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Corporate & Financial Regulation

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Pennsylvania
Insurance Department

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July 8, 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

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:

In recent days, Tracy Shepard ("Tracy"), Gregory Mark Shepard's ("Shepard") brother, has sent Donegal Group Inc. ("DGI") an unsolicited letter informing DGI of a June 24, 2013 Term Sheet proposal (the "Term Sheet") that Shepard sent to Tracy, a copy of which is attached as Exhibit A. Although Tracy has informed DGI that he has no interest in his brother's Term Sheet, we believe that the Term Sheet is relevant to the Pennsylvania Insurance Department's (the "Department") review of the Form A, particularly in light of the Department's letter dated June 19, 2013 to J. Victor Peterson, Esquire, Shepard's counsel, seeking further information concerning Shepard's current tender offer and his future plans with respect to Atlantic States Insurance Company and DGI.

The Term Sheet seeks up to \$60,000,000 in financing for a potential new Shepard tender offer for 3,400,000 Class B Shares to be priced at between \$22 and \$28 – not \$30 – per share. In addition, to secure the financing, Shepard proposes to give the lender a first lien position on all of the 3,602,900 DGI Class A Shares he already owns, all of the 397,100 Class B Shares he already owns and all of the Class B Shares he would acquire pursuant to his newly contemplated tender offer. The Term Sheet also clearly proposes a plan to obtain control of DGI because:

- Condition 2 of the Term Sheet requires that the addition of the Class B Shares tendered to Shepard and the Class A and B Shares already owned by Shepard would "result in Shepard owning a majority of the combined Class A and Class B votes outstanding"; and

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- Condition 4 of the Term Sheet requires DGI, Donegal Mutual Insurance Company and all of their insurance and banking subsidiaries to place sufficient Shepard nominees on their boards of directors so that he has majority control of all such boards.

DGI respectfully submits that Shepard has not been completely candid with the Department, the insurance regulators in Iowa, Maryland, Michigan, Wisconsin and Virginia, the Federal Reserve Bank of Philadelphia, DGI shareholders and the public. In particular, DGI believes that the Term Sheet substantiates DGI's contention that Shepard has broader intentions beyond his pending tender offer, that he is seeking outside financing to effectuate his potential new and more extensive tender offer for control of DGI but at a lower price per share, and, most importantly, despite his contrary denials to the Department and other insurance regulators, that Shepard has continuing and current plans to attempt to merge or sell DGI, with or to other insurance companies.

Based upon the foregoing, DGI believes that Shepard lacks the requisite competence, experience, integrity and financial ability for the Department's approval of his Form A.

Respectfully submitted,



Robert L. Pratter

RLP/lmb
Enclosure

cc: Robert E. Brackbill, Jr.
Jodi Frantz, Esquire
J. Victor Peterson, Esquire

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PROJECT 250**Summary of Proposed Terms – 06/24/13****Loan:**

Borrower Gregory M. Shepard (the "Borrower").

Lender..... Tracy M. Shepard (the "Lender").

Amount Up to \$60,000,000.

Use of Proceeds The proceeds plus \$35,000,000 to \$45,000,000 from Borrower will be used to fund an amicable Amended Tender Offer by Borrower for 3,400,000 shares of Series B common stock, par value \$0.01 per share (the "Class B Shares") of Donegal Group Inc., a Delaware corporation ("DGI") at a price of between \$22.00 to \$28.00 per Class B Share..

Security 1st lien position on: 1. Borrower's 3,602,900 shares of Series A common stock, par value \$0.01 per share (the "Class A Shares") of DGI; 2. Borrower's 397,100 Class B Shares; and 3. All of the Class B Shares acquired by the Borrower in the Tender Offer.

Lender will have the right to begin selling the Class A Shares or the Class B Shares if the price of the Class A stock falls below \$10.00 per share or the Class B Stock falls below \$12.00 per share.

Interest Rate % per annum, payable quarterly in cash.

Term One year.

Conditions.....

- (i) Class A Shares and Class B Shares of DGI must be saleable (in Lender's sole discretion) in the event of a default,
- (ii) Class B shareholders validly tendering and not withdrawing before the expiration of the Borrower's Tender Offer enough shares of Class B stock that when added to the Class A and Class B Shares already owned by Borrower result in Borrower owning a majority of the combined Class A and Class B votes outstanding or issuable under DGI's stock option plans.
- (iii) Borrower receiving all insurance and bank regulatory approvals necessary to acquire control of DGI, its subsidiaries, and its affiliates including Donegal Mutual Insurance Company.
- (iv) Borrower receiving approval for his board nominees to represent a majority of the board seats of DGI, its subsidiaries, and its affiliates including Donegal Mutual Insurance Company, Southern Mutual Insurance Company, Donegal Financial Services Corporation and Union Community Bank.
- (v) No additional shares being issued by DGI, or rights, warrants or options to acquire shares, and no series of stock created with voting or other preferences superior to the Class A Shares and the Class B Shares.

Commitment Fee Lender will receive a \$10.00 fee if DGI accepts this offer on an amicable basis on or before September 30, 2013, unless extended by Borrower.

Closing Fee..... Lender will receive a \$20.00 fee when the transaction closes.

Indemnification..... Offeror shall indemnify Lender.

Law Governing law will be Illinois.

The proposed terms and conditions outlined in this term sheet are provided for discussion purposes only and do not constitute an offer, agreement, or commitment. This term sheet is intended as an outline only and does not purport to summarize all the terms, conditions, covenants, representations, warranties or other provisions which would be contained in definitive legal documentation of the transaction contemplated herein.

Accepted and agreed to:

By: _____

Gregory M. Shepard

By: _____

Tracy M. Shepard