

DONEGAL GROUP INC
Form DEF 14A
March 17, 2008

Table of Contents

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
SCHEDULE 14A**

Proxy Statement Pursuant to Section 14(a) of the Securities
Exchange Act of 1934 (Amendment No.)

Filed by the Registrant

Filed by a Party other than the Registrant

Check the appropriate box:

- Preliminary Proxy Statement
- Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**
- Definitive Proxy Statement
- Definitive Additional Materials
- Soliciting Material Pursuant to §240.14a-12

Donegal Group, Inc.

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

- No fee required.
- Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.

(1) Title of each class of securities to which transaction applies:

(2) Aggregate number of securities to which transaction applies:

(3) Per unit or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):

(4) Proposed maximum aggregate value of transaction:

(5) Total fee paid:

- o Fee paid previously with preliminary materials.
- o Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.

(1) Amount Previously Paid:

(2) Form, Schedule or Registration Statement No.:

(3) Filing Party:

(4) Date Filed:

Table of Contents

NOTICE OF ANNUAL MEETING OF STOCKHOLDERS
To Be Held April 17, 2008

To the Stockholders of
DONEGAL GROUP INC.:

We will hold our annual meeting of stockholders at 10:00 a.m., local time, on April 17, 2008, at our offices, 1195 River Road, Marietta, Pennsylvania 17547. At our annual meeting, our stockholders will act on the following matters:

1. Election of three Class A directors, each for a term of three years and until his or her respective successor has been elected;
2. Ratification of our audit committee's selection of KPMG LLP as our independent registered public accounting firm for 2008; and
3. Any other matter that properly comes before our annual meeting.

We have fixed the close of business on February 25, 2008 as the record date for the determination of our stockholders who are entitled to notice of, and to vote at, our annual meeting and any adjournment or postponement of our annual meeting.

We are mailing our 2007 annual report, which is not part of our proxy soliciting material, to stockholders of record together with this notice.

It is important that you vote your shares at our annual meeting. Please submit your proxy, whether or not you expect to attend our annual meeting in person. If you attend our annual meeting and wish to vote in person, you may withdraw your proxy and vote in person.

By order of our board of directors,

Donald H. Nikolaus,
President and Chief Executive Officer

March 17, 2008
Marietta, Pennsylvania

**Important Notice Regarding the Availability of Proxy Materials for Our
Stockholders Meeting to Be Held on April 17, 2008**

The accompanying proxy statement and our 2007 annual report to stockholders are available at www.donegalgroup.com.

Table of Contents**DONEGAL GROUP INC.****PROXY STATEMENT**

This proxy statement contains information relating to the annual meeting of stockholders of Donegal Group Inc. to be held on Thursday, April 17, 2008, beginning at 10:00 a.m., at our offices, 1195 River Road, Marietta, Pennsylvania 17547 and at any adjournment or postponement of our annual meeting. This proxy statement and the accompanying proxy card are first being mailed to stockholders on or about March 17, 2008. Unless the context indicates otherwise, all references in this proxy statement to we, us, our or the Company mean Donegal Group Inc. and its insurance subsidiaries; all references to Donegal Mutual refer to Donegal Mutual Insurance Company; all references to Atlantic States refer to Atlantic States Insurance Company; all references to Southern refer to Southern Insurance Company of Virginia; all references to Le Mars refer to Le Mars Insurance Company and all references to Peninsula refer to the Peninsula Insurance Group.

CONTENTS

	Page
<u>OUR ANNUAL MEETING</u>	1
<u>What are the purposes of our annual meeting?</u>	1
<u>What should I do now?</u>	1
<u>VOTING</u>	1
<u>How do I vote my shares?</u>	1
<u>Who is entitled to vote at our annual meeting?</u>	2
<u>What are the voting rights of our stockholders?</u>	2
<u>Who can attend our annual meeting?</u>	2
<u>What constitutes a quorum?</u>	2
<u>How do I vote in person?</u>	2
<u>How do I vote if my shares are held in street name?</u>	3
<u>How do I vote my 401(k) plan shares?</u>	3
<u>May I change my vote after I have voted?</u>	3
<u>What are the recommendations of our board of directors?</u>	3
<u>What vote is required?</u>	3
<u>Who will pay the costs of soliciting proxies on behalf of our board of directors?</u>	4
<u>STOCK OWNERSHIP</u>	4
<u>Our Principal Stockholders</u>	4
<u>The Stock Ownership of Our Directors and Executive Officers</u>	5
<u>Section 16(a) Beneficial Ownership Reporting Compliance</u>	5
<u>OUR RELATIONSHIP WITH DONEGAL MUTUAL</u>	6
<u>Background</u>	6
<u>The Coordinating Committee</u>	7
<u>Agreements Between Donegal Mutual and Us</u>	8
<u>HOUSEHOLDING</u>	9

Table of Contents

	Page
<u>ITEM 1 ELECTION OF DIRECTORS</u>	10
<u>Introduction</u>	10
<u>Background of Our Nominating Committee</u>	10
<u>Nominating Procedures</u>	10
<u>Actions Taken by Our Nominating Committee</u>	11
<u>Candidates for Election</u>	11
<u>Directors Continuing in Office</u>	12
<u>Corporate Governance</u>	13
<u>Our Board of Directors and Its Committees</u>	13
<u>DIRECTOR STOCKHOLDER COMMUNICATIONS</u>	14
<u>EXECUTIVE COMPENSATION</u>	15
<u>Compensation Discussion and Analysis</u>	15
<u>Our Compensation Philosophy and Objectives</u>	15
<u>The Compensation of Our Officers</u>	15
<u>The Operation of Our Compensation Process</u>	16
<u>Tax Matters</u>	17
<u>Summary Compensation Table</u>	17
<u>Grants of Plan-Based Awards</u>	18
<u>Stock Incentive Plans</u>	18
<u>Outstanding Equity Awards at Fiscal Year End</u>	19
<u>Option Exercises and Stock Vested</u>	19
<u>Pension Benefits</u>	19
<u>Non-Qualified Deferred Compensation</u>	19
<u>Director Compensation</u>	19
<u>Related Person Transactions</u>	20
<u>Limitation of Liability and Indemnification</u>	21
<u>Evaluation of Executive Performance in 2007 and Executive Compensation</u>	21
<u>Report of Our Compensation Committee</u>	23
<u>Equity Compensation Plan Information</u>	24
<u>AUDIT AND NON-AUDIT FEES</u>	25
<u>Report of Our Audit Committee</u>	25
<u>ITEM 2 RATIFICATION OF OUR AUDIT COMMITTEE S SELECTION OF OUR INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM FOR 2008</u>	26
<u>STOCKHOLDER PROPOSALS</u>	28
<u>OTHER MATTERS</u>	29

Table of Contents

OUR ANNUAL MEETING

What are the purposes of our annual meeting?

At our annual meeting, our stockholders will act upon the election of three Class A directors, the ratification of our audit committee's selection of KPMG LLP as our independent registered public accounting firm for 2008 and any other business that properly comes before our annual meeting or any adjournment or postponement of our annual meeting. In addition, our management will report on our performance during 2007 and respond to appropriate questions from stockholders.

What should I do now?

You should first read this proxy statement carefully. After you have decided how you wish to vote your shares, please vote by submitting your proxy using one of the methods described below. The proxies will vote your shares as you direct. If you are a registered stockholder and attend our annual meeting, you may deliver your completed proxy card in person. Street name stockholders who wish to vote at our annual meeting will need to obtain a signed proxy from the nominee in whose name their shares are registered.

VOTING

How do I vote my shares?

If you are a registered stockholder (that is, if your stock is registered in your name), you may attend our annual meeting and vote in person or vote by proxy. You may vote by proxy by telephone, electronically through the internet or by mail by following the instructions included with your proxy card. The deadline for registered stockholders to vote telephonically or electronically through the internet is 3:00 a.m., eastern daylight time, on April 17, 2008.

We encourage you to take advantage of these ways to vote your shares on the matters to be considered at our annual meeting. The following summary describes the three voting methods registered stockholders may use to vote by proxy.

Vote by telephone use any touch-tone telephone to vote your proxy 24 hours a day, 7 days a week. Have your proxy card in hand when you call. You will be prompted to enter your control numbers, which are located on your proxy card and then follow the directions given.

Vote electronically through the internet use the internet to vote your proxy 24 hours a day, 7 days a week. Have your proxy card in hand when you access the web site. You will be prompted to enter your control numbers, which are located on your proxy card, to create and submit an electronic ballot.

Vote by mail mark, sign and date your proxy card and return such card in the postage-paid envelope we have provided you.

If you vote by telephone or electronically through the internet, you do not need to return your proxy card.

Although there is no charge to you for voting by telephone or electronically through the internet, there may be costs associated with electronic access, such as usage charges from internet service providers and telephone companies. We will not cover these costs; they are solely your responsibility. The telephone and internet voting procedures available

to you are valid forms of granting proxies under the Delaware General Corporation Law, or DGCL.

If you hold your shares through a broker, bank or other nominee, please check your proxy card or contact your broker, bank or nominee to determine whether you will be able to vote by telephone or electronically through the internet.

Table of Contents

Who is entitled to vote at our annual meeting?

Holders of Class A common stock and Class B common stock of record as of the close of business on the record date, February 25, 2008, are entitled to receive notice of and to vote at our annual meeting, and any adjournment or postponement of our annual meeting. A complete alphabetical list of the record holders of our Class A common stock and Class B common stock entitled to vote at our annual meeting will be available for inspection at our principal executive offices during normal business hours for any purpose germane to our annual meeting for a period of ten days prior to the date of our annual meeting.

What are the voting rights of our stockholders?

We have two outstanding classes of stock: Class A common stock and Class B common stock. As of the record date, February 25, 2008, we had outstanding 19,778,568 shares of Class A common stock, each of which may cast one-tenth of a vote with respect to each matter to be voted on at our annual meeting, and 5,576,775 shares of Class B common stock, each of which may cast one vote with respect to each matter to be voted on at our annual meeting. Therefore, the holders of our Class A common stock may cast a total of 1,977,856 votes at our annual meeting and the holders of our Class B common stock may cast a total of 5,576,775 votes at our annual meeting, resulting in a total of 7,554,631 votes that may be cast at our annual meeting.

As of the record date, Donegal Mutual owned 8,253,517 shares, or 42%, of our outstanding Class A common stock and 4,112,215 shares, or 74%, of our outstanding Class B common stock, and therefore will have the right to cast 65% of the votes entitled to be cast at our annual meeting. Donegal Mutual has advised us that it will vote its shares for the election of Robert S. Bolinger, Patricia A. Gilmartin and Philip H. Glatfelter, II as Class A directors and for the ratification of our audit committee's selection of KPMG LLP as our independent registered public accounting firm for 2008. Therefore, Robert S. Bolinger, Patricia A. Gilmartin and Philip H. Glatfelter, II will be elected as Class A directors and our audit committee's selection of KPMG LLP as our independent registered public accounting firm for 2008 will be ratified, irrespective of the votes cast by our stockholders other than Donegal Mutual.

Who can attend our annual meeting?

All stockholders as of the record date, or their duly appointed proxies, may attend our annual meeting. Even if you currently plan to attend our annual meeting, we recommend that you also submit your proxy as described above so that your vote will be counted if you later decide not to attend, or are unable to attend, our annual meeting.

If you hold your shares in street name, that is, through a broker or other nominee, you will need to bring a copy of a brokerage statement reflecting your stock ownership as of the record date and check in at the registration desk at our annual meeting.

If you wish to obtain directions to be able to attend our annual meeting and vote in person, please contact us at (800) 877-0600, attention Jeffrey D. Miller.

What constitutes a quorum?

The presence at our annual meeting, in person or by proxy, of the holders of a majority of the total votes entitled to be cast by the holders of our Class A common stock and our Class B common stock outstanding on the record date will constitute a quorum, permitting the conduct of business at our annual meeting. Proxies received but marked as abstentions and broker non-votes will be included in the calculation of the number of shares present at our annual

meeting.

How do I vote in person?

If your stock is registered in your name and you attend our annual meeting and wish to vote in person, we will provide you with a ballot before voting commences at our annual meeting.

Table of Contents

How do I vote if my shares are held in street name?

If you are not a stockholder of record, but you are a beneficial owner, meaning that your shares are registered in a name other than your own, such as a broker's name, you must either direct the holder of record of your shares as to how you want to vote your shares or obtain a form of proxy from the holder of record that you may then vote.

How do I vote my 401(k) plan shares?

If you participate in Donegal Mutual's 401(k) plan, you may vote your shares of Class A common stock and Class B common stock credited to your 401(k) plan account as of the record date. You may vote by instructing Putnam Fiduciary Trust Company, or Putnam, the trustee of our 401(k) plan, pursuant to the instruction card included with this proxy statement. As long as Putnam receives your duly executed instruction card by April 11, 2008, Putnam will vote your shares in accordance with your instructions.

If you do not return your instruction card, Putnam will vote your shares in the same proportion that Putnam votes the shares for which it did receive timely instruction cards.

You may also revoke previously given voting instructions by filing either a written notice of revocation or a duly executed instruction card bearing a later date with Putnam.

May I change my vote after I have voted?

Yes. You may revoke your proxy at any time before the vote is taken at our annual meeting. If you are a stockholder of record, you may revoke your proxy by:

submitting written notice of revocation to our corporate secretary prior to the voting of that proxy at our annual meeting;

submitting a later dated proxy by telephone, internet or mail; or

voting in person at our annual meeting.

However, simply attending our annual meeting without voting will not revoke an earlier proxy.

If your shares are held in street name (that is, in the name of a bank, broker, nominee or other holder of record), you should follow the instructions of the bank, broker, nominee or other holder of record regarding the revocation of proxies.

What are the recommendations of our board of directors?

Unless you provide contrary instructions on your proxy card, the persons named as proxy holders will vote in accordance with the recommendations of our board of directors. Our board of directors unanimously recommends that you vote:

FOR the election of our three nominees for Class A director; and

FOR the ratification of our audit committee's selection of KPMG LLP as our independent registered public accounting firm for 2008.

What vote is required?

Election of Class A Directors. The three persons nominated in accordance with our by-laws who receive the highest number of FOR votes cast by the holders of our Class A common stock and Class B common stock, voting as a single class, will be elected as Class A directors. A properly executed proxy card marked Withhold Authority will not be voted with respect to the nominee or nominees so indicated although the votes represented by the proxy will be counted for the purposes of determining whether a quorum is present. Our certificate of incorporation and by-laws do not authorize cumulative voting in the election of our directors.

Table of Contents

Ratification of the Selection of KPMG LLP. Ratification of our audit committee's selection of KPMG LLP as our independent registered public accounting firm for 2008 will require the affirmative vote of a majority of the votes entitled to be cast by the holders of our Class A common stock and Class B common stock whose shares are represented at our annual meeting in person or by proxy, voting together without regard to class. Abstentions and shares held by brokers or nominees as to which voting instructions have not been received from the beneficial owner of, or person otherwise entitled to vote the shares, and as to which the broker or nominee does not have discretionary voting power, i.e., broker non-votes, are considered shares of stock outstanding and entitled to vote and are counted in determining the number of votes necessary for a majority. An abstention or broker non-vote will therefore have the practical effect of voting against approval of the ratification of the selection of KPMG LLP as our independent registered public accounting firm for 2008 because each abstention and broker non-vote will represent one fewer vote for approval of the ratification.

Based on the advance notice provisions of our by-laws and applicable provisions of Delaware law, no matter other than the election of three Class A directors and the ratification of our audit committee's selection of KPMG LLP as our independent registered public accounting firm for 2008 can be properly brought before our annual meeting.

Who will pay the costs of soliciting proxies on behalf of our board of directors?

We will pay the costs of preparing and mailing this proxy statement on behalf of our board of directors. In addition to mailing this proxy statement and related materials, our regular officers and employees, who will not receive any special compensation for doing so, may solicit proxies in person, by telephone or over the internet. Upon request, we will reimburse brokers, nominees, fiduciaries, custodians and other persons holding shares in their names or in the names of nominees for their reasonable expenses in sending our proxy material to beneficial owners of our stock.

STOCK OWNERSHIP***Our Principal Stockholders***

The following table identifies each person whom we know owns beneficially more than 5% of our Class A common stock or Class B common stock and states the percentage of total votes entitled to be cast by each. All information is as of February 25, 2008.

Name of Individual or Identity of Group	Class A Shares Beneficially Owned	Percent of Class A Common Stock	Class B Shares Beneficially Owned	Percent of Class B Common Stock	Percent of Total Votes
Donegal Mutual Insurance Company 1195 River Road Marietta, PA 17547	8,253,517	41.7%	4,112,215	73.7%	65.4%
Dimensional Fund Advisors LP(1) 1299 Ocean Avenue Santa Monica, CA 90401	1,640,624	8.3	232,402	4.2	5.2
Wells Fargo & Company(2) 420 Montgomery Street San Francisco, CA 94104	1,349,376	6.8			1.8
	1,217,015	6.2			1.6

The TCW Group, Inc., on behalf of
the TCW Business Unit(3)
865 South Figueroa Street
Los Angeles, CA 90017

- (1) As reported in a Schedule 13G filed with the Securities and Exchange Commission, or SEC, by Dimensional Fund Advisors LP, which serves as an investment advisor to four investment companies and as investment manager to certain other commingled group trusts and separate accounts. Dimensional Fund Advisors LP disclaims beneficial ownership of these securities.

Table of Contents

- (2) As reported in a Schedule 13G filed with the SEC by Wells Fargo & Company on behalf of its subsidiaries, Wells Capital Management, Incorporated, Wells Fargo Funds Management, LLC and Wells Fargo Bank, National Association.
- (3) As reported in a Schedule 13G filed with the SEC, The TCW Group, Inc. and its direct and indirect subsidiaries constitute the TCW Business Unit. The TCW Group, Inc.'s ultimate parent company is Societe General, S.A., a corporation formed under the laws of France.

The Stock Ownership of Our Directors and Executive Officers

The following table shows the amount and percentage of our outstanding Class A common stock and Class B common stock beneficially owned by each director, each nominee for director, each executive officer named in the Summary Compensation Table and all of our executive officers and directors as a group as of December 31, 2007, as well as the percentage of total votes entitled to be cast by them by reason of that beneficial ownership.

Name of Individual or Identity of Group	Class A	Percent	Class B	Percent	Percent of Total Votes
	Shares	of Class A Common	Shares	of Class B Common	
	Beneficially Owned(1)(2)	Stock(3)	Beneficially Owned(1)	Stock(3)	
Directors:					
Donald H. Nikolaus(4)	786,856	4.0%	186,360	3.3%	3.5%
Robert S. Bolinger	17,266		1,450		
Patricia A. Gilmartin	13,552				
Philip H. Glatfelter, II	21,312		3,276		
John J. Lyons	45,773		1,776		
Jon M. Mahan	4,144				
S. Trezevant Moore, Jr.	311		1,000		
R. Richard Sherbahn	16,111		677		
Richard D. Wampler, II	14,787				
Executive Officers:					
Cyril J. Greenya	45,710		820		
Jeffrey D. Miller	49,654		582		
Robert G. Shenk	64,762		5,450		
Daniel J. Wagner	43,960		166		
All directors and executive officers as a group (13 persons)	1,124,198	5.7%	201,557	3.6%	4.2%

- (1) Information furnished by each individual named. This table includes shares that are owned jointly, in whole or in part, with the person's spouse, or individually by his or her spouse.

(2)

See Executive Compensation Outstanding Equity Awards at Fiscal Year End for additional information as to the stock options held at December 31, 2007 by the persons named above. The totals above include stock options that are currently exercisable and exclude stock options not currently exercisable within 60 days of December 31, 2007.

- (3) Less than 1% unless otherwise indicated.
- (4) Includes 128,487 shares of Class A common stock and 3,938 shares of Class B common stock owned by a family foundation of which Mr. Nikolaus is trustee.

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Securities Exchange Act of 1934, or the Exchange Act, requires that our officers and directors, as well as persons who own 10% or more of a class of our equity securities, file reports of their ownership of our securities, as well as statements of changes in such ownership, with us and the SEC. Based upon written representations we received from our officers, directors and 10% or greater stockholders and our review of the statements of beneficial ownership changes our officers, directors and 10% or greater stockholders filed with us during 2007, we believe that all such filings required during 2007 were made on a timely basis.

Table of Contents

OUR RELATIONSHIP WITH DONEGAL MUTUAL

Background

Donegal Mutual was organized in 1889. In the mid-1980s, Donegal Mutual, like a number of other mutual property and casualty insurance companies, recognized the need to develop additional sources of capital and surplus to remain competitive, have the capacity to expand its business and assure its long-term viability. Donegal Mutual, again like a number of other mutual property and casualty insurance companies, determined to implement a downstream holding company structure as a strategic response. Thus, in 1986, Donegal Mutual formed us as a downstream holding company, initially wholly owned by Donegal Mutual, and caused us to form an insurance company subsidiary known as Atlantic States.

As part of the implementation of the downstream holding company strategy, Donegal Mutual and Atlantic States entered into a pooling agreement in 1986, whereby substantially all of the premiums, losses and expenses of Donegal Mutual and Atlantic States are pooled and each company is allocated a given percentage of the combined underwriting results. The consideration to Donegal Mutual for entering into the pooling agreement was Donegal Mutual's ownership of majority control of our Class A common stock and Class B common stock and the expectation that Donegal Mutual's surplus would increase over time as the value of its ownership interest in us increased.

Since 1986, we have completed three public offerings. A major purpose of these offerings was to provide additional capital for Atlantic States and our other insurance subsidiaries and to fund acquisitions. As the capital of Atlantic States increased, its underwriting capacity increased proportionately. Thus, as originally planned in the 1980s, Atlantic States has had access to the capital necessary to support the growth of its direct business and increases in the amount and percentage of business it assumes from the underwriting pool with Donegal Mutual. As a result, the participation of Atlantic States in the underwriting pool has increased over the years from its initial participation of 35% in 1986 to its current 80% participation, and the size of the underwriting pool has increased substantially.

The operations of our insurance subsidiaries are interrelated with the insurance operations of Donegal Mutual and, while maintaining our separate corporate existence and the separate corporate existence of Donegal Mutual, Donegal Mutual and our insurance subsidiaries conduct business together as the Donegal Insurance Group. As such, Donegal Mutual and our insurance subsidiaries have the same business philosophy, the same management, the same employees, the same facilities and offer the same types of insurance products.

The risk profiles of the business written by Atlantic States and Donegal Mutual have historically been, and are expected to continue to be, substantially similar. The same executive management and underwriting personnel administers products, classes of business underwritten, pricing practices and underwriting standards of Donegal Mutual and our insurance subsidiaries.

In addition, as the Donegal Insurance Group, Donegal Mutual and our insurance subsidiaries have a combined business plan to achieve market penetration and underwriting profitability objectives. The products offered by Donegal Mutual and our insurance subsidiaries are generally complementary, thereby allowing Donegal Insurance Group to offer a broader range of products to a given market and to expand Donegal Insurance Group's ability to service an entire personal lines or commercial lines account. Distinctions within the products of Donegal Mutual and our insurance subsidiaries generally relate to the specific risk profiles targeted within similar classes of business, such as preferred tier products compared to standard tier products, but not all of the standard risk gradients are allocated to one of the companies. Therefore, the underwriting profitability of the business directly written by each of Donegal Mutual and Atlantic States will vary. However, the risk characteristics of all business written directly by Donegal

Mutual and Atlantic States are homogenized within the reinsurance pool and each of Donegal Mutual and Atlantic States shares the underwriting results in proportion to its participation in the reinsurance pool. Effective March 1, 2008, we realize 80% of the underwriting profitability of the reinsurance pool because of the 80% participation of Atlantic States in the underwriting pool. The business Atlantic States derives from the underwriting pool represents a predominant percentage of our total revenues.

Table of Contents

In April 2001, we completed a recapitalization under which we effected a one-for-three reverse split of our Class B common stock, which has one vote per share, and issued two shares of our Class A common stock, which has one-tenth of a vote per share, as a stock dividend for each post-reverse split share of our Class B common stock. As a result of the reverse split and the stock dividend, each of our stockholders as of April 19, 2001 continued to own the same number of shares of our common stock, with one-third of the shares being shares of our Class B common stock and two-thirds of the shares being shares of our Class A common stock, and there was no change in the relative voting power or equity of any of our then stockholders.

We completed this recapitalization because we believed a capital structure that has more than one class of publicly traded securities offered us a number of benefits. The principal benefit was our ability after the recapitalization to issue our Class A common stock or securities convertible into our Class A common stock for financing, acquisition and compensation purposes without materially adversely affecting the percentage voting power of any stockholder, including Donegal Mutual. At the time of the recapitalization, our board of directors recognized that the recapitalization tended to favor longer-term investors, including Donegal Mutual, and would discourage attempts to take us over, which our board of directors believed to be remote because Donegal Mutual has voting control of us.

We believe our relationship with Donegal Mutual provides us and our insurance subsidiaries with a number of competitive advantages, including the following:

facilitating our stable management, the consistent underwriting discipline of our insurance subsidiaries, external growth and long-term profitability;

creating operational and expense synergies from the combination of resources and integrated operations of Donegal Mutual and our insurance subsidiaries;

enhancing our opportunities to expand by acquisition because of the ability of Donegal Mutual to affiliate with and, over time, acquire control of other mutual insurance companies and thereafter demutualize them and sell them to us;

producing more stable and uniform underwriting results for our insurance subsidiaries over extended periods of time than we could achieve without our relationship with Donegal Mutual; and

providing Atlantic States with a significantly larger underwriting capacity because of the underwriting pool Donegal Mutual and Atlantic States have maintained since 1986.

The Coordinating Committee

We and Donegal Mutual have maintained a coordinating committee since our formation in 1986. The coordinating committee consists of two members of our board of directors, who are not also members of Donegal Mutual's board of directors, and two members of Donegal Mutual's board of directors, who are not also members of our board of directors.

Under our by-laws and the by-laws of Donegal Mutual, any new agreement between Donegal Mutual and us and any proposed change to an existing agreement between Donegal Mutual and us must first be submitted for approval by the coordinating committee. In determining whether to approve a new agreement between Donegal Mutual and us or a change to an existing agreement between Donegal Mutual and us, our members of the coordinating committee will not grant approval unless they both believe the new agreement or the change in an existing agreement is fair and equitable to us and in the best interests of our stockholders and Donegal Mutual's members of the coordinating committee will not grant approval unless they both believe the new agreement or the change in an existing agreement is fair and

equitable to Donegal Mutual and its policyholders. If approved by the coordinating committee, the new agreement or the change in an existing agreement must then be submitted for consideration by our board of directors and the board of directors of Donegal Mutual. If either the board of directors of Donegal Mutual or our board of directors does not thereafter approve the new agreement or the change in an existing agreement, the new agreement or the change in an existing agreement does not become effective.

Table of Contents

The coordinating committee also meets annually to review each existing agreement between Donegal Mutual and us or our insurance subsidiaries to determine if the terms of the existing agreements remain fair and equitable to us and our stockholders and fair and equitable to Donegal Mutual and its policyholders or if adjustments should be made.

Our members of the coordinating committee are Robert S. Bolinger and John J. Lyons. See Item 1 Election of Directors for information about Mr. Bolinger and Mr. Lyons. Donegal Mutual's members of the coordinating committee are John E. Hiestand and Frederick W. Dreher.

Mr. Hiestand, age 69, has been a director of Donegal Mutual since 1983 and has been a self-employed provider of insurance administrative services for more than the past five years. Mr. Hiestand beneficially owns 4,919 shares of our Class A common stock and 157 shares of our Class B common stock. In 2007, Donegal Mutual paid \$31,000 in cash to Mr. Hiestand as director fees and granted him a restricted stock award of 311 shares as director compensation.

Mr. Dreher, age 67, has been a director of Donegal Mutual since 1996, and has been a partner in the law firm of Duane Morris LLP since 1971. Mr. Dreher beneficially owns 33,338 shares of our Class A common stock and 53,883 shares of our Class B common stock. In 2007, Donegal Mutual paid \$31,000 in cash to Mr. Dreher as director fees and granted him a restricted stock award of 3