

In the matter of,

FINAL DECISION

The Conversion of Sheboygan Falls Mutual Insurance Company;

Petitioner.

Case No. 08-C31480

FINAL DECISION

I have reviewed the Exhibits, including the Appraisal Committee Report, the Financial Examination Report and the Memorandum prepared by OCI Advanced Insurance Financial Examiner, Mr. Vande Hey. I have also reviewed the amended Articles, Bylaws, the Form D filing and the Plan of Conversion from a mutual insurance company to a stock insurance company. Finally, I have reviewed the Proposed Decision by Mr. Ruch, his Findings of Fact, Conclusions of Law and his Discussion.

Based upon the foregoing, I adopt the Hearing Examiner's Proposed Decision, including the Findings of Fact and Conclusions of Law, that is attached to this Final Decision and that was served on the Petitioners with an opportunity for submitting written objections. I have received written notice dated November 10, 2008, from the Petitioner stating its decision to waive its right to object to the Proposed Decision and Order.

Based upon the above, I hereby order that:

(1) The Petitioners' request for approval of the plan for the conversion from a mutual insurance company to a stock insurance company is granted.

(2) It is further ordered that the Form D filing is approved.

NOTICE OF APPEAL INFORMATION

(Notice of rights for rehearing and judicial review, the times allowed for each, and the identification

of the party to be named as respondent)

The following notice is served on you as part of the Final Decision:

1. Rehearing.

Any person aggrieved by this Final Decision may petition for a rehearing within 20 days after the service of this Final Decision, as provided in s. 227.49, Wis. Stat. A petition for rehearing is not a prerequisite for appeal directly to circuit court through a petition for judicial review.

A petition for rehearing must be filed with the Commissioner at the address below.

2. Judicial Review.

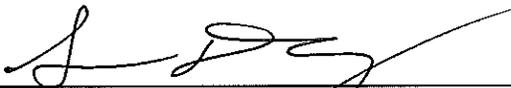
Any person aggrieved by this Final Decision has a right to petition for judicial review of this Final Decision as provided in s. 227.53, Wis. Stat. The petition must be filed in circuit court within 30 days after service of this Final Decision if there has been no petition for rehearing, or within 30 days after service of the order finally disposing of the petition for rehearing, or within 30 days after the final disposition by operation of law of any petition for rehearing.

A petition for judicial review must be served on, and name as the Respondent:

Commissioner of Insurance, Respondent
Office of the Commissioner of Insurance
P. O. Box 7873
Madison, Wisconsin 53707-7873

A copy of the relevant statutory provisions is attached.

Dated at Madison, Wisconsin, this 11 day of November, 2008.



Sean Dilweg
Commissioner of Insurance

WISCONSIN STATUTES

At all times material, the relevant parts of s. 227.49, Wis. Stat., read as follows:

227.49 PETITIONS FOR REHEARING IN CONTESTED CASES

(1) A petition for rehearing shall not be a prerequisite for appeal or review. Any person aggrieved by a final order may, within 20 days after service of the order, file a written petition for rehearing which shall specify in detail the grounds for the relief sought and supporting authorities. An agency may order a rehearing on its own motion within 20 days after service of a final order. . . .

(2) The filing of a petition for rehearing shall not suspend or delay the effective date of the order, and the order shall take effect on the date fixed by the agency and shall continue in effect unless the petition is granted or until the order is superseded, modified, or set aside as provided by law.

(3) Rehearing will be granted only on the basis of:

(a) Some material error of law.

(b) Some material error of fact.

(c) The discovery of new evidence sufficiently strong to reverse or modify the order, and which could not have been previously discovered by due diligence.

(4) Copies of petitions for rehearing shall be served on all parties of record. Parties may file replies to the petition.

(5) The agency may order a rehearing or enter an order with reference to the petition without a hearing, and shall dispose of the petition within 30 days after it is filed. If the agency does not enter an order disposing of the petition within the 30-day period, the petition shall be deemed to have been denied as of the expiration of the 30-day period.

(6) Upon granting a rehearing, the agency shall set the matter for further proceedings as soon as practicable. . . .

At all times material, the relevant part of s. 227.52, Wis. Stat., read as follows:

227.52 JUDICIAL REVIEW; DECISIONS REVIEWABLE.

Administrative decisions which adversely affect the substantial interests of any person, whether by action or inaction, whether affirmative or negative in form, are subject to review as provided in this chapter. . . .

At all times material, the relevant parts of s. 227.53, Wis. Stat., read as follows:

227.53 PARTIES AND PROCEEDINGS FOR REVIEW. (1)

Except as otherwise specifically provided by law, any person aggrieved by a decision specified in s. 227.52 shall be entitled to judicial review thereof as provided in this chapter.

(a) 1. Proceedings for review shall be instituted by serving a petition therefore personally or by certified mail upon the agency or one of its officials, and filing the petition in the office of the clerk of the circuit court for the county where the judicial review proceedings are to be held. . . .

2. Unless a rehearing is requested under s. 227.49, petitions for review under this paragraph shall be served and filed within 30 days after the service of the decision of the agency upon all parties under s. 227.48. If a rehearing is requested under s. 227.49, any party desiring judicial review shall serve and file a petition for review within 30 days after service of the order finally disposing of the application for rehearing, or within 30 days after the final disposition by operation of law of any such application for rehearing. The 30-day period for serving and filing a petition under this paragraph commences on the day after personal service or mailing of the decision by the agency.

. . .

(b) The petition shall state the nature of the petitioner's interest, the facts showing that petitioner is a person aggrieved by the decision, and the grounds specified in s. 227.57 upon which petitioner contends that the decision should be reversed or modified. . . .

. . .

(c) A copy of the petition shall be served personally or by certified mail or, when service is timely admitted in writing, by first class mail, not later than 30 days after the institution of the proceeding, upon each party who appeared before the agency in the proceeding in which the decision sought to be reviewed was made or upon the party's attorney of record. . . .

(d) The agency . . . and all parties to the proceeding before it, shall have the right to participate in the proceedings for review. . .

In the matter of,

PROPOSED DECISION

The Conversion of Sheboygan Falls Mutual Insurance Company;

Petitioner.

Case No. **08-C31480**

Guenther Ruch, Hearing Examiner, presiding

APPEARANCES

For the Office of the
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Timothy J. Vande Hey
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Counsel for the Office
Julie E. Walsh, Attorney

For the Petitioner:

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30 South 17th Street
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PROCEDURAL HISTORY

Sheboygan Falls Mutual Insurance Company (SFMIC), organized in May 1899, as The Village of Sheboygan Falls Mutual Fire Insurance Company commenced business on August 18, 1899. In 1934, the present name of the company was adopted. SFMIC is a mutual fire and casualty insurer licensed to write business only in Wisconsin. The company currently operates on a mutual plan, issuing nonassessable policies, with business acquired through 671 independent agents in 146 agencies.

On December 27, 2006, the company entered into an affiliation agreement with Donegal Mutual Insurance Company (Donegal Mutual), a property and casualty insurer headquartered in Marietta, Pennsylvania. The Office of the Commissioner of Insurance (OCI) approved the affiliation agreement in June 2007. Donegal Mutual acquired control of the company on June 7, 2007.

Between October 2007 and April 2008, the Board and an independent Demutualization Committee met separately to analyze the possible benefits to SFMIC and its policyholders of a conversion. On April 30, 2008, the SFMIC Board received the demutualization committee's recommendation that the proposed conversion would be in the best interest of the company and its policyholders. The Board affirmed the recommendation

and adopted a conversion resolution to the effect that the proposed conversion would be in the best interests of the policyholders. The conversion resolution was filed with the OCI on May 5, 2008.

Pursuant to s. 611.76 (3) (c), Wis. Stats., the Commissioner of Insurance (Commissioner) appointed a three-member Appraisal Committee to review and advise the Commissioner on the value of SFMIC as of the date of conversion. The Appraisal Committee members included: Mr. Randy Blumer, Executive Director of the Wisconsin Insurance Security Fund; Mr. Brian Hogan, Vice President & Chief Financial Officer of the National Guardian Life Insurance Co; and Richard Keintz, Vice President for Business and Finance for Edgewood College, to serve as members of the Appraisal Committee. On July 31, 2008, StoneRidge Advisors, LLC. (StoneRidge), an independent investment banking firm, was engaged to assist the Appraisal Committee in the valuation of SFMIC. The Appraisal Committee met 6 times between June 16, 2008 and September 30, 2008. With the assistance of StoneRidge, the Appraisal Committee prepared a report to the Commissioner dated October 10, 2008, including the Committee's determination that the value of SFMIC as of the date of conversion is \$7,200,000.00. (Ex. 14)

On October 13, 2008, StoneRidge issued a fairness opinion stating that based upon and subject to the areas identified in its opinion letter, the aggregate consideration to be received by the policyholders of SFMIC, as a group, in exchange for their aggregate ownership interests, is fair, from a financial point of view, to such policyholders, as a group. (Ex. 14.2)

On October 14, 2008, the Demutualization Committee reviewed the draft conversion plan, the Articles and Bylaw changes, the valuation determination of the OCI Appraisal Committee, the valuation material and fairness opinion prepared by StoneRidge and such other materials it considered to be relevant and recommended that the Board of SFMIC approve and adopt the plan of conversion. Also on October 14, 2008, the Board of SFMIC met and approved the changes to the Articles and Bylaws, and the plan of conversion. Therefore, SFMIC made the necessary filings with the OCI to complete an application for approval of the conversion under s. 611.76 (5), Wis. Stats., including among other items a Form D filing.

Pursuant to a Notice of Hearing dated October 13, 2008, a hearing was held at 1:00 p.m. on November 7, 2008, before Guenther Ruch, duly appointed Hearing Examiner, at the offices of the OCI. The basis of the hearing was to determine whether the Petitioners' application for approval of the plan of conversion in accordance with s. 611.76, Wis. Stats., should be granted.

A class 1 contested case hearing was held on November 7, 2008 and recorded by a court reporter. The record includes the hearing transcript and Exhibits 1-22.

PROPOSED FINDINGS OF FACT

(1) Sheboygan Falls Mutual Insurance Company, (the Petitioner), 511 Water Street, Sheboygan Falls, Wisconsin, is a mutual insurance company domiciled in the State of Wisconsin and subject to the jurisdiction and control of the Commissioner .

(2) Donegal Mutual Insurance Company, (Donegal Mutual), 1195 River Road, Marietta, Pennsylvania, is a mutual fire insurance company domiciled in the Commonwealth of Pennsylvania and licensed in the State of Wisconsin subject to the jurisdiction and control of the Commissioner. Donegal Mutual is the ultimate controlling entity of the Petitioner.

(3) Donegal Group, Inc., (Donegal Group), 1195 River Road, Marietta, Pennsylvania is a publicly traded insurance holding company domiciled in the State of Delaware.

(4) Effective June 7, 2007, a contribution note was executed between the Petitioner and Donegal Mutual for \$3,500,000 (Contribution Note).

(5) The Petitioner filed with the Commissioner an application for a plan of conversion to a stock insurance company (Plan) on May 5, 2008.

(6) The Petitioner fulfilled the filing requirements of s. 611.76 (3) (a), Wis. Stats.

(7) The Plan of Conversion was filed pursuant to s. 611.76 (4m), Wis. Stats., on the basis that grounds exist under s. 645.41 (2) or (4), Wis. Stats., for rehabilitation or liquidation

of a domestic mutual insurer, or are reasonably expected to exist within one year, unless the board of directors adopts a plan of conversion as submitted for consideration by the Commissioner. The Commissioner determined that SFMIC's failure to consummate a plan of conversion would put it at risk for a disaffiliation with Donegal Mutual, and a disaffiliation at this point in time may reasonably be expected to lead to a financially hazardous condition within a year of a potential disaffiliation.

(8) An examination of SFMIC was performed by the Commissioner to determine SFMIC's financial condition and whether it is operated in accordance with the law pursuant to s. 611.76 (3) (b), Wis. Stats. The examination report was officially adopted on October 20, 2008. No adverse findings affecting the conversion to proceed were discovered

(9) An Appraisal Committee, consisting of three qualified and disinterested persons with differing kinds of training were appointed by the Commissioner to determine the value of the corporation as of the date of conversion in compliance with s. 611.76 (3) (c), Wis. Stats. (Ex. 4 and 14.) The Appraisal Committee considered the assets and liabilities of the corporation, adjusting the liabilities to take into account the amounts of any reserves in excess of or below realistic estimates, the value of the marketing organization, the value of goodwill, the going-concern value, and other factors having influence on the value of the corporation. The Appraisal Committee determined the value of SFMIC to be \$7,200,000.00.

(10) The Petitioner completed an application for approval of the conversion in compliance with S. 611.76 (5), Wis. Stats.

(11) The Petitioner provided to OCI the methodology used to identify policyholders eligible to receive an equitable share of the value of the Company under s. 611.76 (4m) (a), Wis. Stats., and policyholders entitled to receive notice pursuant to s. 611.76 (6) (a), Wis. Stats.

(12) The Petitioner provided an affidavit of mailing that demonstrated compliance with s. 611.76 (6), Wis. Stats.

(13) The conversion expenses have been properly filed and approved by the OCI pursuant to s. 611.76 (10), Wis. Stats. Conversion expenses in the aggregate amount of \$355,653.77 are eligible to be offset against the value of the Company prior to the distribution of equitable shares to eligible policyholders.

(14) Effective on the date of conversion, Sheboygan Falls Mutual Insurance Company name will be changed to Sheboygan Falls Insurance Company (SFIC), and the new stock insurance corporation will be able to satisfy the requirements for the issuance of an amended license to write the lines of insurance for which it is presently licensed.

(15) Effective on or about December 1, 2008, Donegal Group will purchase the Contribution Note from Donegal Mutual for the principal amount thereof and the accrued but unpaid interest thereon.

(16) After the date of conversion, Donegal Group will exchange the Conversion Note and the accrued but unpaid interest thereon for the issuance to Donegal Group of one share of common stock, par value \$1.00 per share, of the authorized capital stock of the Petitioner for each \$1.00 of the principal amount of, and accrued interest on, the Contribution Note. Thereafter, Donegal Group will return the Contribution Note to the Petitioner marked "cancelled". These actions are also described in Petitioner's filing on Form D.

(17) Donegal Group will make an additional capital contribution to the Petitioner so that the Petitioner's surplus shall be no less than \$10,500,000 after distribution of cash equal to the net value of the Company to the eligible policyholders.

PROPOSED CONCLUSION OF LAW

(18) The application is authorized under, and governed by ch. 611 and 617, Wis. Stats., and ch. Ins 40, Wis. Adm. Code. The application has been considered under s. 611.76 (4m), Wis. Stats., and the requirements of s. 611.76, Wis. Stats., as far as they are applicable, are met.

(19) The plan of conversion does not violate the law and is not contrary to the interests of the policyholders or the public. The plan of conversion is not detrimental to the safety and soundness of the insurer or the contractual rights and reasonable expectations of the persons who are policyholders, or the reasonable expectations of the public.

DISCUSSION

I approve the plan of conversion because I am convinced that it is in the public interest. The Commissioner, under the statutes governing this application, is given substantial discretion to determine whether the proposed plan of conversion is contrary to the public interest.

I received the oral and written testimony from Mr. Wilcox, President of Sheboygan Falls Mutual Insurance Company, who affirmed the benefits to the company and policyholders of the Plan as well as the potentially significant negative impact if the Plan fails to receive approval. He testified that of the 11,000 proxies distributed to policyholders, as of November 6, 2008, 1,793 valid proxies have been returned and of those 1,670 or approximately 93%, indicate support for the conversion.

I received the oral testimony of Ms. Connie O'Connell, counsel to the Demutualization Committee. She described the diligent review process the Committee took and its independent determination that the Plan would be in the best interest of the policyholders. The Demutualization Committee unanimously recommended to the full Board of Directors for SFMIC that they approve the Plan.

I received the oral and written testimony of Mr. Nikolaus, President and Chief Executive Officer of Donegal Mutual Insurance Company, who affirmed Donegal's investment in SFMIC, indicating that SFIC will have the benefit of improved access to capital if the Plan is approved and the commitment to improve the infrastructure of the now existing SFMIC. One such example that Mr. Nikolaus noted was the intent that a new computer system may be in place as early as mid-December. He further testified to the commitment

Donegal Mutual has to the policyholders and the State of Wisconsin. Mr. Nikolaus testified that it is the intent of Donegal to maintain and grow the presence of SFIC, if the Plan is approved, with hope for growth in market share and in the physical presence within the State.

The OCI's Advanced Insurance Financial Examiner, Mr. Timothy Vande Hey, was assigned by the OCI to monitor the proposed transaction and advise the OCI of his determination regarding the transaction. Mr. Vande Hey prepared a memorandum summarizing his review and findings dated November 5, 2008. (Ex. 20.) In Mr. Vande Hey's memorandum, Mr. Vande Hey reviewed all documents filed by the Petitioner including the Plan, amended Articles and Bylaws, the financial examination report, the financial projections and the Form D filing as well as providing staff support to the Appraisal Committee through out its deliberations. In his memorandum, Mr. Vande Hey concluded with a recommendation to the Commissioner that the Plan, as proposed, be approved. He included a brief discussion of the potential negative impact on SFMIC if the Plan fails to be approved including the affect of possible disaffiliation by Donegal Mutual. Mr. Vande Hey recommended the Plan be approved as nothing in his review indicated that the Plan would be contrary to the law or contrary to the interests of the policyholders or the public.

Finally, I have reviewed of all the Exhibits including the report of the Appraisal Committee and supporting Fairness Opinion. It is clear that all statutory filing requirements have been met. After careful review of the Appraisal Committee Report and supporting Fairness Opinion of StoneRidge, I am convinced that the full, fair and reasonable value of SFMIC was properly determined and the plan of conversion complies with the statutory requirements. The plan of conversion, along with the Form D filing, assures adequate surplus for SFMIC to meet its obligations going forward.

Based upon the Findings of Fact, Conclusions of Law, Exhibits and Testimony provided in this matter I hereby approve the plan of conversion.

PROPOSED ORDER

Proposed Decision
Case No. 08-C31480

NOW, THEREFORE, based upon the findings of fact and conclusion of law, I hereby recommend that:

(20) The transactions described in Petitioner's Form D filing and Petitioners' request for approval of the plan of conversion be approved.

Dated at Madison, Wisconsin, this 10th day of November 2008.



Guenther Ruch, Administrator
Division of Regulation and Enforcement
Hearing Examiner