David Felderman, Esquire (ID No. 78889)
Daniel J. Mirarchi, Esquire (ID No. 85106)
Mary Ann Giorno, Esquire (ID. No. 92644)
SPECTOR ROSEMAN
KODROFF & WILLIS, P.C.
1818 Market Street, Suite 2500
Philadelphia, Pennsylvania 19103
(215) 496-0300 (Telephone)
(215) 496-6611 (Facsimile)
E-mail: dfelderman@srkw-law.com
E-mail: dmirarchi@srkw-law.com
E-mail: mgiorno@srkw-law.com

Attorneys for Plaintiff and the Proposed Class

NANCY L. GOLDSTEIN
512 Latmer Road
Merion Station, PA 19066,
Individually and on Behalf of All Others Similarly Situated, and Derivatively on Behalf of Harleysville Mutual Insurance Company,

Plaintiff,

v.

MICHAEL L. BROWNE
355 Maple Avenue
Harleysville, PA 19438-2297,

W. THACHER BROWN
355 Maple Avenue
Harleysville, PA 19438-2297,

G. LAWRENCE BUHL
355 Maple Avenue
Harleysville, PA 19438-2297,

NICHOLAS DEBENEDICTIS
355 Maple Avenue
Harleysville, PA 19438-2297,

COURT OF COMMON PLEAS
PHILADELPHIA COUNTY

DECEMBER TERM, 2011

NO. _____

CLASS ACTION

THIS IS NOT AN ARBITRATION CASE

JURY TRIAL DEMANDED

ELLEN M. DUNN
355 Maple Avenue
Harleysville, PA 19438-2297,

MICHAEL L. LAPEYROUSE
355 Maple Avenue
Harleysville, PA 19438-2297,

JERRY S. ROSENBLOOM
355 Maple Avenue
Harleysville, PA 19438-2297,

WILLIAM W. SCRANTON III
355 Maple Avenue
Harleysville, PA 19438-2297,

WILLIAM E. STORTS
355 Maple Avenue
Harleysville, PA 19438-2297, and

HARLEYSVILLE MUTUAL INSURANCE COMPANY
355 Maple Avenue
Harleysville, PA 19438-2297,

Defendants,

-and-

HARLEYSVILLE MUTUAL INSURANCE COMPANY
355 Maple Avenue
Harleysville, PA 19438-2297,

Nominal Defendant.

CLASS ACTION AND DERIVATIVE COMPLAINT – CIVIL ACTION

Nancy L. Goldstein ("Plaintiff"), by and through her undersigned counsel, for her Class Action and Derivative Complaint, alleges upon personal knowledge with respect to herself, and upon information and belief as to all other matters set forth herein, as follows:

NATURE OF THE ACTION

1. This is a class and derivative action on behalf of the policyholder-members of Harleysville Mutual Insurance Company ("Harleysville Mutual") arising from the proposed acquisition by Nationwide Mutual Insurance Company ("Nationwide") of Harleysville Mutual and its direct and indirect subsidiaries (collectively, "Harleysville").

2. Harleysville Mutual's principal direct subsidiary is Harleysville Group Inc. ("Harleysville Group"), a public company in which Harleysville Mutual owns a controlling 53.4% interest.

3. Under the terms of the proposed acquisition (the "Proposed Merger"), Harleysville Mutual's policyholder-members will become policyholders and members of Nationwide, but will receive no cash payment or other compensation for their ownership interest in Harleysville Mutual or its 53.4% stake in Harleysville Group and other substantial assets. By contrast, the minority shareholders of Harleysville Group will receive approximately $840 million in cash, yielding them an extraordinary 137% merger premium – more than *four times* the average of other recent insurance industry merger transactions.

4. While the Proposed Merger does not pay any cash consideration to Harleysville Mutual policyholder-members, its terms do greatly benefit the members of the Harleysville Mutual board of directors (the "Board"), each of whom holds large numbers of shares, restricted stock, and/or options in Harleysville Group, and who collectively will receive a payout of approximately $41.6 million in cash from these interests if the Proposed Merger proceeds.

5. Had the merger premium obtained from Nationwide been fairly allocated *pro rata* to Harleysville Mutual based on its current 53.4% controlling interest in Harleysville Group and other assets, Harleysville Mutual policyholder-members would have received over $300 million.

6. A fair, *pro rata* allocation of the merger premium, however, would have cut the payout personally received by the members of the Harleysville Mutual Board by more than half.

7. The preliminary proxy statement on Schedule 14A (the "Proxy") filed by Harleysville Group with the Securities and Exchange Commission ("SEC") on December 23, 2011 documents the deeply flawed process by which the Proposed Merger was negotiated – a process dominated by conflicted members of management focused on maximizing the value of their Harleysville Group shares, assisted by legal and financial advisors with longstanding ties to management.

8. As detailed in the Proxy, the Board made no effort to adopt effective procedural protections, such as the appointment of a committee of disinterested directors with a clear mandate to negotiate on behalf of unaffiliated stakeholders, assisted by independent advisors. Rather, after all material terms of the Proposed Merger had been negotiated, the Board appointed a "special committee" of two directors who together stand to personally gain nearly $900,000 from the wrongful diversion of merger consideration, and they selected as their advisors a law firm and investment banking firm that had previously been retained by management to perform other work for Harleysville.

9. As set forth in the Proxy, among the competing offers rejected by management and the Board was an offer that would have *paid Harleysville Mutual's policyholder-members $250,000,000 in recognition of the value that was being taken from them through the sale*. The Board and management rejected this offer in favor of the Nationwide offer – which allowed them to direct all cash proceeds to the class of shares owned by them.

10. The Proxy further demonstrates the unfairness of the merger price allocation at the heart of this action: by *every measure of value* used by the financial advisor *selected by*

Harleysville itself to opine on the fairness of the Proposed Merger to the minority shareholders of Harleysville Group, the merger consideration paid to the minority far *exceeds* the high end of the range of fair value. The Board's own financial advisor thus confirms that the Board has structured the Proposed Merger to pay itself more than was paid in any relevant precedent transaction, more than any comparable company valuation would justify, and more than any reasonable discounted cash flow analysis would support. The reason the members of the Board were able to get such an extraordinary deal for themselves is simple: the deal they approved misappropriated *most* of the value and all of the cash consideration belonging to Harleysville Mutual's members and redirected it to the minority shares held by themselves.

11. The decision by the directors of Harleysville Mutual to approve a transaction in which the minority shares in Harleysville Group they hold receive the entire merger premium, and in which no cash payment is allocated to Harleysville Mutual's controlling interest in Harleysville Group or other assets, is fundamentally unfair to Harleysville Mutual's policyholder-members and constitutes manifest self-dealing.

12. For these reasons, and as further set forth below, Plaintiff seeks to enjoin the distribution of the Proposed Merger consideration to which Plaintiff and other policyholder-members of Harleysville Mutual are entitled and impose a constructive trust thereon. Plaintiff further seeks damages as a result of the breaches of duty alleged herein.

PARTIES AND VENUE

13. Plaintiff Nancy L. Goldstein is a Pennsylvania resident. Plaintiff became a policyholder and member of Harleysville Mutual under a policy effective April 17, 2010 and has at all times subsequent remained a member and policyholder of Harleysville Mutual. The relevant contractual provisions establishing Plaintiff's status as a member of Harleysville Mutual are annexed hereto as Exhibit A.

14. Defendant Harleysville Mutual is a Pennsylvania mutual insurance company with its principal place of business in Harleysville, Pennsylvania.

15. Defendant Michael L. Browne became president and chief executive officer ("CEO") of Harleysville Mutual and CEO of Harleysville Group in February 2004. He has been a director of Harleysville Mutual since 2003 and is also a director of Harleysville Group.

16. Defendant W. Thacher Brown has been a director of Harleysville Mutual since 1994 and is also a director of Harleysville Group.

17. Defendant G. Lawrence Buhl has been a director of Harleysville Mutual since 2005 and is also a director of Harleysville Group.

18. Defendant Nicholas DeBenedictis has been a director of Harleysville Mutual since 2005.

19. Defendant Ellen M. Dunn has been a director of Harleysville Mutual since 2007.

20. Defendant Michael L. Lapeyrouse has been a director of Harleysville Mutual since 2002.

21. Defendant Jerry S. Rosenbloom has been a director of Harleysville Mutual since 1995 and is also a director of Harleysville Group.

22. Defendant William W. Scranton III has been a director of Harleysville Mutual since 1999 and has been non-executive chairman of the Harleysville Mutual Board since 2004. He is also a director of Harleysville Group and non-executive chairman of its Board.

23. Defendant William E. Storts has been a director of Harleysville Mutual since 2001 and is also a director of Harleysville Group.

24. The defendants listed in paragraphs 15 through 23 are referred to herein collectively as the "Director Defendants".

25. Harleysville Mutual regularly conducts business in this County, this action is upon a policy of insurance issued by Harleysville Mutual, and according to the Proxy, a substantial number of the acts giving rise to the claims at issue in this action occurred in this County. Accordingly, venue is appropriate in this Court pursuant to subdivisions (a)(2), (a)(3), and (b)(1) of Pennsylvania Rule of Civil Procedure 2179.

FACTUAL BACKGROUND

A. The History, Business and Organizational Structure of Harleysville

26. Harleysville was originally organized in 1915 to provide a fund to recover or replace stolen cars belonging to its members, and assumed the name Harleysville Mutual Insurance Company in 1956.

27. Today, Harleysville is engaged in the property and casualty insurance business in the United States and underwrites a broad array of personal and commercial coverages, marketed primarily in the eastern and midwestern United States through independent insurance agencies.

28. Harleysville is a leading "super-regional" provider of insurance products and services for small and midsized businesses and individuals, and ranks among the top 60 U.S. property/casualty insurance groups based on net premiums written.

29. In 2010, Harleysville had net income (as reported on the Combined Annual Statement for Harleysville Mutual and Subsidiaries) of $124.9 million on premiums earned of $1.095 billion, and net surplus (a measure of net asset value widely used in the insurance industry) of $1.3 billion.

30. Harleysville Group was established in 1979 as a wholly-owned subsidiary of Harleysville Mutual. An approximately 30% interest in Harleysville Group was sold to the public in an initial public offering ("IPO") in 1986. As of November 30, 2011, Harleysville Mutual owned approximately 53.4% of the outstanding shares of Harleysville Group.

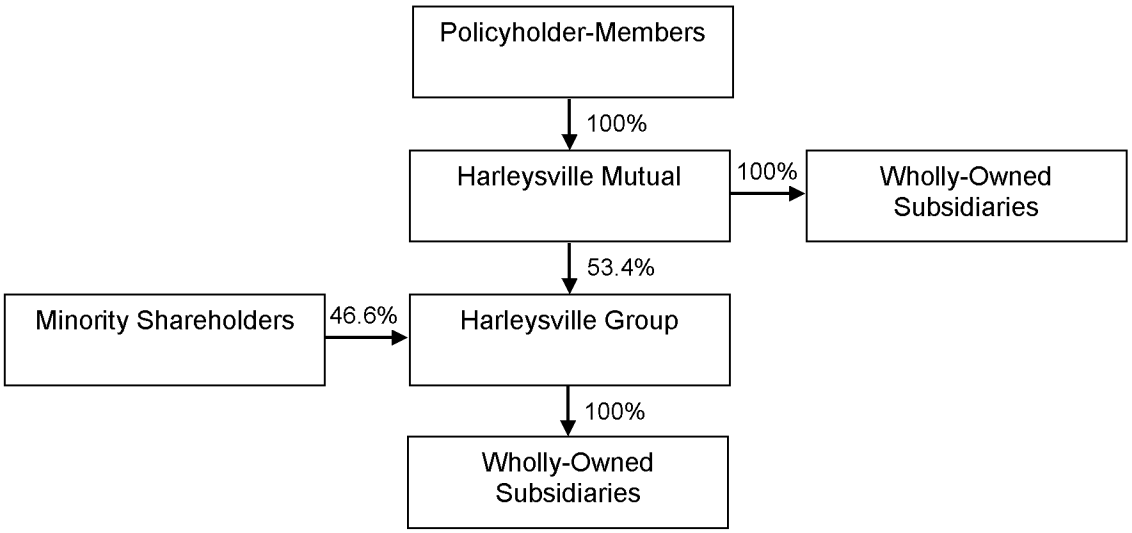
31. Based on the $25.33 closing price of Harleysville Group shares on September 22, 2011, the last trading day before merger discussions were publicly reported, the minority, publicly-traded shares representing a 46.6% interest in Harleysville Group had a total market value of $320.3 million.

32. In addition to its controlling interest in Harleysville Group, Harleysville Mutual writes insurance and conducts other operations directly and through wholly-owned subsidiaries (collectively, the "Parent Businesses").

33. The Parent Businesses represent a substantial portion of Harleysville's overall operations, and pursuant to an intercompany pooling arrangement among Harleysville Mutual, Harleysville Group, and their respective property/casualty subsidiaries (the "Pooling Arrangement"), Harleysville Mutual is allocated a 20% participation in the pool on account of policies written directly and through its wholly-owned subsidiary, Harleysville Pennland Insurance Co.

34. Harleysville Mutual also writes life insurance policies through its wholly-owned subsidiary, Harleysville Life Insurance Co., and provides insurance-related services though a third wholly-owned subsidiary, Harleysville Services Inc.

35. Harleysville's organization structure is reflected in the following chart:



B. Management and Control of Harleysville

36. Harleysville Mutual and Harleysville Group conduct their operations jointly through the Pooling Arrangement, a management agreement, and other cost-allocation agreements.

37. Through Harleysville Mutual's ownership of approximately 53.4% of the outstanding shares of Harleysville Group, Harleysville Mutual exercises control over Harleysville Group. As disclosed in Harleysville Group's public filings with the SEC, Harleysville Group is categorized as a "controlled company" under NASDAQ Stock Market listing rules, and Harleysville Mutual's controlling interest allows it to unilaterally determine the outcome of any shareholder vote at Harleysville Group.

38. Harleysville Mutual, as a Pennsylvania mutual insurance company, has members in lieu of stockholders, and such members are generally treated in the same manner as stockholders of a stock corporation, as provided by 15 Pa.C.S. § 2102(c). Among other rights, Plaintiff and the other members of Harleysville Mutual have the authority to elect directors and receive payment of dividends declared by Harleysville Mutual. Pursuant to 15 Pa.C.S. § 2126,

they are also entitled to receive payment of the net assets of Harleysville Mutual upon liquidation.

39. Harleysville Mutual is governed by a nine-member Board comprised of the Director Defendants. Harleysville Group is governed by an eight-member Board that largely overlaps with the Harleysville Mutual Board, as reflected by the following table:

	Harleysville Mutual	Harleysville Group
Michael L. Browne	X	X
Barbara A. Austell		X
W. Thacher Brown	X	X
G. Lawrence Buhl	X	X
Nicholas DeBenedictis	X	
Ellen M. Dunn	X	
Mirian M. Graddick-Weir		X
Michael L. Lapeyrouse	X	
Jerry S. Rosenbloom	X	X
William W. Scranton III	X	X
William E. Storts	X	X

40. As further discussed below, each member of the Harleysville Mutual Board owns substantial numbers of publicly-traded shares, restricted stock and/or options in Harleysville Group, and the value of these interests far exceeds their interest in Harleysville Mutual as policyholder-members.

C. The Terms of the Proposed Merger

41. On September 29, 2011, Harleysville and Nationwide announced their entry into the Proposed Merger. Under the terms of the Agreement and Plan of Merger governing the Proposed Merger (the "Merger Agreement," Exhibit B hereto), Nationwide has agreed that it would pay $60.00 per share in cash (the "Minority Merger Price") for the minority publicly-traded shares of Harleysville Group and for all outstanding options, restricted stock, and similar interests in Harleysville Group.

42. The Merger Agreement further provides that Harleysville Mutual policyholder-members would become policyholders and members of Nationwide, but receive no cash payment or other consideration on account of their ownership interest in Harleysville Mutual.

43. The Proposed Merger would be effected through the merger of Harleysville Mutual with and into Nationwide, with Nationwide continuing as the surviving entity, and by the merger of Nationals Sub, Inc., a wholly-owned subsidiary of Nationwide, with and into Harleysville Group, with Harleysville Group surviving as a wholly-owned subsidiary of Nationwide.

44. News reports concerning the Proposed Merger first circulated on September 23, 2011, nearly a week before the Proposed Merger was announced, and immediately resulted in a 23.6% increase in the trading price of Harleysville Group shares. The last unaffected closing price of Harleysville Group's shares prior to the public report of merger discussions, on September 22, 2011, was $25.33. The $60.00 Minority Merger Price thus represented a 137% merger premium.

45. The proposed transactions are subject to approval by the policyholder-members of Harleysville Mutual and Nationwide, the Pennsylvania Insurance Department, the Ohio Department of Insurance, and various other regulatory bodies. According to the Proxy, subject to the receipt of all necessary approvals, the Proposed Merger is expected to close in the first half of 2012.

D. The Proposed Merger Misappropriates Harleysville Mutual's Share of the Merger Premium – Worth over $300 Million – to Harleysville Mutual's Directors and Other Minority Shareholders

46. While Harleysville Mutual owns a majority, controlling interest in Harleysville Group and also owns other substantial assets, the Proposed Merger will provide no payment to Harleysville Mutual or its policyholder-members; members' interests in Harleysville Mutual

would be converted directly into member interests in Nationwide with no premium or other consideration for their ownership of Harleysville Mutual or its control of Harleysville Group.

47. Rather, the entire cash consideration to be paid by Nationwide – $839.5 million – would be paid to the minority shareholders of Harleysville Group and management, providing them a 137% premium to the trading price of their shares immediately before merger negotiations were first reported, representing a total merger premium of over $508 million.

48. The Proposed Merger thus treats identical shares very differently: the minority, publicly-traded shares held by the members of the Harleysville Boards and Harleysville senior management will receive an extraordinary cash merger premium; the majority interest in the same shares held by Harleysville Mutual will not participate at all in the merger premium to be paid by Nationwide.

49. The allocation of the Proposed Merger consideration is thus indefensible on economic grounds: while it is well established that control shares have *greater* value than minority shares, the Proposed Merger diverts the full merger premium to the *minority* shares held by Harleysville Mutual's directors and management.

50. The effect of this diversion is to greatly enrich the Director Defendants at the direct expense of Harleysville Mutual's policyholder-members.

51. Had the merger premium obtained from Nationwide been fairly allocated *pro rata* to Harleysville Mutual based on its current 53.4% controlling interest in Harleysville Group (reduced to 49.2% on a *pro forma* basis as a result of accelerated vesting of options, restricted stock and restricted stock units through the Proposed Merger), together with its separate 20% participation under the Pooling Arrangement, Harleysville Mutual policyholder-members would have been entitled to receive 59.4% of the total merger premium – approximately $302 million.

52. By misappropriating the entire merger premium paid by Nationwide to the minority shares in which they own a substantial interest, however, the Director Defendants have more than doubled their anticipated payout from the Proposed Merger – increasing their collective personal profits from the transaction from approximately $20 million to more than $41 million.

53. The gain from the diversion is particularly substantial for Harleysville's CEO, Defendant Michael Browne, due to his large holdings of out-of-the-money stock options that would have profited only modestly from a fairly-allocated merger premium. Under the terms of the Proposed Merger, his profit from the transaction is nearly two and one-half times what it would have been based on a fair allocation.

54. The effect of the unfair allocation for each of the Director Defendants is set forth in the following table:

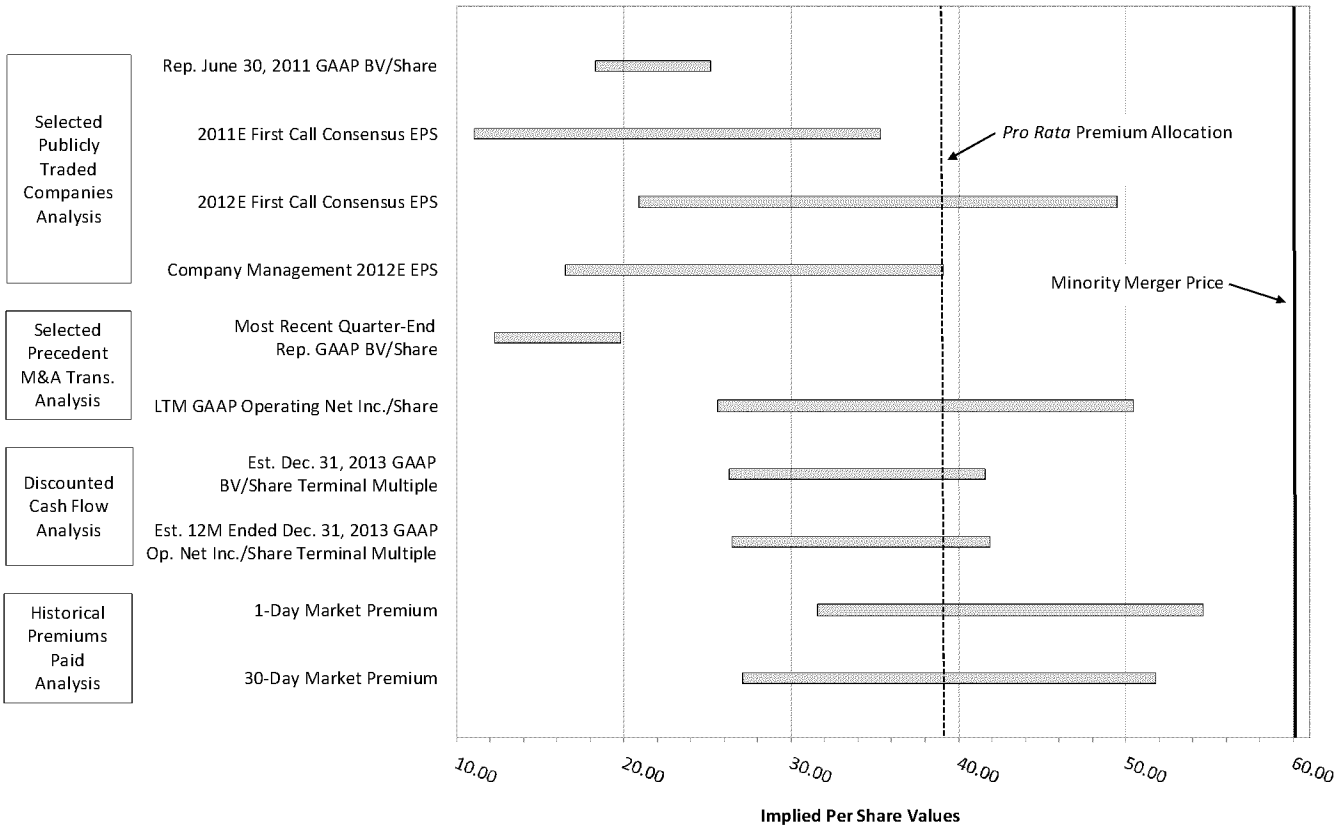
	Shares and Restricted Stock Owned	Options Owned	Value at Minority Merger Price ($60.00/share)	Value if *Pro Rata* Premium Allocation ($39.10/share)	**Gain From Diversion**
Michael L. Browne	224,653	557,235	$28,258,933	$11,917,474	**$16,341,459**
W. Thacher Brown	55,681	7,500	$3,614,835	$2,294,352	**$1,320,483**
G. Lawrence Buhl	13,147		$788,820	$514,048	**$274,772**
Nicholas DeBenedictis	28,707		$1,722,420	$1,122,444	**$599,976**
Ellen M. Dunn	7,641		$458,460	$298,763	**$159,697**
Michael L. Lapeyrouse	10,239	2,500	$714,340	$448,095	**$266,245**
Jerry S. Rosenbloom	43,590	7,500	$2,889,375	$1,821,594	**$1,067,781**
William W. Scranton III	17,229	7,500	$1,307,715	$790,879	**$516,836**
William E. Storts	30,129		$1,807,740	$1,178,044	**$629,696**
Total (All Directors)	431,016	582,235	$41,562,638	$20,385,693	$21,176,946
Total (Outside Directors)	206,363	25,000	$13,303,705	$8,468,218	$4,835,487

55. The wrongful nature of the Director Defendants' diversion of the merger premium entirely to the minority shares owned by them and senior management is further demonstrated by the fact that the valuation assigned to the minority shares of Harleysville Group owned by the Director Defendants in the Proposed Merger cannot be justified by *any* recognized measure of

valuation. Indeed, Harleysville's *own financial advisor* determined that the price to be paid for the minority shares substantially exceeded the top of the range of fair values by each of the ten methodologies it used to value Harleysville.

56. As is typical of valuation analyses of this kind, the prominent financial advisor retained by Harleysville to perform a valuation analysis, Keefe, Bruyette & Woods, Inc. ("KBW"), used a variety of standard methodologies: (1) comparable companies analysis, in which the merger price for the subject company is compared to the trading price of selected peer companies, (2) precedent transactions analysis, in which the merger price for the subject company is compared to prior transactions in which similar companies were sold, (3) discounted cash flow analysis, in which the subject company is valued based on assumptions regarding its future profitability, and (4) historical premiums paid analysis, in which the merger premium for the subject transaction is compared to the premiums paid in precedent merger transactions. *See* Proxy at 47-51

57. Here, every measure shows that the Minority Merger Price far exceeds the fair value of the minority shares, as shown on the following chart:



58. This kind of transaction price is truly unprecedented: it shows that the Proposed Merger price to be paid to the minority cannot be justified by *any* recognized valuation analysis. The Director Defendants were able to obtain this kind of payout from Nationwide only because they required Nationwide to pay *them* for the value attributable to Harleysville Mutual's majority interest in Harleysville Group and its wholly-owned Parent Businesses.

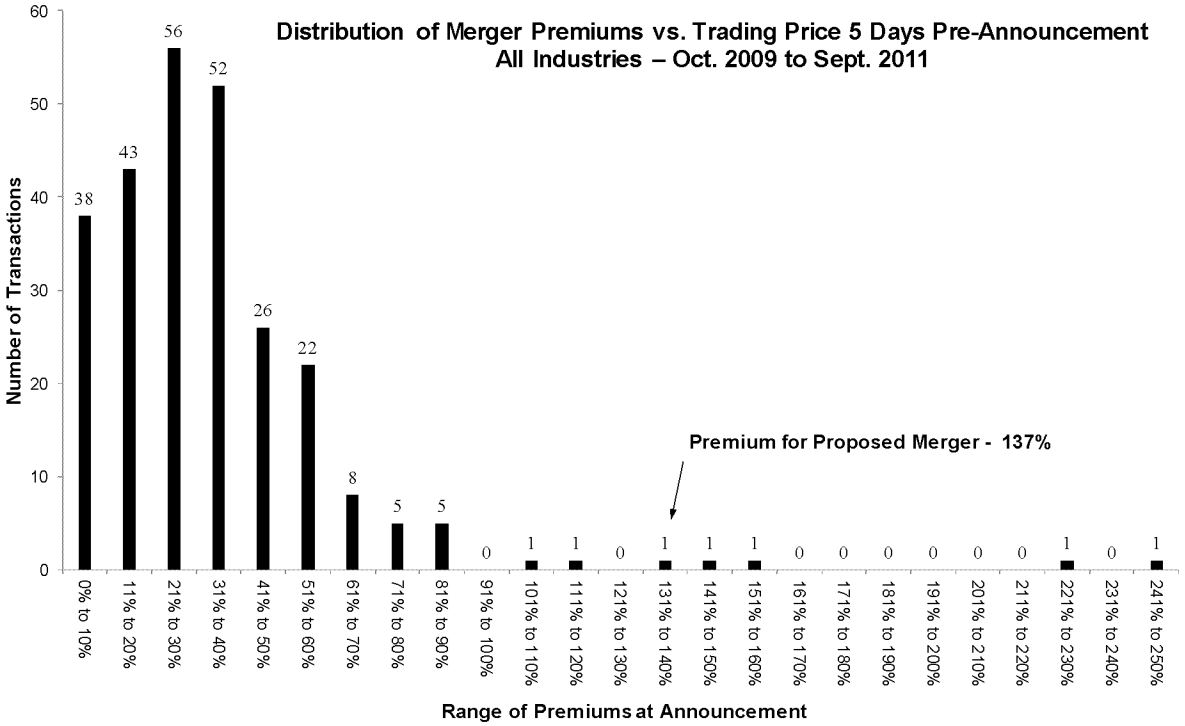
59. By contrast, as reflected by the dashed line in chart above, a fair, *pro rata* allocation of the merger premium – yielding a merger price of $39.10 – would have delivered a value in line with the majority of the valuation ranges calculated by KBW.

60. KBW's analysis is further supported by the analysis performed by Plaintiff of the merger premium to be paid here in relation to the premiums paid in other merger transactions.

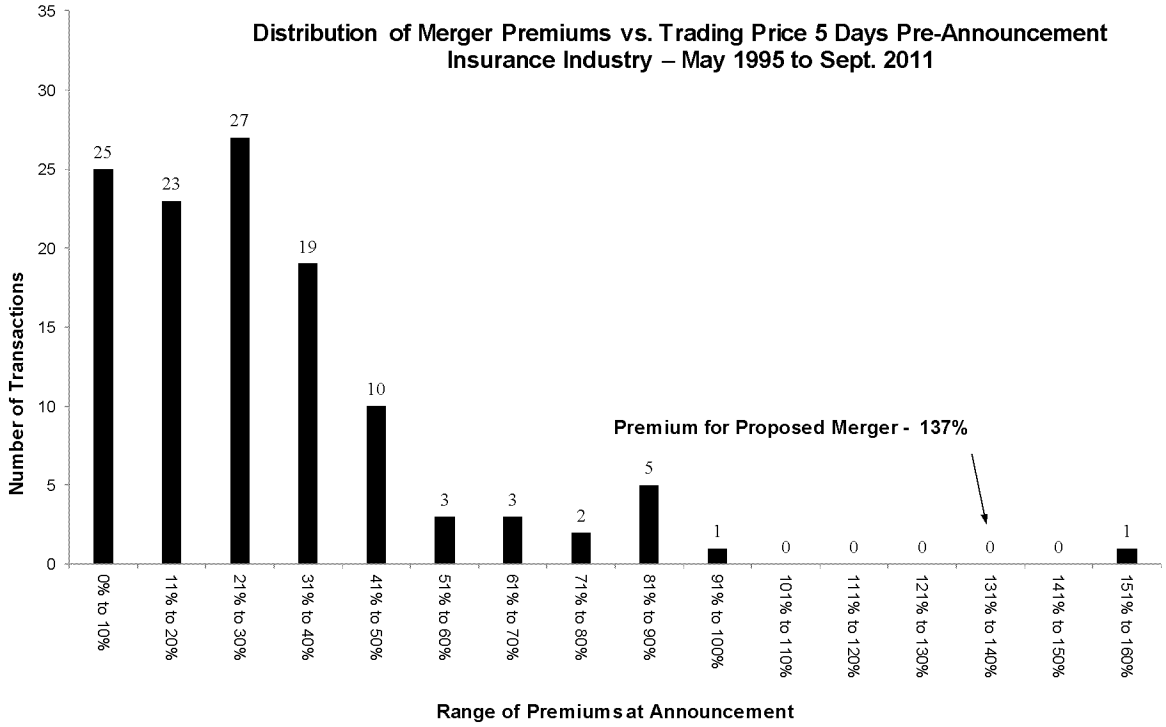
61. Of the 262 completed mergers reported in the FactSet Mergerstat database over the past two years, the 137% Proposed Merger premium over Harleysville Group's trading price five days pre-announcement (which captures the run-up after merger discussions were first reported on September 23) would be the fifth largest – thus ranked in the top 2% of all deals – and is more than *four times* the average reported premium of 34%.

62. Similarly, of the 119 completed merger transactions in the insurance industry reported in the FactSet Mergerstat database since 1995, the 137% premium here would rank as the second largest, and is also more than *four times* the average premium of 29%.

63. The extraordinary nature of the premium that the Harleysville Mutual directors appropriated to themselves is further illustrated graphically by comparison to the merger premiums obtained in other transactions:



Reflects all completed transactions with positive merger premiums announced between October 1, 2009 and September 30, 2011 for U.S. targets where the target's stock price 1, 5 and 30 days before the announcement of the transaction was $5 per share or more. Source for data: FactSet Mergerstat



Reflects all completed transactions with postitive merger premiums announced between May 30, 1995 and September 30, 2011 for U.S. targets in the insurance industry where the target's stock price 1, 5 and 30 days before the announcement of the deal was $5 per share or more.
Source for data: FactSet Mergerstat

64. Instructively, neither Harleysville Mutual nor its advisors have attempted to justify the allocation of all cash merger consideration to the minority shares of Harleysville Group as a fair economic allocation. Rather, they disregard the ownership interests of Harleysville Mutual's members, and instead focus on the asserted benefits of the Proposed Merger to Harleysville Mutual's members as policyholders.

65. In a letter to the Pennsylvania Insurance Commissioner dated November 17, 2011, for example, Harleysville's general counsel asserted that the Proposed Merger was fair to Harleysville Mutual members based on Nationwide's larger net surplus, higher A.M. Best rating, "more diverse set of financial products and services," its operation of a "national independent agency distribution network," and the fact that Harleysville Mutual members "will continue as members of a non-stock mutual insurance company with similar membership rights." He made

no reference to Harleysville Mutual members' ownership interest in Harleysville Mutual, or to them receiving fair compensation for their economic stake in Harleysville.

66. Similarly, in a public filing providing talking points about the Proposed Merger, Harleysville attempted to justify the Proposed Merger as providing a benefit to policyholders because "they will now be offered a broader portfolio of insurance, financial, and banking products and services" and "will enjoy the full backing of Nationwide's financial strength," stating that "[w]hile Harleysville has approximately $1.3 billion of surplus, the combined companies will have approximately $13.5 billion of surplus after the merger is complete." Harleysville Group Form 8-K, filed Oct. 11, 2011, Ex. 99.1, at 1.

67. The financial advisor retained to analyze the fairness of the Proposed Merger to Harleysville Mutual policyholder-members, Griffin Financial Group, LLC ("Griffin"), similarly cited the fact that Nationwide had "an A.M. Best rating of A+, a significantly greater surplus, enhanced claims paying ability, enhanced lines of business, a broader array of products and services, improved competitive pricing, and a broadened agency force as contrasted with Harleysville on a stand alone basis." Proxy at 35.

68. Griffin also sought to justify the Proposed Merger as fair to Harleysville Mutual members on the grounds that the legal rights of members under Ohio law are superior to those provided under Pennsylvania law in the event of demutualization or liquidation. *Id.* at 37.

69. Instructively, however, Griffin made *no* attempt to actually value the membership interests currently held by Harleysville Mutual members or compare them to the value of membership interests in Nationwide.

70. Plaintiff's preliminary analysis of the relative value of such interests indicates that the ownership rights of Harleysville Mutual members will be significantly impaired, because

Nationwide's larger net surplus is more than offset by the far larger number of its member-policyholders.[1] Harleysville, by contrast, writes the majority of its insurance through subsidiaries to policyholders who are not members of Harleysville Mutual. While definitive valuation of the relative worth of Harleysville Mutual and Nationwide member interests cannot be made on the basis of public information, analysis of net surplus per dollar in premiums earned for both companies indicates that the value of a member interest in Nationwide is substantially *lower* than the value of a member interest in Harleysville Mutual. While Harleysville Mutual had $4.45 in net surplus per dollar in premiums earned in 2010, Nationwide had only $1.07 in net surplus per dollar in premiums earned in the same period.

71. Thus, in addition to being wrongfully deprived on any part of the cash merger premium to be paid by Nationwide in the Proposed Merger, there is strong evidence that the value of Harleysville Mutual members' interests would be affirmatively impaired through the transaction.

E. The Process Leading to the Proposed Merger Was Dominated by Conflicted Members of Management and Focused on Maximizing the Payout to Them

72. As required by SEC rules, the Proxy contains a detailed narrative of the negotiation process leading to the Proposed Merger. As detailed in the Proxy, the manifestly unfair terms of the Proposed Merger resulted from a deeply flawed process dominated by conflicted members of management who focused on maximizing the value of their Harleysville Group shares, assisted by legal and financial advisors with longstanding ties to management.

73. While the Proxy repeatedly asserts concern for "all of the constituencies of the Company and Harleysville Mutual, including stockholders, policyholders, employees, agents and

[1] The number of each company's policyholder-members does not appear to be publicly disclosed. Accordingly, the amount of premiums paid by policyholder-members is used as a proxy.

the communities in which the Company and Harleysville Mutual and their respective insurance subsidiaries operate," Proxy at 24-25, the actual process reflects a paramount focus on maximizing the payout to management and the Director Defendants.

74. According to the Proxy, the discussions between Harleysville and Nationwide leading to the Proposed Merger began in early 2011. After initial meetings between the companies' respective chairmen and CEOs in which Nationwide advised it "would be willing to consider paying some premium over the market price for the shares held by the public stockholders of the Company," Nationwide sent Harleysville a letter indicating its interest "in a transaction that would involve the payment of $55 per share in cash to the public stockholders of the Company." *Id.* at 25-26.

75. In the period following receipt of Nationwide's offer, the parties' respective investment bankers held discussions regarding "their respective preliminary views of the valuation of the Company." *Id.* at 26.

76. In none of these discussions, as reported in the Proxy, was there any reference to concern for the interests of Harleysville Mutual's policyholder-members – the *sole* focus was what "the public stockholders" of Harleysville Group – including management and the Board – would receive.

77. In a meeting on April 27, 2011, the Proxy reports that the Harleysville Mutual Board "suggested that such negotiations focus on Harleysville Mutual and its constituencies, including policyholders, employees, agents, the communities in which Harleysville does business, the potential impact of a transaction on the Harleysville brand and other related issues." *Id.* Instructively, however, the first meeting to discuss such issues with Nationwide did not occur until July 14, more than 2 1/2 months later. *Id.* at 29.

78. The priority given by the Director Defendants and management to their own interests is reflected by their directives to Harleysville's principal financial advisor, Credit Suisse Securities (USA) LLC ("Credit Suisse") following "two days of annual offsite strategic planning meetings" in June 2011. According to the Proxy, the Harleysville Mutual and Harleysville Group Boards identified a list of objectives that they "emphasized to management and to Credit Suisse . . . must be met and satisfied" and further "directed that these objectives be conveyed to the three parties (and any other party) considering a potential transaction for Harleysville . . . ." *Id.* at 27-28. The first objective on the list was: "*maximize value for the public stockholders of the Company*," *id.* at 27 (emphasis added).

79. The *Harleysville Mutual* Board thus resolved that maximizing the payout to the minority stockholders of Harleysville Group – including themselves – should be the primary objective in the merger negotiations.

80. Consistent with this focus on achieving maximum payout for the minority shares owned by management and the Director Defendants, the definitive offer letter later presented by Nationwide on August 9, described in detail in the Proxy, set forth ten key points, none of which made any reference to the interests of Harleysville Mutual members or policyholders. *Id.* at 31.

F. The Harleysville Mutual Board Rejected an Alternative Bid That Would Have Paid Harleysville Mutual Members $250 Million

81. The Director Defendants' self-dealing and misappropriation of value from Harleysville Mutual members are most clearly crystalized in their rejection of a competing bid from an unidentified bidder that would have paid Harleysville Mutual members $250,000,000.

82. According to the Proxy, the transaction proposed by the bidder, referenced in the Proxy as "Company B," would have paid $42 per share to minority shareholders of Harleysville Group, $250 million to Harleysville Mutual members, and certain additional payments to

management. *Id.* at 33. In addition, Harleysville Mutual members would have become members of Company B's mutual holding company. The total value of the payments offered by Company B was approximately $844 million – slightly more than the total consideration offered by Nationwide.

83. However, rather than pursue negotiations over a competing proposal that would have paid hundreds of millions of dollars to Harleysville Mutual members (but proportionately less to themselves), the Director Defendants declined to pursue Company B's proposal.

84. As grounds for rejecting the Company B proposal, Harleysville's financial advisor and management supplied a variety of rationales, including that it "was subject to the completion of a due diligence review," that it "could take significantly longer to complete," and that it did not set forth "specific protections" for Harleysville employees, the Harleysville "brand," or Harleysville's geographic reach post-merger. *Id.* at 36. Instructively, the "specific protections" for these interests provided by Nationwide extend for *just twenty-four months* after the closing. *See* Proxy at 40.

G. The Use of a Financially-Interested "Special Committee" Assisted by Advisors with Ties to Management Further Demonstrates a Profoundly Flawed Process

85. Special committees of disinterested directors are today widely used to address conflicts of interests between insiders and unaffiliated stakeholders in merger transactions. In the present case, however, the "special committee" formed in the course of negotiations over the Proposed Merger violates many of the recognized precepts of an effective special committee, further demonstrating the profoundly flawed process that led to the misappropriation of the Proposed Merger consideration from Harleysville Mutual's members.

86. First, the essential prerequisite of an effective special committee is that the members of the committee in fact be independent and disinterested. Here, the committee was

comprised of Defendants DeBenedictis and Lapeyrouse, who would receive, respectively, $599,976 and $266,245 in personal profits from the wrongful diversion of merger consideration from Harleysville Mutual's members. *See* chart at paragraph 54, above. The members of the committee purportedly acting to provide independent review of the Proposed Merger for the benefit of Harleysville Mutual's members and other constituents thus had direct, personal interests in conflict with them.

87. Second, special committees are deemed effective only when assisted by advisors of their own choosing, who do not owe allegiances to conflicted insiders. Here, each of the advisors whom DeBenedictis and Lapeyrouse relied upon had prior ties to management.

88. In the case of Griffin – hired by DeBenedictis and Lapeyrouse shortly before the Proposed Merger was announced "because of the prior relationship between Harleysville and Credit Suisse," Proxy at 31 – the firm itself had, according to allegations by a former Harleysville employee, previously been retained by Harleysville and had provided substantial financial advisory services to it. Similarly, the law firm hired by DeBenedictis and Lapeyrouse, Stevens & Lee, P.C., is affiliated with Griffin and, according to the former Harleysville employee, also previously performed legal services for Harleysville.

89. The conduct of Griffin in advising DeBenedictis and Lapeyrouse whether the deal was fair to Harleysville Mutual raises further doubts as to its independence. As noted above (at paragraphs 67 and 68), Griffin strikingly failed to perform *any* analysis of either the value of Harleysville Mutual or the value of the consideration received by it in the Proposed Merger. Rather, it concluded simply that because Nationwide is a larger company with a higher A.M. Best rating, and because Ohio law confers more legal rights on members than does the law of Pennsylvania, the Proposed Merger was fair to Harleysville Mutual's members.

90. In addition to retaining new advisors who lacked independence, the Proxy makes clear that DeBenedictis and Lapeyrouse also relied on management's advisors – Ballard Spahr LLP ("Ballard") and Credit Suisse. *See* Proxy at 33-38. Given the recognized need for a special committee and for new advisors, their continued reliance on advisors with close ties to conflicted management is hard to explain.

91. For a special committee to be effective, the committee must also be given a clear mandate and be empowered to bargain at arm's length with the freedom to select from among the range of alternatives that an independent, disinterested board would have had available to it. Here, by contrast, the special committee was formed in August 2011, after four months of negotiations, at a point when the competing bidders had already been ruled out, and *after* an agreement in principle with Nationwide had been reached.

92. In addition, DeBenedictis and Lapeyrouse apparently failed to retain their advisors for over a month after the committee was formed, waiting until early September – just weeks before the Proposed Merger was announced. They further did not find the opportunity to adopt a charter until September 26 – just two days before the Merger Agreement was approved and signed.

93. Thus, the "special committee" formed by the Director Defendants, purportedly to protect the interests of Harleysville Mutual members and other constituents, suffered from disabling flaws similar to those faced by the entire Board, and it entirely failed to conform to the recognized standards governing effective independent committees.

H. The Proxy Discloses Additional Financial Benefits to Management and the Board

94. In addition to the tens of millions of dollars diverted from Harleysville Mutual members to the Board through the Proposed Merger's allocation of consideration, the Proxy

discloses that Harleysville management and the Board would profit from the Proposed Merger in additional respects.

95. First, Nationwide agreed to establish an "advisory group" comprised of the directors of Harleysville Mutual and Harleysville Group, for which each Director Defendant will be paid $40,000 annually ($80,000 for the Chairman). Proxy at 63.

96. Second, for the asserted reason of avoiding certain tax liabilities, Harleysville has elected to accelerate payment of 2011 cash bonuses and the vesting of restricted stock and restricted stock units, thereby providing an early payout to Defendant Browne and other senior executives in anticipation of the later closing of the Proposed Merger. *Id.* at 59-60.

97. Third, Defendant Browne and other senior executives will receive a retention bonus payment equal to one or two years' base salary and short-term incentives awards, payable 12 to 24 months after the closing of the Proposed Merger. *Id.* at 62-63.

---

98. Briefly stated, there was no defensible basis for the Director Defendants' decision to divert over $300 million in merger premium fairly owed to Harleysville Mutual and its members to the minority Harleysville Group shares owned by them, and their failure to provide any procedural protections for Harleysville Mutual members in light of the manifest conflict of interest they faced is simply inexcusable. The Director Defendants' approval of a transaction structure that favors their own interests at the expense of the members of Harleysville Mutual constitutes a manifest breach of the Director Defendants' fiduciary duty of loyalty and renders the Proposed Merger fundamentally unfair.

CLASS ACTION ALLEGATIONS

99. Plaintiff brings this action as a class action pursuant to Rules 1701 *et seq.* of the Pennsylvania Rules of Civil Procedure, on behalf of herself and a Class comprised of all

Harleysville Mutual members, excluding Defendants and any person, firm, trust, corporation, or other entity related to or affiliated with any Defendant (the "Class").

100. This action is properly maintainable as a class action.

101. The Class is so numerous that joinder of all members is impracticable. Upon information and belief, Harleysville Mutual has thousands of policyholder-members, and they are therefore so numerous that it is impracticable to bring them all before this Court.

102. Questions of law and fact common to the Class predominate over any question affecting only individual members of the Class, and include, among others:

(a) Whether the terms of the Proposed Merger are fundamentally unfair;

(b) Whether the Director Defendants breached their fiduciary duties in connection with the Proposed Merger; and

(c) Whether Plaintiff and the other members of the Class will be irreparably harmed if the Proposed Merger is allowed to proceed.

103. Plaintiff is committed to prosecuting this action and has retained competent counsel experienced in litigation of this nature. Plaintiff's claims are typical of the claims of the other members of the Class and Plaintiff has the same interests as the other members of the Class. Accordingly, Plaintiff is an adequate representative of the Class and will fairly and adequately protect the interests of the Class.

104. In view of the complexities of the issues and the expense of litigation, the separate claims of individual Class members are insufficient in amount to support separate actions.

105. A class action provides a fair and efficient method for adjudication of the controversy at issue in this action. The prosecution of separate actions by individual members of the Class would create the risk of (i) inconsistent or varying adjudications with respect to

individual members of the Class which would confront Defendants with incompatible standards of conduct, and (ii) adjudications with respect to individual members of the Class which would, as a practical matter, be dispositive of the interests of other members not party to the adjudications or substantially impair or impede their ability to protect their interests.

106. Plaintiff anticipates that there will be no difficulty in the management of this litigation as a class action.

107. Preliminary and final injunctive relief on behalf of the Class as a whole is appropriate because Defendants have acted on grounds generally applicable and causing injury to the Class.

DEMAND EXCUSED

108. If any of the claims set forth herein are determined to be claims that must be asserted derivatively, then Plaintiff asserts such claims derivatively pursuant to Section 1506 of the Pennsylvania Rules of Civil Procedure on behalf of Harleysville Mutual.

109. Efforts were not made to secure enforcement by Harleysville Mutual of the claims asserted herein prior to the commencement of this action because Harleysville Mutual faces the prospect of irreparable injury from the closing of the Proposed Merger. In the event that the Proposed Merger is permitted to close without entry of the injunction requested hereby, the merger consideration wrongfully diverted by Defendants will be paid to third parties from whom it cannot be recovered. In addition, there is substantial uncertainty regarding the nature of the post-closing remedies available to Plaintiff, and limitations on the availability of such remedies may preclude full relief from Defendants after the consummation of the Proposed Merger.

DISCLAIMER

110. Plaintiff does not assert any claim in this action to the extent such claim would be inconsistent with the jurisdiction of the Insurance Department.

CLAIMS FOR RELIEF

COUNT I
Direct Class Claim for Review of Contested Corporate Action and Equitable Relief on Grounds of Fundamental Unfairness

111. Plaintiff repeats and realleges the foregoing paragraphs 1 through 110 as if fully set forth herein.

112. Plaintiff seeks review of the validity of the Proposed Merger pursuant to 15 Pa.C.S. §§ 1105 and 1793.

113. The Proposed Merger unlawfully diverts merger consideration belonging to Plaintiff and the Class to the Director Defendants, Harleysville management, and other minority shareholders of Harleysville Group, and is therefore fundamentally unfair to Plaintiff and the Class.

114. Unless enjoined by this Court, Defendants may consummate the Proposed Merger, subjecting Plaintiff and the Class to irreparable harm.

115. Plaintiff and the Class have no adequate remedy at law.

COUNT II
Direct Class Claim for Unjust Enrichment and Constructive Trust

116. Plaintiff repeats and realleges the foregoing paragraphs 1 through 115 as if fully set forth herein.

117. If the Proposed Merger is consummated, the Director Defendants, Harleysville management and other minority shareholders of Harleysville Group will be paid the merger consideration, a portion of which is lawfully due to Plaintiff and the other members of the Class.

118. An equitable duty exists to convey that portion of the merger consideration to which Plaintiff and the other members of the Class are entitled, on the grounds that unjust

enrichment would result if the Director Defendants, Harleysville management and other minority shareholders are permitted to receive and retain it.

119. Accordingly, in the event that the Proposed Merger is consummated, Plaintiff seeks the imposition of a constructive trust upon that portion of the merger consideration to which the Plaintiff and other members of the Class are lawfully entitled, and further seeks payment of such funds to Plaintiff and the Class.

120. Plaintiff and the Class have no adequate remedy at law.

COUNT III
Derivative Claim for Breach of Fiduciary Duty

121. Plaintiff repeats and realleges the foregoing paragraphs 1 through 110 as if fully set forth herein.

122. As directors of Harleysville Mutual, the Director Defendants owe a fiduciary duty of loyalty.

123. As discussed herein, the Director Defendants have breached and continue to breach their fiduciary duty of loyalty by causing Harleysville Mutual to enter into the Merger Agreement on terms that benefit themselves and other members of management at the expense of Harleysville Mutual.

124. As a result of the Director Defendants' breaches of their fiduciary duties, Harleysville Mutual will suffer irreparable injury resulting from the diversion and payment of merger consideration to the Director Defendants and third parties to which Harleysville Mutual is lawfully entitled.

125. Unless enjoined by this Court, the Director Defendants will continue to breach their fiduciary duties, and may consummate the Proposed Merger, subjecting Harleysville Mutual to irreparable harm.

126. Harleysville Mutual has no adequate remedy at law.

PRAYER FOR RELIEF

WHEREFORE, Plaintiff, on behalf of herself and the other members of the Class, and derivatively on behalf of Harleysville Mutual, demands judgment as follows:

A. With respect to Counts I and II, declaring this action properly maintainable as a class action;

B. Pursuant to the Declaratory Judgment Act, 42 Pa.C.S. §§ 7531-41, and Rule 1602 of the Pennsylvania Rules of Civil Procedure, declaring (i) that the Proposed Merger is fundamentally unfair by reason of the allocation of all cash consideration to the minority shares of Harleysville Group, and (ii) that the Director Defendants have breached their fiduciary duty of loyalty by approving the Proposed Merger.

C. Enjoining the distribution of Proposed Merger consideration to which Plaintiff and the Class are entitled and imposing a constructive trust thereon;

D. Directing Defendants, jointly and severally, to account to Plaintiff and the Class for all damages suffered and to be suffered by them as a result of the wrongs complained of herein;

E. Awarding Plaintiff the costs and disbursements of this action, including a reasonable allowance for the fees and expenses of Plaintiff's attorneys and experts; and

F. Granting Plaintiff and the other members of the Class such other and further relief as is just and equitable.

Dated: December 30, 2011

/s/ David Felderman

David Felderman (ID No. 78889)
Daniel J. Mirarchi (ID No. 85106)
Mary Ann Giorno (ID. No. 92644)
SPECTOR ROSEMAN
KODROFF & WILLIS, P.C.
1818 Market Street, Suite 2500
Philadelphia, Pennsylvania 19103
(215) 496-0300 (Telephone)
(215) 496-6611 (Facsimile)
dfelderman@srkw-law.com
dmirarchi@srkw-law.com
mgiorno@srkw-law.com

WOHL & FRUCHTER LLP
Ethan D. Wohl
(*pro hac vice* motion to be filed)
570 Lexington Avenue, 16th Floor
New York, New York 10022
(212) 758-4000 (Telephone)
(212) 758-4004 (Facsimile)
ewohl@wohlfruchter.com

Attorneys for Plaintiff and the Proposed Class