vis-à-vis MIGI's shareholders with respect to the Shepard revised tender offer. A copy of the MIGI 14D-9 Amendment is contained in DGI's Appendix as Exhibit 15.

26. In its 14D-9 Amendment, MIGI again recommended that the MIGI shareholders refrain from tendering any shares in response to the Shepard tender offer for several reasons, including those set forth in subparagraphs 21(b)(c) and (e) and paragraph 22 hereof. Ex. 15 at 2-3.

27. As a result of Shepard's manipulative attempt to acquire control of MIGI and his troubled history involving Illinois HealthCare, MIGI was forced to find a "white knight" to prevent Shepard from acquiring additional MIGI common stock and influencing its affairs.

28. Accordingly, on October 25, 2000, MIGI, Meridian Mutual and State Automobile Mutual Insurance Company ("State Auto Mutual") entered into Merger Agreements providing for State Auto Mutual to acquire all of MIGI's common stock for a price of \$30 per share. A copy of Amendment No. 4 to the MIGI 14D-9 reporting this fact at page 3 thereof is contained in DGI's Appendix as Exhibit 16.

Stephen J. Johnson
April 4, 2006
Page 9

29. Thereafter, Shepard withdrew his tender offer and the State Auto Mutual-MIGI merger was consummated.

B. The SEC And Indiana Securities Division Regulatory Actions

30. As a result of his manipulative and illusory efforts to acquire control of MIGI, Shepard was subjected to complaints filed against him and his companies by the SEC and the Indiana Securities Division.

31. On October 6, 2000, Shepard filed Amendment No. 3 to his TO reporting these regulatory actions. A copy of the Shepard TO Amendment is contained in DGI's Appendix as Exhibit 17.

32. Thus, on September 20, 2000, the SEC entered a Cease and Desist Order against Shepard, with his consent, for purchasing MIGI common stock on the open market during his "Dutch auction" tender offer commencing April 2, 1999. A copy of the SEC Order is contained in DGI's Appendix as Exhibit 18.

33. Similarly, the Indiana Securities Division commenced an action against Shepard and AUFC on September 21, 2000 arising out of their purchase of MIGI common stock on the open market during Shepard's "Dutch auction" tender offer commencing April 2, 1999. Ex. 17 at 12-16 [Ex. (a)(1)(T)].

34. In addition, the Indiana Securities Division commenced a second action against Shepard's tender offeror MIGAC on September 21, 2000 for failing to adequately disclose MIGAC's sources of funding for its tender offer. Ex. 17 at 7-11 [Ex. (a)(1)(S)].

Stephen J. Johnson
April 4, 2006
Page 10

35. On October 4, 2000, after hearing, the Indiana Securities Commissioner made findings of fact and entered a final order, *inter alia*, prohibiting Shepard and MIGAC from proceeding with their tender offer for MIGI common stock without first providing MIGI's shareholders with "an adequate description of the source of the funds and consideration to be used to finance the takeover offer." Ex. 17 at 17-29 [(Ex. (a)(1)(U))].

C. Shepard's Baseless MIGI Litigation

36. Despite the patent inadequacy and illusory nature of his tender offer, Shepard filed two baseless complaints against MIGI and State Auto Mutual.

37. Thus, on August 30, 2000, the same date that he filed his TO to commence his tender offer for MIGI common stock, Shepard filed a complaint against MIGI and its Board of Directors in the United States District Court for the Southern District of Indiana contending, *inter alia*, that the Board's failure to approve his tender offer would constitute a breach of fiduciary duty to MIGI's shareholders and constitute a violation of the securities laws of the State of Indiana. Ex. 12 at 31-32.

38. Thereafter, on December 8, 2000, Shepard filed an amended complaint against MIGI and its Board of Directors seeking to enjoin the State Auto Mutual-MIGI merger despite the fact that he had withdrawn his illusory tender offer effective as of the same date. A copy of Shepard's Amendment No. 9 to his Schedule 13D reporting the withdrawal of his tender offer at page 3 thereof is contained in DGI's Appendix as Exhibit 19. A copy of MIGI's 2000 Form 10-K reporting the filing of Shepard's original and amended complaints at page 16 thereof is contained in DGI's Appendix as Exhibit 20.

Stephen J. Johnson
April 4, 2006
Page 11

39. On May 14, 2001, MIGI filed a Form 10-Q reporting at page 12 thereof that Shepard's claims against MIGI and its Board of Directors for injunctive relief had been dismissed with prejudice and his claims for monetary relief had been dismissed for lack of jurisdiction without prejudice. A copy of the MIGI 10-Q is contained in DGI's Appendix as Exhibit 21.

D. Illinois HealthCare

40. Shepard was the Chairman, CEO and majority shareholder of Illinois HealthCare, an Illinois life, accident and health insurance company with HMO authority, from its founding in 1997 to June 30, 2000. Ex. 15 at 2.

41. On June 30, 2000, the Illinois Department of Insurance entered an order of liquidation of Illinois HealthCare. A copy of page 10 of the Illinois Department of Insurance 2000 Annual Report reporting the June 30, 2000 liquidation of Illinois HealthCare is contained in DGI's Appendix as Exhibit 22.

42. According to The Indianapolis Star, the Illinois HealthCare liquidation left 26,000 policyholders in Indiana, Illinois and Ohio without insurance coverage and required guaranty funds in those states to cover the health claims owed to its policyholders. Ex. 15 at 2.

E. State Auto Financial Corp. ("SAFC")

43. Having lost out to State Auto Mutual on his illusory bid to acquire control of MIGI, Shepard launched a new equally illusory effort to gain control of SAFC, the insurance holding company for State Auto Mutual, which had merged with MIGI.

44. On December 13, 2002, Shepard filed a Schedule 13D with the SEC reporting that he had acquired 2,000,000 shares or 5.13% of SAFC common stock. A copy of the Shepard 13D is contained in DGI's Appendix as Exhibit 23.

45. In order to raise the funds to purchase the SAFC shares, Shepard entered into a loan agreement with Commerce Bank. Ex. 23 at 3, 8-11 (Ex. 7.1) and 12-21 (Ex. 7.2).

46. In his Schedule 13D, Shepard stated that he had acquired the SAFC shares because he believed the "true value" of the acquired SAFC shares exceeded their current market price. Ex. 23 at 4.

47. In addition, Shepard stated that he had submitted a proposal to SAFC's Board of Directors to be voted on at SAFC's 2003 annual meeting of shareholders which, if adopted, would require the SAFC Board of Directors, *inter alia*, to explore "strategic alternatives," including the merger of SAFC's 68% owner State Auto Mutual with another mutual insurance company followed by the sale or merger of SAFC.⁵ Ex. 23 at 4.

48. On May 30, 2003, Shepard filed an Amendment No. 1 to his 13D. A copy of the Shepard 13D Amendment is contained in DGI's Appendix as Exhibit 24.

49. In his Amendment, Shepard recited that he had engaged Jefferies & Company, Inc. ("Jefferies") to render financial advisory and investment banking services in connection with his evaluation of his strategic alternatives concerning SAFC. Ex. 24 at 4.

⁵ Not surprisingly, the unnamed other merger partner was Shepard's own company. See ¶ 50, *infra*.

Stephen J. Johnson
April 4, 2006
Page 13

50. Astonishingly, it was Shepard's and Jefferies' plan, as set forth in Jefferies' so-called "highly confident" letter, that Shepard finance the merger of SAFC with his newly formed mutual insurance company, Mid-West Mutual Insurance Company, by having State Auto Mutual issue \$400 million of two year notes secured by the stock of State Auto Mutual's insurance subsidiaries. Ex. 24 at 8 (Ex. 7.3). Put another way, Shepard intended to acquire SAFC by using State Auto Mutual's own assets.

51. On August 20, 2003, Shepard filed a Schedule TO with the SEC using State Auto Financial Acquisition Corporation ("SAFAC") as the vehicle to make his tender offer for 8,000,000 shares of SAFC common stock at \$32.00 per share. A copy of the SAFAC Offer to Purchase is contained in DGI's Appendix as Exhibit 25.

52. In order to finance his proposed acquisition cost of \$256 million (excluding expenses), which was beyond his financial capability based upon his reported net worth, Shepard secured a second "highly confident" letter from Jefferies. A copy of Jefferies' August 20, 2003 "highly confident" letter is contained in DGI's Appendix as Exhibit 26.

53. In keeping with the approach of its first "highly confident" letter (*see* ¶ 50, *supra*), the second Jefferies letter also proposed to finance Shepard's acquisition of SAFC common stock from State Auto Mutual's own assets. Thus, Jefferies proposed that State Auto Mutual issue up to \$300 million of surplus notes with an effective yield of up to 10% and a two year maturity to finance Shepard's purchase of SAFC common stock. Ex. 26 at 1; Ex. 25 at 19.

Stephen J. Johnson
April 4, 2006
Page 14

54. On September 2, 2003, SAFC filed a Schedule 14D-9 with the SEC to report the position it was taking vis-à-vis SAFC's shareholders with respect to the Shepard tender offer. A copy of the SAFC 14D-9 is contained in DGI's Appendix as Exhibit 27.

55. In its Schedule 14D-9, SAFC recommended that the SAFC shareholders refrain from tendering any shares in response to the Shepard tender offer, *inter alia*, because:

a. State Auto Mutual's Board of Directors and Special Committee comprised of independent directors had unanimously decided to oppose and reject Shepard's tender offer (Ex. 27 at 17);

b. State Auto Mutual's Board of Directors and Special Committee had unanimously decided not to issue State Auto Mutual's surplus notes or to provide any other financing from State Auto Mutual's assets to finance Shepard's tender offer (Ex. 27 at 17); and

c. State Auto Mutual's Board of Directors and Special Committee had unanimously decided to vote State Auto Mutual's 67% ownership of shares of SAFC against approval of Shepard's tender offer at any SAFC shareholder meeting called to consider the same (Ex. 27 at 17-18).

56. As a result of the actions of State Auto Mutual's Board of Directors and Special Committee, SAFC's Board of Directors and Special Committee comprised of independent directors concluded that Shepard's tender offer was illusory because neither the tender offer's financing condition nor the tender offer's change of control condition could be satisfied. Ex. 27 at 17-18.

Stephen J. Johnson
April 4, 2006
Page 15

57. On May 10, 2004, after numerous extensions of his tender offer and numerous rejections of his tender offer by State Auto Mutual and SAFC, Shepard filed Amendment No. 9 to his TO announcing the termination of his tender offer as of May 7, 2004. A copy of the Shepard TO Amendment reporting this fact at page 6 thereof is contained in DGI's Appendix as Exhibit 28.

F. Shepard's Baseless SAFC Litigation

58. As he did with MIGI, Shepard engaged in baseless litigation with SAFC and State Auto Mutual in an effort to coerce them into supporting his illusory and unfinanceable tender offer.

59. Accordingly, on August 21, 2003, Shepard filed a complaint in the United States District Court for the Southern District of Ohio, Eastern Division, against SAFC, State Auto Mutual and SAFC's and State Auto Mutual's Boards of Directors. Ex. 25 at viii and 32. Shepard's complaint contended that SAFC's and State Auto Mutual's Boards had breached their fiduciary duties by failing to support his tender offer. Ex. 25 at viii and 32.

60. On October 20, 2003, Shepard filed an Amendment No. 5 to his TO announcing that, on October 16, 2003, the Ohio Court dismissed his complaint for lack of subject matter jurisdiction. A copy of the Shepard TO Amendment reporting this fact at page 2 thereof is contained in DGI's Appendix as Exhibit 29.

G. 21st Century Insurance Group

61. As a result of the January 17, 1994 Northridge, California earthquake and an adverse rollback order, the financial condition and operating results of 21st Century Insurance Group ("21st Century") were significantly adversely affected.

62. To deal with these adverse events, 21st Century entered into an Investment Agreement with American International Group, Inc. ("AIG") as of October 17, 1994 which provided for AIG to purchase 200,000 shares of 21st Century preferred stock convertible into 17,652,250 shares of common stock and 16,000,000 warrants to purchase 16,000,000 shares of common stock.

63. When combined with the 900,000 shares of 21st Century common stock already owned by AIG, if AIG converted the preferred stock and exercised the warrants, AIG would own approximately 40% of 21st Century common stock.

64. On May 8, 1995, Shepard filed a Schedule 13D with the SEC reporting that his company Union Auto, together with its wholly-owned subsidiary AULIC, owned 4,850,000 shares or 9.42% of 21st Century common stock. A copy of the Shepard 13D is contained in DGI's Appendix as Exhibit 30.

65. In his 13D, Shepard stated that Union Auto and AULIC had purchased their 21st Century shares "for investment purposes" and that he had no present plans to seek control of 21st Century. Ex. 30 at 3-4.

Stephen J. Johnson
April 4, 2006
Page 17

66. In addition, Shepard's 13D reported that he had been nominated for election to the 21st Century Board of Directors at its 1995 annual meeting of shareholders. Ex. 30 at 3.

67. Thereafter, Shepard was elected to the 21st Century Board.

68. By July 27, 1998, AIG had converted its preferred stock and exercised its warrants so that, when combined with its increased ownership of AIG common stock, AIG owned more than 50% of 21st Century common stock. A copy of AIG's Amendment No. 10 to its Schedule 13D reporting this development at page 2 thereof is contained in DGI's Appendix as Exhibit 31.

69. At the September 3, 1998 21st Century Board meeting, AIG and the non-AIG members of the Board agreed to reconstitute the Board giving AIG 7 of the 13 members. Shepard remained on the Board as one of the six non-AIG members. A copy of AIG's Amendment No. 14 to its Schedule 13D reporting this development at page 7 thereof is contained in DGI's Appendix as Exhibit 32.

70. On May 3, 1999, AIG filed an Amendment No. 20 to its Schedule 13D reporting that it owned 53,013,920 shares or 60.5% of 21st Century common stock. A copy of the AIG 13D Amendment is contained in DGI's Appendix as Exhibit 33.

71. On December 20, 1999, Shepard filed an Amendment No. 1 to his Schedule 13D reporting that his company American Union owned 5,505,100 shares or 6.3% of

Stephen J. Johnson
April 4, 2006
Page 18

21st Century common stock. A copy of the Shepard 13D Amendment is contained in DGI's Appendix as Exhibit 34.

72. Despite the fact that AIG's 60% ownership of 21st Century dwarfed his 6% ownership, Shepard decided to challenge AIG's management by urging it "to explore extraordinary corporate actions such as a merger, reorganization or liquidation of the Company." Ex. 34 at 8.

73. Shortly thereafter, Shepard issued a press release offering to serve as the CEO of 21st Century. A copy of Shepard's January 25, 2000 press release is contained in DGI's Appendix as Exhibit 35.

74. Instead of accepting Shepard's offer to be President, 21st Century's Board elected Bruce Marlow ("Marlow") President. Marlow had been President, Independent Agency Markets, and Senior Vice President of Allstate Corporation and before that Chief Operating Officer of Progressive Corporation. A copy of the 21st Century Form 8-K reporting this development is contained in DGI's Appendix as Exhibit 36.

75. Shepard's press release also reported that he had submitted a proposal for inclusion in 21st Century's 2000 annual proxy for 21st Century to retain an investment banker unconnected to AIG and 21st Century to explore strategic alternatives, including the possible sale or merger of 21st Century. Ex. 35 at 2.

Stephen J. Johnson
April 4, 2006
Page 19

76. On April 17, 2000, 21st Century filed its annual proxy statement with the SEC. A copy of the 21st Century 2000 annual proxy is contained in DGI's Appendix as Exhibit 37.

77. In its 2000 annual proxy, the 21st Century Board recommended that shareholders vote against Shepard's proposal to retain an investment banker to explore strategic alternatives, including the possible sale or merger of 21st Century, stating:

The Board has carefully considered the foregoing proposal in light of the fact that the Company is being run profitably following a strategy agreed to by its majority shareholder and its stock has a superior valuation relative to other companies in the personal lines business. In that context, the Company believes that it is not appropriate or beneficial for it to initiate the expensive and disruptive process of engaging an investment banking firm, thereby creating uncertainty in the market, simply because certain investors are not satisfied with the price of the stock.

Unfortunately, proposals of this type merely serve to take the Board's time and attention and the Company's resources away from what we all agree to be the primary goal: improving the Company's earnings and enhancing shareholder value.

Ex. 37 at 21.

78. On April 21, 2004, 21st Century filed its annual proxy statement with the SEC. A copy of the 21st Century 2004 annual proxy is contained in DGI's Appendix as Exhibit 38.

79. As reported in its 2004 annual proxy, the 21st Century Nominating and Corporate Governance Committee decided not to renominate Shepard for election to the Board.

Ex. 38 at 4 (Election of Directors).

Stephen J. Johnson
April 4, 2006
Page 20

80. Accordingly, Shepard's tenure as a director of 21st Century ended at the May 26, 2004 annual meeting.

H. Conclusion

For the foregoing reasons, it is imperative that the Department prevent Shepard from repeating his prior inimical tactics to the detriment of DGI. Accordingly, DGI respectfully requests that the Department should, at a minimum, prohibit Shepard from acquiring any additional shares of DGI common stock until he has filed a sworn Form A with the Department.⁶

Very truly yours,



David H. Pittinsky

DHP/gpa
Enclosures

cc: Frederick W. Dreher, Esquire
Donald H. Nikolaus

⁶ See n. 1 at p. 2, *supra*.

DuaneMorris*

FIRM and AFFILIATE OFFICES

Robert L. Pratter
DIRECT DIAL: 215 979 1173
PERSONAL FAX: 215 754 4845
E-MAIL: rlpratter@duanemorris.com

www.duanemorris.com

April 9, 2013

Via E-Mail, Original to Follow by U.S. Mail

Jodi Frantz, Esquire
Commonwealth of Pennsylvania Insurance Department
1321 Strawberry Square
Harrisburg PA 17120

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

NEW YORK
LONDON
SINGAPORE
PHILADELPHIA
CHICAGO
WASHINGTON, DC
SAN FRANCISCO
PALO ALTO
SAN DIEGO
BOSTON
HOUSTON
LOS ANGELES
HANOI
HO CHI MINH CITY
ATLANTA
BALTIMORE
WILMINGTON
MIAMI
PITTSBURGH
NEWARK
LAS VEGAS
CHERRY HILL
BOCA RATON
LAKE TAHOE

MEXICO CITY
ALLIANCE WITH
MIRANDA & ESTAVILLO

Dear Ms. Frantz:

We write to you as counsel to Atlantic States Insurance Company ("Atlantic States") and its parent corporation, Donegal Group Inc. ("DGI") with respect to the Form A Filing. As set forth below, based on our initial review of the Form A Filing, which is ongoing, we believe that the Form A Filing does not meet the requirements of applicable Pennsylvania law (40 P.S. Section 991.1401 et seq.,) and the regulations adopted thereunder by the Pennsylvania Insurance Department (31 Pa. Code Chapter 25).

40 P.S. Section 991.1402 (a)(1) requires, among other things, that Mr. Shepard file the Form A Filing ". . . with the Department **and has sent to such insurer a statement containing the information required by this section** and such offer, request, invitation, agreement or acquisition has been approved by the Department in the manner hereinafter prescribed." (Emphasis added). Mr. Shepard is in clear violation of this statutory provision.

40 P.S. Section 991.1402(b)(3) specifies that the Form A Filing contain ". . . fully audited financial information as to the earnings and financial condition of each acquiring party for the preceding five (5) fiscal years . . . and similar unaudited information as of a date not earlier than ninety (90) days prior to the filing of the statement."

We have attached for your information a true and correct copy of the relevant portion of the Form A Filing that Mr. Shepard sent to DGI. (Attachment "A"). As you will see, Mr. Shepard omitted Exhibits "H-M" referred to as "Mr. Shepard's financial statements" from the

DUANE MORRIS LLP

30 SOUTH 17TH STREET PHILADELPHIA, PA 19103-4196

PHONE: +1 215 979 1000 FAX: +1 215 979 1020

Jodi Frantz, Esquire
April 9, 2013
Page 2

Form A Filing sent to DGI. As stated above, 40 P.S. Section 991.1402(a)(1) expressly requires that Mr. Shepard send DGI and Atlantic States the **complete** Form A Filing and all exhibits, including Mr. Shepard's financial statements. The omission of this information seriously and adversely limits DGI's and Atlantic States' ability to review the Form A Filing and to protect the interests of the policyholders of Atlantic States. The self-selective information that Mr. Shepard sent to DGI does not comply with this requirement and, therefore, his Form A Filing is incomplete and defective on its face.

Attachment "A" further states that "Mr. Shepard's financial statements will be provided to DGI upon its entry into an appropriate confidentiality and non-disclosure agreement." Moreover, counsel to Mr. Shepard in his letter dated March 19, 2013 to Commissioner Consedine purported to request confidential treatment from public inspection of Exhibits "H-M" pursuant to 31 Pa. Code Section 25.12(c). These attempts to shield Mr. Shepard's earnings and financial condition from DGI and Atlantic States and the policyholders of Atlantic States fail for the following reasons:

- First, as previously stated, Pennsylvania law requires that the insurer in question receive the **complete** Form A Filing, not just the portions that Mr. Shepard selectively chooses to give it. Mr. Shepard does not have the unilateral right to withhold these documents from DGI and Atlantic States.
- Second, a request for confidentiality pursuant to 31 Pa. Code Section 25.12 relates only to what must be available for "public inspection". Regulation 25.12 does not provide a basis for withholding or conditioning information that DGI and Atlantic States as the subjects of the Form A Filing have the express legal right to receive as part of the Form A Filing, review, have an opportunity to comment upon and contest in the Form A Filing review process.
- Third, the provision in 31 Pa. Code Section 25.12(c) that allows the Department (as opposed to Mr. Shepard unilaterally) to grant confidentiality concerning public disclosure of the personal financial statements of non-publicly held ultimate controlling persons does not apply to Mr. Shepard or this Form A Filing. To the contrary, this provision addresses the situation where a corporate or other entity is the filer and the ultimate controlling person of the filer wishes to request confidential treatment from public inspection of his or her personal financial statements. Mr. Shepard is the filer and he cannot utilize the provisions of Section 25.12(c) to shield from scrutiny his very own financial statements in deprivation of the constitutional and statutory rights of DGI and Atlantic States as the subjects of the Form A Filing.
- Fourth, 31 Pa. Code Section 25.12(c) requires that a request for confidentiality from public inspection "state the basis upon which the assertion of confidentiality is premised." The request from Mr. Shepard's counsel ignores this requirement.

Duane Morris

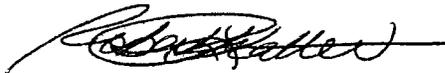
Jodi Frantz, Esquire
April 9, 2013
Page 3

The standards set forth for approval of the Form A Filing include, among other things, that the Department not find that "the financial condition of any acquiring party is such as might jeopardize the financial stability of the insurer or prejudice the interests of its policyholders." 40 P.S. Section 991.1402(f)(1)(iii). As the entities entitled to review the Form A Filing and participate as parties in its consideration by the Department, DGI and Atlantic States have the statutory and constitutional rights to receive Exhibits "H-M" without pre-condition so that they have the fair opportunity to review Mr. Shepard's financial condition and address the requirements of 40 P.S. Section 991.1402(f)(1)(iii) and the other requirements of 40 P.S. Section 991.1401 et seq. in their comments and at a public hearing. So, too, Atlantic States policyholders, the stockholders of DGI and the public have the same constitutional and statutory rights and the request for confidentiality with respect to the public should also be denied.

In conclusion, for the reasons set forth in this letter, DGI and Atlantic States request that the Department immediately order Mr. Shepard to send true and correct copies of Exhibits "H-M" to them. DGI and Atlantic States further request that Mr. Shepard's request for confidentiality from public disclosure of these exhibits also be denied.

DGI and Atlantic States hereby also respectfully reserve the opportunity to submit additional comments and take such other and further action as provided by law to protect their interests and the interests of Atlantic States policyholders and the insurance buying public. Among other things, DGI and Atlantic States believe the Form A Filing contains numerous erroneous and misleading statements and fails to meet the standards for approval of the filing. DGI and Atlantic States will advise the Department of these deficiencies in the Form A Filing under separate cover.

Sincerely,



Robert L. Pratter

RLP/lmb
Enclosures

cc: Stephen J. Johnson, Deputy Insurance Commissioner
Robert E. Brackbill, Jr.
J. Victor Peterson, Esq.

ATTACHMENT "A"

EXHIBITS H - M

Omitted.

Mr. Shepard's financial statements will be provided to DGI upon its entry into an appropriate confidentiality and non-disclosure agreement.