

REINSURANCE AND RETROCESSION AGREEMENT

Between

SHEBOYGAN FALLS MUTUAL INSURANCE COMPANY

And

DONEGAL MUTUAL INSURANCE COMPANY

**Article 1**   **Business Covered**

This Agreement, subject to the terms and conditions herein contained, is for Donegal Mutual Insurance Company (Donegal Mutual) to indemnify Sheboygan Falls Mutual Insurance Company (Sheboygan Falls) in respect of the net liability as herein provided and specified which may accrue to Sheboygan Falls as a result of any loss or losses under any and all binders, policies and contracts of insurance or reinsurance (hereinafter referred to as "policy" or "policies") heretofore or hereafter issued or entered into by or on behalf of Sheboygan Falls and for Donegal Mutual to retrocede the net liability back to Sheboygan Falls and Sheboygan Falls to assume the net liability back from Donegal Mutual as part of the retrocession.

**Article 2**   **Territory**

This Agreement shall cover all territories covered by Sheboygan Falls' policies.

**Article 3**   **Exclusions**

This Agreement shall not cover:

A. Business classified by Sheboygan Falls as:

- (1) Overhead transmission and distribution lines and their supporting structures other than those on or within 150 meters (or 500 feet) of the insured premises. It is understood and agreed that public utilities extension and/or suppliers extension and/or contingent business interruption coverage are not subject to this exclusion provided that these are not part of a transmitter's or distributor's policy.

- (2) Pools, Associations, or Syndicates, including State Insurance Guaranty Associations. However, such operations which Sheboygan Falls is obliged to cover by reason of membership or participation in any Automobile Assigned Risk Pool, Plan or Facility, any FAIR Plan or any Coastal Pool are not to be excluded.
- (3) Insurance on Growing and/or Standing Crops.
- (4) Reinsurance of any kind assumed by Sheboygan Falls, except local agency reinsurance accepted in the normal course of business.
- (5) Bridges, tunnels and art collections.
- (6) Aviation.
- (7) Insolvency Funds, as per clause attached.
- (8) Flood, when written as such.

B. Extra Contractual Obligations and Losses in Excess of Original Policy Limits – "Extra Contractual Obligations" are defined as those liabilities not covered under any other provision of this Agreement and which arise from the handling of any claim on business covered hereunder, such liabilities arising because of, but not limited to, the following: failure by Sheboygan Falls to settle within the policy limit, or by reason of alleged or actual negligence, fraud or bad faith in rejecting an offer of settlement or in the preparation of the defense or in the trial of any action against its Insured or Reinsured or in the preparation or prosecution of an appeal consequent upon such action.

The term "Losses in Excess of Original Policy Limits" shall mean a net loss of Sheboygan Falls which is in excess of the limit of its original policy, such loss in excess of the limit having been incurred because of the following: failure by Sheboygan Falls to settle within the policy limit or by reason of alleged or actual negligence, fraud or bad faith in rejecting an offer or settlement or in the preparation of the defense or in the trial of any action against its Insured or Reinsured or in the preparation or prosecution of an appeal consequent upon such action.

- C. Fidelity, Surety, Credit, Title, Insolvency and Financial Guaranty.
- D. Loss or Liability excluded by the provisions of the Nuclear Incident Exclusion Clause – Physical Damage – Reinsurance, as per clause attached hereto.

E. War, as defined in the original policy.

F. Ocean Marine.

**Article 4**

**Term**

This Agreement shall become effective on May \_\_, 2007 at 12:01 A.M. Standard Time. It is unlimited as to its duration and may be terminated by either party upon giving twelve months notice of cancellation in writing. In the event either party terminates in accordance with the above, it is understood that all transactions coming within the terms of this Agreement will continue in effect within the said twelve months. In addition coverage will be provided on a "run-off" basis for policies incepted prior to the effective date of the termination.

**Article 5**

**Definition of Loss Occurrence**

The term "Loss Occurrence" shall mean any one occurrence or series of occurrences arising out of one event.

**Article 6**

**Net Retained Lines**

This Agreement applies only to that portion of any insurance or reinsurance covered by this Agreement which Sheboygan Falls retains net for its own account, and in calculating the amount of any loss hereunder and also in computing the amount in excess of which this Agreement attaches, only loss or losses in respect of that portion of any insurance or reinsurance which Sheboygan Falls retains net for its own account shall be included. It being understood and agreed that the amount of Donegal Mutual's liability hereunder in respect of any loss or losses shall not be increased by reason of the inability of Sheboygan Falls to collect from any other reinsurer, whether specific or general, any amounts which may have become due from them whether such inability arises from the insolvency of such other reinsurer or otherwise.

**Article 7**

**Ultimate Net Losses Incurred**

The term "Ultimate Net Losses Incurred" shall mean the actual losses sustained by Sheboygan Falls during the term of this Agreement or the "run-off" period under Article 4 hereof under its policies, regardless of whether such policies were written before or after the effective date of this Agreement, and includes (i) all sums paid in settlement of claims and suits and in satisfaction of judgments including, without limitation, prejudgment and post-judgment interest when added to a judgment, (ii) all reserves for losses reported and outstanding, (iii) reserves for incurred but not reported losses and (iv) reserves for allocated loss adjustment expenses. Allocated loss adjustment expenses include expenses of litigation,

if any, and all other loss expenses of Sheboygan Falls including legal expenses and costs incurred in connection with coverage and validity questions and legal actions connected thereto which are allocable only to a specific claim or action on policies covered hereunder. "Ultimate Net Losses Incurred" includes proper deductions for all recoveries (including amounts recoverable under other reinsurance) and salvages actually made by Sheboygan Falls; provided always that nothing in this Article shall be construed to mean that losses under this Agreement are not recoverable until Sheboygan Falls' ultimate net loss has been ascertained.

All salvages, recoveries and payments recovered or received subsequent to a loss settlement under this Agreement shall be applied as if recovered or received prior to the said settlement and all necessary adjustments shall be made by the parties hereto.

**Article 8**                                **Ceding and Retroceding Net Losses**

- A. As of the effective date and time of this Agreement, Sheboygan Falls will cede and Donegal Mutual will accept 100% of Sheboygan Falls' Ultimate Net Losses Incurred.
  
- B. As of the effective date and time of this Agreement, Donegal Mutual will retrocede and Sheboygan Falls will accept 100% of the Ultimate Net Losses Incurred Donegal Mutual assumed from Sheboygan Falls.

**Article 9**                                **Rate and Premium**

Sheboygan Falls shall pay to Donegal Mutual and Donegal Mutual will retrocede to Sheboygan Falls during the term of this Agreement, the Net Earned Premium Income of Sheboygan Falls during such term in respect of business which is the subject matter of this Agreement.

The term "Net Earned Premium Income" as used herein shall be understood to mean gross premiums earned by Sheboygan Falls less premiums for reinsurance which inure to the benefit of this Agreement.

All premiums and losses paid under this Agreement shall be made in United States currency.

**Article 10**                                **Access to Records**

Sheboygan Falls and Donegal Mutual, by their duly appointed representatives, shall have the right at any reasonable time, to examine all papers in the possession of the other referring to business effected hereunder.

**Article 11**

**Errors and Omissions**

Any inadvertent delay, omission or error shall not be held to relieve either party hereto from any liability which would attach to it hereunder if such delay, omission or error had not been made. Such delay, omission or error shall be rectified immediately upon discovery.

**Article 12**

**Insolvency Funds Exclusion Clause**

This Agreement excludes all liability of Sheboygan Falls arising, by contract, operation of law, or otherwise, from its participation or membership, whether voluntary or involuntary, in any insolvency fund. "Insolvency fund" includes any guaranty fund, insolvency fund, plan, pool, association, fund or other arrangement, howsoever denominated, established or governed; which provides for any assessment of or payment or assumption by Sheboygan Falls of part or all of any claim, debt, charge, fee, or other obligation of an insurer, or its successors or assigns, which has been declared by any competent authority to be insolvent, or which is otherwise deemed unable to meet any claim, debt, charge, fee or other obligation in whole or in part.

**Article 13**

**Insolvency**

In the event of the insolvency of Sheboygan Falls, the right of the parties under this Agreement shall be governed by the Wisconsin Insurance Code.

This agreement made and executed in duplicate effective May \_\_, 2007

DONEGAL MUTUAL INSURANCE COMPANY

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

SHEBOYGAN FALLS MUTUAL INSURANCE COMPANY

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