

IN THE COURT OF COMMON PLEAS, FRANKLIN COUNTY, OHIO

MARY JO HUDSON, Ohio Superintendent of Insurance, in her capacity as Liquidator of LMI Insurance Company,

Plaintiff,

v.

LMI Insurance Company,

Defendant.

Case No. 00CVH03-2431

Judge Charles A. Schneider

JOURNAL ENTRY AND ORDER APPROVING ADMINISTRATIVE EXPENSE OPERATING PROCEDURES UPDATED EFFECTIVE JANUARY 1, 2011

This matter came before the Court upon the Motion of Mary Jo Hudson, Superintendent of Insurance, in her capacity as the Liquidator of LMI Insurance Company for Approval of Administrative Expense Operating Procedures updated effective January 1, 2011, as set forth in the attachment to the Liquidator's Motion.

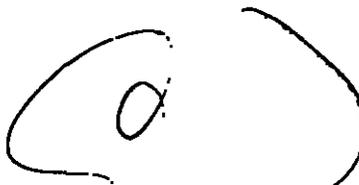
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COMMON PLEAS COURT
FRANKLIN CO. OHIO
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CLERK OF COURTS-CV

For good cause shown, the Motion is GRANTED and:

1. The updated Administrative Costs and Expenses Procedures updated effective January 1, 2011, attached hereto, are hereby approved and fully incorporated into this Order.
2. The Liquidator is authorized to pay all past, present and future administrative expenses and/or costs pursuant to the attached updated Administrative Costs and Expenses Procedure updated effective January 1, 2011.

IT IS SO ORDERED.

Dated: 12/21/2010



Judge Charles A. Schneider

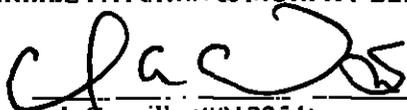
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ADMINISTRATIVE COSTS AND EXPENSES PROCEDURE

Updated Effective January 1, 2011

The Liquidator's Administrative Costs and Expense Operating Procedure (AOP) is updated to reflect the change in the Estate through which employee compensation, payroll taxes and benefits are administered effective January 1, 2011. It is further updated to reflect that, effective January 1, 2011, the inter-company billing and reimbursement accounting methods used for Joint Administrative Services and Expenses (other than payroll/wages, employer payroll taxes, and withholding and remittance of employees' taxes, employer 401K and HSA contributions) under the Administrative Costs and Expenses Procedure approved by the Liquidation Court beginning in 2008 are suspended and discontinued. Instead, under this updated Procedure, each Estate will write a check equal to its percentage share of the invoice amount which is calculated pursuant to the GOE formula set forth below. These improvements are the result of the closure of a number of liquidation estates and other improvements in accounting procedures and the efficiency and economies of scale for open estates. Last, this update documents the Liquidator's administrative costs and expenses procedures for closing and closed Estates after a final distribution of assets to creditors.

Purpose

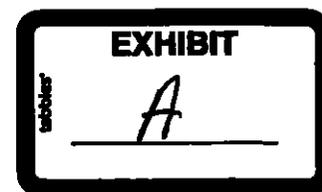
This Administrative Operating Procedure documents the practices and procedures of the Office of the Ohio Insurance Liquidator with respect to incurring, paying for and accounting for Administrative Services and Expenses, including the sharing, advancement, allocation and reimbursement of Joint Administrative Services and Expenses among the various open Rehabilitation and Liquidation Estates that have not made a final distribution of assets. This Administrative Operating Procedure also documents beginning on page 7 the separate practices and procedures with respect to a closing or closed Estate incurring and paying for Administrative Services and Expenses.

OPEN ESTATES

Introduction

1. The Superintendent of Insurance in her capacity as Liquidator (the "*Liquidator*") is vested by operation of law with the title to all of the property, contracts, and rights of action of each Liquidation Estate pursuant to Section 3903.18(A) of the Ohio Revised Code (the "*ORC*") and the Liquidation Orders issued by the Franklin County Court of Common Pleas in each Liquidation case (the "*Supervising Court*"). The Liquidator is generally charged under ORC §3903.18 with the duty to secure, marshal, administer and distribute the assets of all liquidated insurers under the supervision of the Supervising Court.

2. The Superintendent of Insurance in her capacity as Rehabilitator (the "*Rehabilitator*") is vested by operation of law with the title to all of the property, contracts, and rights of action of each Rehabilitation Estate pursuant to ORC §3903.13(A) and the Rehabilitation Orders issued by the Supervising Court for each Rehabilitation Estate. The



Rehabilitator is generally charged under ORC §3903.13 with the duties to take possession of the assets of rehabilitated companies, and to administer them under the supervision of the Supervising Court.

3. To assist in the economic and efficient performance of her statutory and fiduciary duties to administer and resolve the affairs of an insurer in rehabilitation or liquidation for the benefit of the creditors, policyholders and the general public, the Liquidator and Rehabilitator (collectively, the "Receiver") is required to incur Administrative Services and Expenses on behalf of insurance companies in court-ordered rehabilitation or liquidation (collectively, the "Estates"). The Receiver has, among other things, (1) employed a Chief Deputy Liquidator and various other Deputy Rehabilitators/Liquidators and employees; (2) incurred attorneys' fees; (3) retained consultants; (4) leased office space at 50 West Town Street, Suite 350, Columbus, Ohio 43215 and one warehouse necessary and appropriate for the operation of the Office of the Ohio Insurance Liquidator separate and apart from the State of Ohio Department of Insurance and for the Receiver's deputies, employees, attorneys and consultants to perform administrative services; and (5) entered into service and supply contracts with vendors and suppliers for office supplies, goods, equipment or services that support the deputies, employees and consultants in carrying out their administrative duties with respect to the efficient and economical liquidation or rehabilitation of all insurance companies in rehabilitation or liquidation. Estates retain administrative services and incur administrative expenses alone (individually) or in limited circumstances jointly with other Estates, as explained further below. Even when Administrative Services and Expenses are incurred jointly, each incurring Estate separately pays its share of the expense pursuant to the GOE formula set forth below. There is no commingling of assets and no Estate funds or pays for the administration of another Estate.

4. Generally, Estates individually and directly incur and pay out of the individual estates' bank accounts their own Administrative Services and Expenses for administrative and professional goods or services from employees, attorneys, actuaries, accountants, appraisers, consultants and other vendors on a matter-specific/estate-specific basis, as necessary to assist the Receiver in taking possession of the particular insurer, to separately administer each Estate's assets and liabilities and to conduct the rehabilitation or liquidation proceeding in the best interests of each Estate's creditors, policyholders and the general public. Under this updated AOP, Individual Estate Administrative Services and Expenses include rent equal to the actual leased cost on a square foot basis of the square footage that each open estate utilizes within the Liquidator's office and warehouse facilities. These Administrative Services and Expenses are referred to herein as, the "*Individual Estate Administrative Services and Expenses*."

5. Estates jointly incur Administrative Services and Expenses only when such expenses and services benefit all or more than one of the Estates and improve efficiency and economics of scale in the best interests of one or more of the Estates, and each Estate's creditors, policyholders and the general public, including but not limited to the following:

- (A) general administrative services (*i.e.*, time and services that are not provided and cannot be charged only to an individual estate) by such executive, management, professional, technical, clerical and other employees of the Office of the Ohio Insurance Liquidator as may be assigned for such purposes by the Receiver,

including but not limited to general administrative services of the Chief Deputy Liquidator and various other Deputy Rehabilitators/Liquidators and employees, financial and accounting services, legal services, audit services, information and technology services, treasury services, human resources services, communications services, payroll processing services, employee benefits participation, procurement services, tax and related services, contract negotiation and administration services, insurance and risk management services, and clerical services;

- (B) the purchase or rental and use of common areas within the Liquidator's office and storage facilities, including, but not limited to, office space that is a common area, utilities, equipment, machinery, supplies, computers and computer software, communications equipment, insurance policies, and other personal property that is utilized by all estates;
- (C) all other necessary expenses incurred by the Receiver in resolving the affairs of multiple insurers in rehabilitation or liquidation.

These Administrative Services and Expenses are collectively referred to herein as the "*Joint Administrative Services and Expenses*."

6. ORC § 3903.21(A)(4) authorizes the Liquidator to defray from the funds or assets of the insurer all expenses of taking possession of, conserving, conducting, liquidating, disposing of, or otherwise administering the business and property of a liquidated insurer. ORC § 3903.14(A) similarly authorizes the Rehabilitator to pay out of the funds or assets of the rehabilitated insurer all expenses of taking possession of the insurer and of conducting the rehabilitation proceedings.

7. The Receiver accounts for and fairly allocates the costs of the "*Joint Administrative Services and Expenses*" as they are incurred, *pro rata* among the Liquidation and Rehabilitation Estates pursuant to a GOF Allocation Formula, in use since at least 1993, that weighs the salaries/wages relative to the number of hours liquidation office personnel charge to each Estate and the amount of assets held by each Estate.

8. This Procedure documents the Receiver's practices and procedures with respect to incurring Individual and Joint Administrative Services and Expenses, including the sharing, advancement, allocation and reimbursement of Joint Administrative Services and Expenses among the Estates.

Incurring Administrative Expenses

1. Estates shall incur Joint Administrative Services and Expenses only when they benefit more than one Estate (and specifically each Estate that is incurring the Joint Administrative Services and Expenses) and when incurring such expenses and services jointly improves efficiency and economies of scale of each incurring Estate. Otherwise, each Estate shall directly incur Individual Administrative Services and Expenses based on the needs of that particular Estate.

Payment of Administrative Expenses

1. *Individual Administrative Services and Expenses.* All Individual Administrative Services and Expenses except Employment Administrative Services and Expenses described below shall be billed to and paid for as they are incurred directly by the incurring Estate from that Estate's own, segregated bank account. Payment of Individual Administrative Services and Expenses shall not be advanced by, paid from, shared by or allocated to any other person or Estate, except the Ohio Department of Insurance and only to the extent provided in ORC §3903.14(A).

2. *Joint Administrative Services and Expenses.* With the exception of Employment Administrative Services and Expenses described below, Joint Administrative Services and Expenses are also paid directly as they are incurred by each incurring Estate from that Estate's own, segregated bank account. Payment of an Estate's share of Joint Administrative Services and Expenses (calculated pursuant to the GOF Allocation formula described below) shall not be paid from, shared by or allocated to any other person or Estate, except the Ohio Department of Insurance and only to the extent provided in ORC §3903.14(A). Effective January 1, 2011, the inter-company billing, payment through the Credit General Insurance Company Estate and reimbursement accounting methods used under the prior AOP for all Joint Administrative Services and Expenses except Employment Administrative Services are suspended. Instead, each Estate that incurs the Joint Employment Services and Expenses will write a check equal to its allocated share of the invoice amount.

3. *Employment Administrative Services and Expenses.* None of the employees in the Office of the Ohio Insurance Liquidator is a State employee. Effective January 1, 2011, the LMI Insurance Company In Liquidation employs at will and pays all compensation and related payroll taxes and employee benefits of employees in the Office of the Ohio Insurance Liquidator, regardless of whether the employment expenses are Individual (that portion of payroll/wages that is for time charged to one or more individual estates other than LMI) or Joint (e.g., employee benefit participation) Administrative Expenses. The LMI Insurance Company in Liquidation shall be responsible for the issuance of pay checks and payment of all employer payroll taxes, and withholding and remittance of employees' taxes, employer 401K and HSA contributions for services provided to one or more of the Estates. Funds to pay payroll/wages, employer payroll taxes and withholding and remittance of employees' taxes, employer 401K and HSA contributions and other payroll-related expenses for services provided to one or more of the Estates that are disbursed by LMI Insurance Company in Liquidation on payroll pay dates (generally scheduled the Friday after the pay period ending) are advanced to LMI by other estates as necessary on the payroll date.

The LMI Insurance Company in Liquidation shall maintain Workers' Compensation, unemployment compensation, Social Security, professional liability and similar coverages with respect to such employees and shall, in this regard, prepare and file all necessary reports and make all necessary remittances to the appropriate governmental agencies. The LMI Insurance Company in Liquidation Estate will maintain the Section 125 Benefits Plan that will enable participants to pay health and other insurance premiums from pre-tax dollars.

The funds to pay the costs of administering LMI Insurance Company in Liquidation as the "employer estate" are also paid by the other estates.

Charges and payments or set-offs between Estates for provision and payment of Employment Administrative Services and Expenses shall be supported by documentation sufficient to independent auditors, which may be maintained in electronic form.

4. Some Estates may not incur or receive any Joint Administrative Services and Expenses, such as when a company in rehabilitation or liquidation continues to maintain its own offices and/or where the Receiver has determined that it is more economic, efficient or practical for that company to continue to (i) employ and pay directly all compensation and employee benefits of that rehabilitated or liquidated company's employees and (ii) incur and pay directly for its own general and other Administrative Services and Expenses. In those cases, all Administrative Services and Expenses shall be treated as Individual Administrative Services and Expenses and paid for directly and exclusively by the Estate that incurred the expenses from that Estate's own, segregated bank account. In those cases, the Receiver shall not allocate the cost of the administrative services and expenses to any other Estate.

5. No Estate or the Receiver shall charge any other Estate a fee for allocating, accounting or payment of Joint Administrative Services and Expenses.

6. Each Estate does maintain, and shall continue to maintain, its own segregated bank accounts from which the Estate shall pay directly for its Individual Administrative Services and Expenses and for its *Joint Services and Expenses* and from which the Estate shall pay (directly or through same day advance to LMI or reconciliation) for its allocated share of Joint Administrative Services and Expenses.

Accounting and Allocation of Joint Administrative Services and Expenses

1. Each Estate shall continue to maintain clear and accurate records sufficient to independent auditors documenting and accounting for procurement and payment of all Individual and Joint Administrative Services and Expenses, which records are not public records under ORC §149.43, or any other state or federal statute, regulation, common law or law governing public records.

2. Joint Administrative Services and Expenses are allocated and charged to individual estates using the General Operating Expense Allocation Procedure and Formula (the "*GOE Allocation Percentage*") set forth below.

3. The GOE Allocation Percentage is a method of cost allocation that the Liquidation Office has used since approximately 1993. The GOE Allocation Percentage weighs assets and salaries of each Estate equally to calculate a percentage of Joint Administrative Services and Expenses and Joint Employment Administrative Service Expenses that are General Administration that will be allocated to and paid by each Estate. The GOE Allocation Percentage is calculated quarterly. The GOE Percentage is derived from the total salary obligation of the Liquidation Office for the previous quarter (that is, the salaries/wages relative to the amount of all hours all persons

have spent benefiting all Estates, including time charged as General Administration) and the amount of total assets each Estate held for the previous quarter.

(A) *Calculating the Quarterly GOE Allocation Percentage.* Every three (3) months, each Estate will total and average the par value of the invested assets of that Estate in order to calculate a quarterly average of the par value of invested assets for each Estate. Using this weighted average, a percentage will be calculated reflecting the total par value of invested assets that each Estate has in relation to the total par value of all investments held by all Estates. ("Quarterly Asset Percentage Per Estate").

Second, for the same three (3) month period, each Estate will total and average the amount of salaries directly charged to and paid (or reimbursed to the Ohio Department of Insurance) by that Estate for the previous quarter in order to calculate a quarterly average of the salary obligations of each Estate using this average, a percentage will be calculated reflecting the amount of salaries that each Estate incurred in relation to the amount of salaries paid by all Estates. ("Quarterly Salary Percentage Per Estate").

Third, the Quarterly Asset Percentage Per Estate and the Quarterly Salary Percentage Per Estate are then averaged on an Estate by Estate basis to arrive at the GOE Percentage to be used by each Estate for the following quarter.

	ASSET %	SALARY %	GOE %
Estate A	10.40	5.49	7.94
Estate B	14.23	4.75	9.49
Estate C	13.27	6.62	9.95
Estate D	43.52	57.52	50.52
Estate E	5.53	9.28	7.41
Estate F	9.87	9.82	9.84
Estate G	0.63	0.81	0.72
Estate H	0.84	3.44	2.14
Estate I	1.71	2.27	1.99
TOTALS	100.00	100.00	100.00

(B) *Allocating Individual and Joint Employment Administrative Services and Expenses.* The costs of employees in the Office of the Ohio Insurance Liquidator shall be allocated to each Estate in proportion to the time each employee actually spends administering such

Estate. Each employee is required to record as Individual Administrative Services and Expenses all actual hours worked to each Estate for which the employee is performing services. The GOE Allocation Formula is not used to calculate the sum that each estate pays for time charged by employees for services rendered to individual estates. Instead, each Estate pays the actual cost of these Individual Administrative Services and Expenses on the same payroll date LMI pays them.

When an employee is performing services that benefit all of the Estates, such employee time shall be designated and charged as "General Administrative Services" and then allocated and charged to all Estates as Joint Administrative Services and Expenses using the GOE Allocation Percentage. All employee time for Paid Time Off (PTO) is deemed Joint Administrative Services and Expenses and allocated to all Estates as a General Administrative Service using the GOE Allocation Percentage.

(C) *Allocating Other Joint General Services and Expenses.*

(i) *50 West Town Street:* Rent, utilities and all other expenses related to occupation of common areas within 50 West Town Street, Suite 350 for purposes of the operation of the Office of the Ohio Insurance Liquidator shall be allocated to all Estates using the GOE Allocation Percentage.

(ii) *Warehouse:* The records and other property of every insurance company in rehabilitation or liquidation are stored at either the warehouse leased by the Office of the Ohio Insurance Liquidator or at outside records storage facilities (e.g. Fireproof Records Center, Iron Mountain). Rent for common areas, utilities and all other expenses related to the occupation a warehouse is allocated only to the Estates whose records and other property is stored at that warehouse using the GOE Allocation Percentage.

(iii) *General Administrative Services:* All other Joint Administrative Services and Expenses shall be allocated to all Estates using the GOE Allocation Percentage.

4. The Receiver shall adjust charges and payments for Joint Administrative Services and Expenses based on reconciliation of amounts charged and costs incurred by each Estate.

CLOSING AND CLOSED ESTATES

Incurring and Payment of Administrative Services and Expenses after a Final Distribution of a Closing Estate's Assets

1. After the Liquidator has collected all of an Estate's assets that are reasonable to collect and the Liquidator and the Liquidation Court have adjudicated and approved all claims, the Liquidator prepares to make a final distribution of the Estate's assets to allowed claimants and shortly thereafter close the Estate and terminate the Liquidation Case. Toward this end, the Liquidator files in each Liquidation Case one or more motions seeking the Court's approval of

(a) the Liquidator's report(s) on allowed proofs of claims to be paid in the final distribution and (b) the Liquidator's detailed reserves ("holdback") from the final distribution of sums needed to pay the closing Estate's known future administrative expenses (*i.e.*, tax returns, final court cash, document retention and destruction, etc.) that will be incurred after the final distribution of the Estate's assets to allowed creditors. The reserved (held back) shares of the closing Estate's Joint Administrative Services and Expenses are calculated pursuant to the GOE Allocation Formula in place at the time the Liquidator files the Motion seeking approval of the holdback as part of the requested final distribution.

2. Generally, it takes approximately six months after the court approves the final distribution and holdback to close an Estate. In most cases, the majority of funds reserved and held back in the Estate for payment of that Estate's known future administrative expenses are in fact incurred and paid by the closing Estate after the final distribution and prior to the final closure of that Estate. For example, documents that can be destroyed immediately pursuant to the Court's approval orders set forth in paragraph 1 above are destroyed and the cost of destruction is paid for out of the reserve or "holdback" remaining in the closing Estate's bank account while the distribution checks are clearing and, thus, prior to final closure of the Estate. Administrative expenses that are incurred and paid from the holdback after the final distribution and prior to the closure of the Estate are allocated pursuant to the approved holdback and paid for out of the reserve or "holdback" remaining in the closing Estate's bank account and reported in the final court cash report.

3. Approximately six months after the final distribution, the Liquidator files an Application for a court order ("the Closing Order") closing the Estate, terminating the Liquidation Case, dissolving the company if it is not already dissolved, closing the Estate's bank accounts, discharging the Liquidator and providing for other matters necessary to end the liquidation. Once the Closing Order is entered and the Liquidator discharged, there is no Estate, no Liquidation Case and no authorized Liquidator for the closed insolvent company or its closed Estate except to the limited extent required to perform the remaining ministerial tasks outlined above (e.g., document retention and destruction, final tax return). Therefore, future administrative obligations and expenses that cannot be incurred and paid for prior to entry of the Closing Order (e.g., document retention of certain documents for 7 years under IRS regulations) and the holdback to pay for those authorized Administrative Services and Expenses of a closed Estate are administered by another entity. Under the prior practice of the Liquidator dating back to 1995 and most recently reviewed by the Liquidator's independent auditors and accounts in 2010, the few remaining administrative obligations of the closed Estate along with the remaining reserves/holdback are thereafter administered by an open estate, now LMI. The transfer of the holdback to LMI is deemed a prepayment to LMI for its administration of the closed Estate's few remaining court-authorized future Administrative Services and Expenses necessary to efficiently terminate a liquidation so that LMI's assets and liabilities are not commingled with those of the closing estate and so that LMI's assets are not used to pay the obligations of another Estate. Post-closing administrative expenses (including employee time spent on the closed Estate) are not separately charged to the closed Estate or tracked in relation to the holdback or separately reported on LMI's court cash reports. LMI's court cash reports, however, will show LMI's receipt of the remaining holdback from a closed Estate.

COURT APPROVAL

Court Approval of Administrative Services and Expenses

1. Beginning January 1, 2011, the Receiver shall submit the following matters to the Supervising Court that is overseeing any Estate that will incur the Administrative Services and Expenses for prior approval to incur Administrative Services and Expenses:

- (A) Any lease of real estate;
- (B) The hiring of consultants, if, the cost of such services is expected to exceed, or in fact exceeds, \$10,000, except that the Receiver shall not seek court approval to retain experts, attorneys or consultants in anticipation or furtherance of litigation;
- (C) Banking relationships, which shall be reassessed no less frequently than every five (5) years, and modified based upon responses to requests for proposals issued by the Chief Deputy Liquidator to several banking institutions (for purposes of applying this procedure, the last reassessment of banking relationships occurred in October 2008);
- (D) Retention of independent auditors, which shall be reassessed no less frequently than every five (5) years, and modified based upon responses to requests for proposals issued by the Chief Deputy Liquidator to several public accounting firms (for purposes of applying this procedure, the last reassessment of the independent auditor relationship occurred in 2006, and an RFP for 2011 was issued);
- (E) Any court-ordered expense, i.e., expense to publish notices;
- (F) Any expense that is outside the ordinary course of business of the Office of the Ohio Insurance Liquidator, except for emergency expenditures;
- (G) Any expense in the ordinary course of business of the Office of the Ohio Insurance Liquidator that is expected to exceed, or in fact exceeds, \$25,000; and
- (H) The settlement and/or compromise of all litigation and disputes initiated by the Receiver under the authority of R.C. Chapter 3903; provided, however, that,
 - (i) proofs of claims are not claims initiated by the Receiver and shall be determined and approved by the Supervising Court exclusively pursuant to ORC §3903.39 and ORC §3903.43; and/or
 - (ii) if the gravamen of a case or claim initiated by the Receiver under the authority of R.C. Chapter 3903 is a claim for less than \$25,000

(examples of such claims include: claims against policyholders for the collection of premiums, certain subrogation claims and the collection of certain accounts receivable), then such claims may be settled by the Receiver, or by collection agencies or collection law firms retained by the Receiver, without approval of the Supervising Court, so long as each settlement is within the parameters of the Receiver's internal Collection Project Guidelines. The Collection Project Guidelines shall be reassessed no less frequently than every five (5) years (for purposes of applying this procedure, the last reassessment of the Collection Project Guidelines occurred in 2008).

2. In addition, the Receiver shall prepare and file with the Supervising Court for each Estate a periodic accounting showing the cash receipts and disbursements of each Estate. The Receiver shall prepare and file the periodic accounting no less than twice annually, or more frequently if ordered by the Supervising Court.

Independent Audit of Each Estate's Administrative Services and Expenses

1. The Chief Deputy Liquidator shall retain one independent auditor to conduct the annual audits of each Estate's finances and internal controls based upon responses to requests for proposals issued by the Chief Deputy Liquidator to several public accounting firms no less frequently than every five (5) years. For purposes of applying this procedure, the Chief Deputy Liquidator last retained an independent auditor in 2006. An RFP for 2011 was issued.

2. The independent auditor shall audit, on an individual Estate basis, the finances and internal controls of each Estate. The audit shall be conducted annually as of June 30 each year beginning on the date the Order of Rehabilitation or Liquidation is entered and ending on the Receiver closes the Estate using Generally Accepted Auditing Standards.

3. The Receiver shall promptly file the independent auditor's annual Report of Audit of Financial Statements and Internal Controls for each Estate in that Estate's Rehabilitation or Liquidation Case.