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FORM OF  
SERVICES AGREEMENT

THIS SERVICES AGREEMENT (this "Agreement") is entered into this \_\_\_\_ day of \_\_\_\_\_, 2007 between SHEBOYGAN FALLS MUTUAL INSURANCE COMPANY, a Wisconsin mutual fire and casualty insurance company ("Sheboygan Falls") and DONEGAL MUTUAL INSURANCE COMPANY, a Pennsylvania mutual fire insurance company ("Donegal Mutual").

WITNESSETH:

WHEREAS, Sheboygan Falls, in order to obtain additional capital and assure its future competitive viability, entered into a Contribution Note Purchase Agreement dated as of December 27, 2006 (the "Purchase Agreement") with Donegal Mutual;

WHEREAS, Donegal Mutual purchased on the date hereof a contribution note (the "Contribution Note") of Sheboygan Falls in the principal amount of Three Million Five Hundred Thousand Dollars (\$3,500,000) pursuant to the Purchase Agreement;

WHEREAS, a condition precedent in the Purchase Agreement to Donegal Mutual's purchase of the Contribution Note is that Sheboygan Falls and Donegal Mutual enter into this Agreement to assist Sheboygan Falls in reducing its expense ratio and to provide advice and assistance to the officers and employees of Sheboygan Falls in connection with their conduct of the operations of Sheboygan Falls; and

WHEREAS, Sheboygan Falls and Donegal Mutual are also entering into a Technology License Agreement whereby Donegal Mutual will license certain of its computer applications and systems to Sheboygan Falls on the terms and conditions set forth in the Technology License Agreement;

NOW, THEREFORE, in consideration of the premises and mutual covenants herein contained, and intending to be legally bound hereby, Donegal Mutual and Sheboygan Falls agree as follows:

1. Effective Date. The Effective Date of this Agreement shall be \_\_\_\_\_, 2007. This Agreement shall continue in effect unless and until terminated pursuant to Section 5.

2. Services To Be Rendered.

(a) In order to achieve the objectives of Sheboygan Falls in entering into this Agreement, Donegal Mutual shall provide advice and assistance to the officers and employees of Sheboygan Falls engaged in the following operations of Sheboygan Falls:

(i) Underwriting -- the development, implementation and administration of policies relating to underwriting and the acceptance of risks, the maintenance of underwriting manuals and guidelines and services relating to the development of rates, the provision of all actuarial services necessary or appropriate for the operation of Sheboygan Falls' business, the analysis of loss trends and reserve developments and risk concentrations and the arranging for insurance and other reasonable risk management services in the underwriting process to protect Sheboygan Falls and its properties and other assets against loss, damage and liabilities;

(ii) Claims -- the admitting, adjusting, compromising, rejection and settlement of claims under insurance policies issued by Sheboygan Falls and the collection of reinsurance and recoverables;

(iii) Reinsurance -- the review, negotiation, monitoring and coordination of all reinsurance contracts and placements, including the determination of the amounts, terms, types and structure of reinsurance to be obtained and the selection of the reinsurers;

(iv) Investments -- the investment of all available funds in the name of and on behalf of Sheboygan Falls pursuant to its investment policy, and the management of Sheboygan Falls' investments;

(v) Data Processing -- the providing of routine data processing and computer services for preparation of journals, ledgers, cash, cash equivalents, receivables, surplus and other inventory, fixed assets, accounts payable, notes payable, other trade payables, payroll and taxes and for maintaining information as to Sheboygan Falls' investments, the preparation and analysis of daily, weekly and monthly reporting systems, claims processing, policy issuance, premium billing and the maintenance of data processing and computer programs used in providing such services, which services shall not include the services to be provided and the payments to be made pursuant to the Technology License Agreement;

(vi) Personnel and Professional Services -- the appointment, direction, removal and suspension, in the name of and on behalf of Sheboygan Falls, of employees and agents, including the determination of the appropriate levels thereof, and the ongoing review and analysis of professional services, including the retention of counsel, accountants and other consultants and the payment to them, from the funds of Sheboygan Falls, of their reasonable fees for services and reasonable expenses incurred in connection with such services; and

(vii) Financial Reporting -- the analysis and reporting of actual performance to budgeted performance, including analysis of financial results through the

budgeted period and the preparation of all statements and reports necessary or appropriate for Sheboygan Falls' business, including reports to insurance regulatory authorities.

(b) Donegal Mutual shall also advise and consult with, and provide assistance to, the officers and employees of Sheboygan Falls, in connection with the following administrative functions of Sheboygan Falls:

(i) Tax Administration -- the ordinary and necessary tax administration services for income taxes, premium taxes, sales and use taxes, franchise and similar taxes and any other taxes incurred;

(ii) Accounting Services -- the providing of routine accounting and bookkeeping services relating to cash, cash equivalents, receivables, supplies and other inventory items, fixed assets and other asset accounting, accounts payable, notes payable, other trade payables, payroll and payroll taxes, other general ledger items, accounting services relating to investments and the reconciliation of all bank accounts; and

(iii) Policyholder Services -- the maintenance of policyholders' customer relation services and the maintenance of policyholder information, including names, addresses, policy anniversary dates and premiums due.

(c) Donegal Mutual shall use its best efforts to provide the services described above and such other or additional services as Sheboygan Falls' Board of Directors may from time to time request pursuant to this Agreement in such manner as Sheboygan Falls' Board of Directors, in its business judgment, exercised in accordance with applicable law, deems necessary or appropriate. Notwithstanding the foregoing, Sheboygan Falls agrees that Donegal Mutual shall have no obligation to provide services to Sheboygan Falls of a quality greater than the quality of such services that Donegal Mutual maintains for its own operations. All byproducts from the services provided by Donegal Mutual pursuant to this Agreement shall be the property of Sheboygan Falls except whereby expressly provided to the contrary in this Agreement or in the Technology License Agreement. Donegal Mutual shall cause the services to be rendered by it to Sheboygan Falls pursuant to this Agreement to be covered by Donegal Mutual's disaster recovery plans.

(d) Donegal Mutual shall, within 90 days after the expiration of each calendar year during the term of this Agreement, furnish Sheboygan Falls' Board of Directors with a written statement of amounts received under or on account of this Agreement and amounts expended hereunder during such calendar year, with such classification of items and further detail as Sheboygan Falls' Board of Directors may reasonably request from time to time.

(e) Nothing in this Agreement shall constitute or be construed to be or create a partnership or joint venture relationship between Sheboygan Falls and Donegal

Mutual. In connection with the performance of services under this Agreement, neither Sheboygan Falls nor Donegal Mutual shall make any statement or take any action that is inconsistent with the provisions of this Section 2(e).

3. Payment for Services.

(a) Sheboygan Falls shall pay from its own funds all of its own operating costs and expenses and shall promptly reimburse Donegal Mutual for any such costs and expenses paid by Donegal Mutual.

(b) Sheboygan Falls shall pay Donegal Mutual for all of Donegal Mutual's costs and expenses incurred in providing the services called for by Section 2 of this Agreement. Donegal Mutual's charges for its services shall be reasonable after taking into account all relevant factors and shall be determined as follows:

(i) Direct expenses - Direct expenses that are paid by Donegal Mutual for administrative ease, convenience or simplicity will be reimbursed based upon the actual costs incurred.

(ii) Services – Any direct services provided, e.g., data processing, financial services, underwriting, investment, claims, marketing and other, will be incurred at a rate not to exceed the actual cost incurred by Donegal Mutual. For this purpose, cost, in the case of services provided that are directly attributable to a specific employee of Donegal Mutual, will be determined based upon actual time incurred times an hourly rate that will include a factor for all employment taxes and benefits. Cost, in the case of services provided that are not directly attributable to a specific employee of Donegal Mutual or that cannot otherwise be easily determined by reference to hours worked, will be based upon an allocation of total costs calculated upon an apportionment formula fair to Sheboygan Falls. For example, data processing costs would be allocated based upon premiums written or claims adjustment costs would be allocated based on total claims payments. Initial apportionment formulas are set forth on Appendix A hereto, which is incorporated by reference herein.

Such payments shall be made within 15 days after each submission of an expense report by Donegal Mutual to Sheboygan Falls setting forth in reasonable detail the services performed and the expenses incurred. Sheboygan Falls may, within 15 days after the receipt of an expense report, give Donegal Mutual notice of its disagreement with any of the costs and expenses enumerated in such an expense report, and, if it does so, and Sheboygan Falls' Board of Directors and Donegal Mutual are unable to resolve such disagreement within 60 days following Donegal Mutual's receipt of the notice from Sheboygan Falls' Board of Directors, then such disagreement shall be submitted to binding arbitration in Madison, Wisconsin in accordance with the Commercial Arbitration Rules of the American Arbitration Association.

(c) Sheboygan Falls shall be solely responsible for, and shall hold harmless and indemnify Donegal Mutual, including its successors, officers, directors, employees, agents and affiliates, from and against all losses, claims, damages, liabilities and expenses, including any and all reasonable expenses and attorneys' fees and disbursements incurred in investigating, preparing or defending against any litigation or proceeding, whether commenced or threatened, or any other claim whatsoever, whether or not resulting in any liability, suffered, incurred, made, brought or asserted by any person not a party to this Agreement in connection with Donegal Mutual's provision of services to Sheboygan Falls, unless such loss, claim, damage, liability or expense results from the negligence, willful misconduct or fraud of Donegal Mutual or its officers, directors, employees, agents or affiliates or any other person engaged by Donegal Mutual to provide services to Sheboygan Falls.

(d) Donegal Mutual shall be solely responsible for, and shall hold harmless and indemnify Sheboygan Falls, including its successors, officers, directors, employees, agents and affiliates, from and against all losses, claims, damages, liabilities and expenses, including any and all reasonable expenses and attorneys' fees and disbursements incurred in investigating, preparing or defending against any litigation or proceeding, whether commenced or threatened, or any other claim whatsoever, whether or not resulting in any liability, suffered, incurred, made, brought or asserted by any person not a party to this Agreement resulting from the negligence, willful misconduct or fraud of Donegal Mutual or its officers, directors, employees, agents or affiliates or any other person engaged by Donegal Mutual to provide services to Sheboygan Falls.

4. Approval by OCI. Donegal Mutual and Sheboygan Falls agree to submit this Agreement and any other required information and filings to the Office of the Commissioner of Insurance of the State of Wisconsin for its review and approval in accordance with Wisconsin Insurance Code.

5. Termination; Extension.

(a) This Agreement shall terminate on December 31, 2010, except if extended by Sheboygan Falls as provided in Section 5(b); and further provided, however, that this Agreement may be terminated at any time prior to such date in any of the following events:

(i) By Donegal Mutual, upon written notice to Sheboygan Falls, if Sheboygan Falls shall become insolvent or shall become subject to any voluntary or involuntary conservatorship, rehabilitation, receivership, reorganization, liquidation or bankruptcy case or proceeding or the surplus of Sheboygan Falls is less than the minimum amount of surplus required by the laws of the State of Wisconsin for the classes of insurance Sheboygan Falls is then transacting;

(ii) By Donegal Mutual, upon written notice to Sheboygan Falls, if the designees of Donegal Mutual shall cease to constitute a majority of the members of the Board of Directors of Sheboygan Falls;

(iii) By Sheboygan Falls, upon written notice to Donegal Mutual, if Donegal Mutual shall become insolvent or shall become subject to any voluntary or involuntary conservatorship, receivership, reorganization, liquidation or bankruptcy case or proceeding; or

(iv) By Sheboygan Falls, upon written notice to Donegal Mutual, subsequent to payment in full of the Contribution Note.

(b) Subject to subsection (a) of this Section 5, Sheboygan Falls shall have the option to extend the term of this Agreement for one additional year upon delivery of a written notice of extension to Donegal Mutual not later than 90 days prior to the expiration of the then current term. Sheboygan Falls shall have the right to exercise the extension option for five successive years commencing with an option to extend the termination date to December 31, 2011 and ending with an option to extend the termination date to December 31, 2015, provided, however, that notwithstanding one or more exercises of this extension option by Sheboygan Falls, Donegal Mutual, upon written notice to Sheboygan Falls, may terminate this Agreement after the date that:

(i) The Office of the Commissioner of Insurance of the State of Wisconsin shall have denied approval of a plan of conversion pursuant to which Sheboygan Falls would convert into a stock fire and casualty insurance company and would become a wholly owned subsidiary of Donegal Mutual or Donegal Group Inc. ("DGI"); or

(ii) The policyholders of Sheboygan Falls shall have failed to approve by the requisite vote a plan of conversion of Sheboygan Falls pursuant to which Sheboygan Falls would convert into a stock fire and casualty insurance company and would become a wholly owned subsidiary of Donegal Mutual or DGI.

(c) Any termination of this Agreement by Donegal Mutual pursuant to Sections 5(a)(i), 5(a)(ii) or 5(b) of this Agreement shall only become effective (i) 18 months after the date on which written notice of termination is given to Sheboygan Falls by Donegal Mutual and (ii) subject to the receipt of any necessary insurance regulatory approvals.

6. Confidentiality. Donegal Mutual agrees during the term of this Agreement and subsequent to its termination to hold in confidence all documents, materials and other information that Donegal Mutual shall have obtained about Sheboygan Falls during the term of this Agreement (the "Confidential Information").

7. Miscellaneous.

(a) All notices, communications and deliveries under this Agreement shall (i) be made in writing, signed by the party making the same to the address as specified below, (ii) specify the section of this Agreement pursuant to which it is being given, (iii) be deemed to be given if delivered in person, on the date delivered, or if sent by facsimile, on the date sent (if the party giving the notice, or its employee or agent, has no reason to believe that the facsimiled notice was not made or received), or if sent by Federal Express or some other overnight express courier with costs paid, on the date delivered to such express courier and (iv) be deemed received if delivered in person, on the date of personal delivery, or if by facsimile, on the first business day after sent (if the party giving the notice, or its employee or agent, has no reason to believe that the facsimiled notice was not made or received), or if sent by Federal Express or some other overnight express courier, on the first business day after delivered to such overnight express courier:

if to Sheboygan Falls, to:

Sheboygan Falls Mutual Insurance Company  
511 Water Street  
Sheboygan Falls, WI 53085-0159  
Attention: Lee F. Wilcox, President  
Facsimile: 920-467-3364

if to Donegal Mutual, to:

Donegal Mutual Insurance Company  
1195 River Road  
Marietta, Pennsylvania 17547  
Attention: Donald H. Nikolaus, President  
Facsimile: 717-426-7009

Such notice shall be given at such other address or to such other representative as a party to this Agreement may furnish pursuant to this Section 7(a) to the other party to this Agreement.

(b) No assignment, transfer or delegation, whether by merger or other operation of law or otherwise, of any rights or obligations under this Agreement shall be made by a party to this Agreement without the prior written consent of the other party to this Agreement and, if required by applicable law, the Wisconsin Commissioner of Insurance and any other insurance regulatory authority having jurisdiction over this Agreement. This Agreement shall be binding upon the parties hereto and their respective permitted successors and assigns.



(c) This Agreement constitutes the entire agreement of the parties to this Agreement with respect to its subject matter, supersedes all prior agreements, if any, of the parties to this Agreement with respect to its subject matter and may not be amended except in writing signed by the party to this Agreement against whom the change is asserted. The failure of any party to this Agreement at any time or times to require the performance of any provision of this Agreement shall in no manner affect the right to enforce the same and no waiver by any party to this Agreement of any provision or breach of any provision of this Agreement in any one or more instances shall be deemed or construed either as a further or continuing waiver of any such provision or breach or as a waiver of any other provision or breach of any other provision of this Agreement.

(d) In case any one or more of the provisions contained herein shall, for any reason, be held to be invalid, illegal or unenforceable in any respect, such invalidity, illegality or unenforceability shall not affect any other provision of this Agreement, but this Agreement shall be construed as if such invalid, illegal or unenforceable provision or provisions had never been contained herein unless the deletion of such provision or provisions would result in such a material change as to cause continued performance of this Agreement as contemplated herein to be unreasonable or materially and adversely frustrate the objectives of the parties as expressed in this Agreement. In the event of a holding of invalidity so fundamental as to prevent the accomplishment of the purposes of this Agreement, the parties shall immediately commence negotiations in good faith to reach agreement on a mutually acceptable successor provision.

(e) This Agreement shall be governed by and construed in accordance with the laws of the State of Wisconsin.

IN WITNESS WHEREOF, the parties hereto have executed this Agreement the day and year first above written.

SHEBOYGAN FALLS MUTUAL INSURANCE COMPANY

By: \_\_\_\_\_  
Lee F. Wilcox, President

DONEGAL MUTUAL INSURANCE COMPANY

By: \_\_\_\_\_  
Donald H. Nikolaus, President

INITIAL APPORTIONMENT FORMULAS

Information Services/Data Processing Costs – Information services expenses (e.g., depreciation, software expense, etc.) will be proportionally allocated based upon net premiums written by Sheboygan Falls compared to total net premiums written by all entities utilizing the information services once Sheboygan Falls' systems have been linked to those of Donegal Mutual. Until that time, Donegal Mutual personnel providing information services to Sheboygan Falls will maintain time records for the services provided to Sheboygan Falls and be charged at hourly rates that represent the actual cost (salary rate plus an appropriate benefit cost factor) of providing such services.

Underwriting and Claims Adjustment Costs - Donegal Mutual personnel providing underwriting, reunderwriting and claims adjustment services to Sheboygan Falls will maintain time records for the services provided to Sheboygan Falls and be charged at hourly rates that represent the actual cost (salary rate plus an appropriate benefit cost factor) of providing such services.

Record Keeping and Processing – Allocation will be made based upon the estimated number of hours Donegal Mutual personnel spend performing these tasks for Sheboygan Falls.