UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 54812 / November 22, 2006

Administrative Proceeding
File No. 3-11524

In the Matter of PILGRIM BAXTER & ASSOCIATES, LTD., Respondent.	:	Order Approving a Distribution Plan

I.

On June 21, 2004, in the above-captioned matter, the Commission issued an Order instituting and simultaneously settling public administrative and cease-and-desist proceedings against Pilgrim Baxter & Associates, Ltd. (the "PBA Order"). In the PBA Order, the Commission authorized and established a Fair Fund of $90 million in disgorgement and penalties paid by Pilgrim Baxter & Associates, Ltd. ("PBA"). According to the PBA Order, the Fair Fund is to be distributed to investors injured by market timing in the PBHG Funds pursuant to a distribution plan to be developed by an Independent Distribution Consultant (the "IDC"). In September 2004, PBA engaged Kenneth Lehn, Ph.D., as the IDC.

In two related matters: *Gary L. Pilgrim*, Admin. Proc. File No. 3-11739 (Nov. 17, 2004) and *Harold J. Baxter*, Admin. Proc. File No. 3-11740 (Nov. 17, 2004), the Commission issued two orders simultaneously instituting and settling administrative and cease-and-desist proceedings against the former principals of PBA, Gary L. Pilgrim ("Pilgrim") and Harold J. Baxter ("Baxter"). Among other things, the Commission authorized and established in each of these Orders a Fair Fund comprised of $80 million in disgorgement and penalties paid by Pilgrim and Baxter for distribution in accordance with the distribution plan developed by the IDC, Dr. Lehn.

On June 6, 2006, Dr. Lehn submitted a proposed distribution plan to the Commission's Office of the Secretary (the "Plan"). The Plan provides for distribution to all eligible investors of their proportionate share of the disgorgement and civil penalties paid by PBA, Pilgrim, and Baxter to compensate such investors for injury they may have suffered as a result of market timing in PBHG Funds for the period spanning June 1998 through December 2001. The aggregated Fair Fund includes $250 million plus any accumulated interest (the "PBA Fair Fund"). Under the Plan, eligible investors in the PBHG Funds would receive a *pro rata* share of the PBA Fair Fund, calculated by Dr. Lehn as a percentage of the value of the PBHG fund held by an accountholder on a given day multiplied by the fund's daily settlement proceeds. The *pro rata* shares of the PBA Fair Fund would be determined based on information contained in PBA's records, as well as records obtained from third-party intermediaries, obviating any need for a claims process.

In accordance with the Commission's Rules on Fair Fund and Disgorgement Plans (the "Fair Fund Rules"), 17 C.F.R. § 201.1100, *et seq*., the Plan proposed a Fund Administrator and sets forth, among other things, procedures for the receipt of additional funds; categories of persons potentially eligible to receive proceeds from the PBA Fair Fund; procedures for providing notice to such persons of the existence of the fund and their potential eligibility to receive proceeds; procedures for the administration of the fund, including provisions for filing tax returns; and a proposed date for the termination of the PBA Fair Fund.

Boston Financial Data Services, Inc., proposed in the Plan as the Fund Administrator, has not posted the bond generally required of third-parties under Fair Fund Rule 1105(c).[1] Rather, the Plan incorporates several layers of protection for the PBA Fair Fund. Among other things, under the Plan: (1) the Fund Administrator will have no custody, and only restricted control, of the PBA Fair Fund; (2) the PBA Fair Fund will be held by the United States Department of the Treasury, Bureau of Public Debt ("Treasury") until immediately before checks or wires are transmitted to eligible investors; (3) upon transfer from Treasury, funds will be held in an escrow account, separate from the assets of the bank identified in the Plan (the "Bank"), until presentment of a check or wire; (4) upon presentment of checks or wire instructions, funds will be subject to "positive pay" or similar controls before honored by the Bank; (5) no more than $125 million (approximately one half of the amount in the PBA Fair Fund) will be in the Bank's possession at any one time; and (6) both the Bank and the Fund Administrator will maintain, throughout this process, insurance and/or a financial institution bond that covers errors and omissions, misfeasance, and fraud.

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[1] Based on one estimate provided to the staff of the Commission, the cost of a bond posted on behalf of the Fund Administrator for the $250 million (plus interest) Fair Fund could approach $3.4 million.

On June 30, 2006, the Commission published the Plan and issued a Notice of Proposed Distribution Plan and Opportunity for Comment (Exchange Act Release No. 34-54073) pursuant to Rule 1103 of the Fair Fund Rules, 17 C.F.R. § 201.1103. The Notice advised interested parties that they could obtain a copy of the Plan at http://www.sec.gov/litigation/admin/34-54073-pdp.pdf, or by submitting a written request to Catherine E. Pappas, United States Securities and Exchange Commission, 701 Market Street, Suite 2000, Philadelphia, PA 19106. The Notice also advised that all persons desiring to comment on the Plan could submit their comments, in writing, no later than July 31, 2006.

In response to the Notice, the Spark Institute, Inc. ("Spark"), the Coalition of Mutual Fund Investors ("CMFI"), and Gregory D. Barnes, CPA ("Barnes") submitted public comments to the Office of the Secretary. The Commission staff engaged in subsequent communications with each of these commenters to discuss and more fully understand the issues that they each raised in their respective letters. In general, the Spark Letter seeks relief on behalf of intermediaries for Non-IRA Retirement Accounts[2] eligible for a distribution under the Plan from fiduciary obligations and costs that may arise from distributions under the Plan.[3] The CMFI Letter, written on behalf of individual mutual fund investors, expresses concern about the Plan's "outreach process," or the procedures by which the IDC will seek individual investor information from omnibus account intermediaries. The Barnes letter, written by a former investor in the PBHG Funds, objects to the return of any amounts to "undamaged PBHG individual shareholders" through the Plan's provision for the return of undistributed (residual) amounts to the PBHG Funds.

After careful consideration, the Commission has concluded that the Plan should be modified to include, among other things, additional detail concerning procedures applicable to Non-IRA Retirement Accounts, and approved with such modifications. The Commission has further determined that, for good cause shown, the bond required under Fair Fund Rule 1105(c) will be waived and the time for entry of an Order approving the Plan shall be extended, *nunc pro tunc*, through the date of this Order.

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[2] "Non-IRA Retirement Account" as used in the Plan and herein, means any account of an employee benefit plan, as such plans are defined in section 3(3) of the Employee Retirement Income Security Act of 1974, 29 U.S.C. 1001, *et seq*. ("ERISA"), which is not an Individual Retirement Account, whether or not the plan is subject to Title I of ERISA.

[3] The Spark Letter includes three additional requests for relief. Spark had concerns regarding the confidentiality of information provided by the intermediaries to the IDC, time constraints imposed on the provision of the data, and tax reporting issues if the IDC distributed the funds to retirement plan participants. In fact, only ¶ 8.6.4.2 (¶ 8.6.5. of the Plan as modified) applies to the distribution to Non-IRA Retirement Accounts, the intermediaries of such accounts do not provide data to the IDC, and the IDC will not be making any distributions to non-IRA retirement plan participants.

II.

A. Public Comments on the Plan

1. The Spark Letter

The Spark letter, dated July 31, 2006, is written on behalf of "retirement plan record keepers that will be responsible for gathering and providing accountholder information, making certain allocations, receiving distributions, and making distributions to plan participants who are the intended beneficiaries of a substantial portion of the distribution at issue." In its letter, Spark claims that, under the Plan and pursuant to Department of Labor ("DOL") April 19, 2006 Field Assistance Bulletin (2006-01) (the "FAB"), a retirement plan record keeper that is not otherwise a retirement plan fiduciary must choose between assuming fiduciary obligations under ERISA and replicating the IDC's calculations.[4] Spark further claims that the complexity of the IDC's calculations, and the effort and cost associated with gathering daily accountholder information for a 3½ year period, eliminates any possibility for a record keeper or other intermediary to use the IDC's methodology and thus, fall within the Safe Harbor. Finally, Spark claims that the Plan does not provide sufficient information as to what costs will be reimbursed under the Plan, thereby preventing intermediaries from performing the cost-benefit analysis described in the FAB.[5] The Commission addresses these claims below.

As is evident from the FAB, fiduciary obligations accompanying a distribution under a distribution plan are not new developments under the law. Rather, these obligations arise under

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[4] The FAB, in essence, provides a regulatory safe harbor to intermediaries using an IDC's methodology (the "Safe Harbor"), providing: "[i]f an IDC, as part of its distribution plan approved by the SEC, makes available to an intermediary or requires, as a condition to the distribution, that the intermediary utilize a particular methodology for allocating settlement fund proceeds among individual omnibus account clients, the [DOL] will, as an enforcement matter, view the application of such methodology to the allocation of settlement fund proceeds among individual omnibus account clients as satisfying the requirements of section 404(a) with respect to the methodology for allocating assets to employee benefit plans," as long as such methodology is implemented prudently. FAB at p. 3.

[5] For instance, in the FAB, the DOL states:

> In some instances, the intermediary will be responsible both for developing and implementing the plan for allocating proceeds among its omnibus account clients. As fiduciaries, intermediaries must be prudent in the selection of the method of allocating the proceeds among its clients in an omnibus account, including plans. Prudence in such instances would, at a minimum, require a process by which the fiduciary chooses a methodology where the proceeds of the settlement would be allocated, where possible, to the affected clients in relation to the impact the … [market timing] may have had on the particular plan. However, prudence would also require a process by which the fiduciary weighs the costs and ultimate benefit to the clients associated with achieving that goal.

FAB at p. 3.

pre-existing ERISA legislation and common law.[6] In sum, assuming fiduciary duties under ERISA is not a new possibility for record keepers or other ERISA plan intermediaries in connection with a distribution of litigation proceeds. Accordingly, requiring intermediaries to distribute funds in accordance with fiduciary duties is neither inappropriate nor unreasonable.

Nevertheless, certain modifications to the Plan are appropriate in order to (1) assist Spark members and others similarly situated in understanding the Plan and complying with their responsibilities under the law; and (2) provide some less costly distribution alternatives in connection with Non-IRA Retirement Accounts and thereby increase the possibility that distributions will be made through the plan participant level:

- To improve the clarity of the sections concerning Non-IRA Retirement Accounts, the existing ¶ 8.6.4.2 ("Non-IRA Retirement Accounts") has been renumbered to be a separate section: ¶ 8.6.5, and "Non-IRA Retirement Account" has been defined (Plan, note 10);

- To provide additional information to Non-IRA Retirement Accounts in order to facilitate intermediary preparation to distribute funds received under the Plan, and to distribute funds in accordance with their fiduciary, contractual, and/or legal obligations, the following has been added to the Plan description of distributions to Non-IRA Retirement Accounts:

    - a procedure for notifying accountholders entitled to $1000 or more of their respective final distribution amount in advance of distributing funds to those accountholders (Plan, ¶ 8.6.5.2.1);
    - language specifying the timing of distributions to such accounts (Plan, ¶ 8.6.5.2.2);
    - a fixed cost reimbursement amount (Plan, ¶ 8.6.5.4); and
    - alternative distribution methodologies (Plan, ¶¶ 8.6.5.3.1- 8.6.5.3.2).

The modifications to the Plan which provide to the intermediaries notice of a distribution amount in advance of any distribution, and which clarify that costs associated with Non-IRA Retirement Account distributions will not be reimbursed, address some of the concerns of Spark members and others similarly situated by enabling them to perform a precise cost benefit analysis, and to develop and seek approval of a distribution methodology in advance of performing any distribution, thereby possibly avoiding the assumption of fiduciary responsibility.[7]

[6] *See, e.g.,* FAB at p. 2 (*citing* ERISA and "ordinary notions of property rights").

[7] *See* FAB at p. 4 and note 8 ("If the receipt, allocation and/or distribution services of the intermediary, and compensation for such services, are carried out in accordance with the directions and approval of appropriate plan fiduciaries, the intermediary may be able to avoid fiduciary status and issues relating to self-dealing under ERISA.").

With respect to costs, the staff has obtained cost estimate information from Spark which indicates that the costs faced by intermediaries of Non-IRA Retirement Accounts in connection with a distribution pursuant to the IDC's methodology could be substantial and significantly larger than those faced by intermediaries in connection with other types of omnibus accounts. Plan required reimbursement of these costs at or near the cost estimates provided to the staff simply would be cost prohibitive and unreasonable, especially in view of substantial flexibility in the FAB for an intermediary or plan-level fiduciary to develop a more cost efficient method of distribution.[8] In the context of a fixed cost reimbursement amount, Spark has requested that any specified cost reimbursement upper limit approach the cost estimates provided by Spark. Spark further has rejected a cost reimbursement upper limit based on the cost reimbursement sought by intermediaries of other types of omnibus accounts. In view of the foregoing, and in consideration of Spark's contention that unspecified cost reimbursement prevents Non-IRA Retirement Account intermediaries from performing with precision any requisite cost benefit analysis, the modification to the Plan to provide less costly alternative methodologies, and no cost reimbursement, is a reasonable and practical resolution.

2. <u>The CMFI Letter</u>

The CMFI comments are in furtherance of "the interests of individual mutual fund investors." In its Comment Letter dated July 31, 2006, CMFI claims that the Plan's specified outreach to intermediaries for individual investor information will not sufficiently protect the individual investor. Rather, CMFI suggests that the Plan should require the PBHG Funds or their representative to request from intermediaries, pursuant to Rule 22c-2 of the Investment Company Act (17 C.F.R. § 270.22c-2) ("Rule 22c-2") the information currently sought through the omnibus account outreach process. In addition, CMFI objects to the cessation of outreach efforts sixty days after the Plan's approval as inadequate, proposing alternatively, six months. The Commission addresses these points below.

Rule 22c-2(a)(2) provides that a fund or its principal underwriter must enter into a written agreement with each financial intermediary of the fund under which the intermediary must agree to "provide promptly upon request by the fund, the Taxpayer Identification Number of all shareholders that purchased, redeemed, transferred, or exchanged…," along with the amount and dates of such transactions. Rule 22c-2 does not, however, provide for the retention or provision of historical data. Accordingly, even assuming that the PBHG Funds already have agreements in place with all intermediaries, Rule 22c-2, as it currently exists, cannot be used by the PBHG Funds or their representative to require the provision of data from 1998 through 2001.[9]

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8 *See* FAB at pp. 3-5. "Plan-level fiduciary," as used herein, means the retirement plan-identified fiduciary, trustee, or other entity authorized to distribute allocated funds directly to non-IRA retirement plan participants.

9 Under Rule 22c-2, funds must enter into shareholder information agreements with their intermediaries by April 16, 2007, and must be able to request and promptly receive shareholder identity and transaction information pursuant to shareholder information agreements by October 16, 2007. *See* 71 Fed. Reg. at p. 58262, § III.

With respect to the CMFI request that the Plan provide omnibus account intermediaries six months in which to comply with the IDC's request for omnibus account information, the Commission notes that, in anticipation of an eventual distribution, the IDC began outreach efforts in connection with the Plan at the end of May 2006. Accordingly, under the Plan, which continues the outreach efforts through sixty days beyond the date of approval of the Plan, each omnibus provider will have been permitted substantially more than sixty days to comply and, in some instances, will have been provided with the requested six months, if not more.

3. The Barnes Letter

In the Barnes letter, dated September 13, 2006, Barnes objects to the return of any amounts to "undamaged PBHG individual shareholders" through the Plan's provision for the return of undistributed (residual) amounts to the PBHG Funds and thus, current (and not necessarily former) accountholders. It is anticipated at this time that this residual amount will be comprised of undeliverable mail for which the Fund Administrator cannot find a good address, and uncashed checks. Although the residual amount cannot be predicted with any precision, the IDC and the Fund Administrator have informed the staff that they expect the undeliverable mail component of this to be minimal in view of the substantial identifying information that they have for each accountholder, and that, accordingly, the residual amount likely will be too small to justify the delay and costs of additional distributions. Accordingly, the Commission believes that the existing Plan sufficiently addresses the subject of Barnes' objection.

B. The Modifications

The modifications discussed above with respect to Non-IRA Retirement Accounts, namely:

- a procedure for notifying accountholders entitled to $1000 or more of their respective final distribution amount well in advance of distributing funds to those accountholders (Plan, ¶ 8.6.5.2.1);
- language specifying the timing of distributions to such accounts (Plan, ¶ 8.6.5.2.2);
- a provision clarifying that costs associated with such accounts will not be reimbursed (Plan, ¶ 8.6.5.4); and
- alternative, less costly, distribution methodologies (Plan, ¶¶ 8.6.5.3.1-8.6.5.3.2);

do not take away any rights originally afforded to Non-IRA Retirement Accounts but, rather, provide to them additional details and options concerning the distribution, and facilitate their compliance with their responsibilities under applicable law.

The remainder of the modifications, namely:

- the renumbering of the existing ¶ 8.6.4.2 ("Non-IRA Retirement Accounts") to be a separate section: ¶ 8.6.5 and the inclusion of a definition of Non-IRA Retirement Accounts;
- the addition of "Fund Administrator" to ¶ 8.7; and

- the express exception of the Commission and the Fair Fund from the "persons" included in ¶ 8.2;

are generally clarifying or otherwise technical in nature.

In view of the fact that the modifications set forth herein were drafted primarily in response to the only comments made with respect to Non-IRA Retirement Accounts; the staff has addressed all public comments submitted in connection with the Plan; and the modifications do not take away or otherwise impair any rights originally afforded but rather add options and clarification, the Commission, in its discretion, does not believe these modifications require publication of the modified Plan.

C. The Bond Requirements of Fair Fund Rule 1105(c)

Fair Fund Rule 1105(c) provides:

> *Administrator to Post Bond*. If the administrator is not a Commission employee, the administrator shall be required to obtain a bond in the manner prescribed in 11 U.S. C. 322, in an amount to be approved by the Commission. The cost of the bond may be paid for as a cost of administration. The Commission may waive posting of a bond for good cause shown.

17 C.F.R. § 201.1105(c). The Commission believes that the risk protection provisions of the Plan, generally included in ¶¶ 8.3 and 8.4 of the Plan, and the high cost of bond coverage, suffice to constitute good cause for waiving the posting of the bond under Rule 1105(c).

D. Extension of Time for Entry of Order

Fair Fund Rule 1104 provides, in relevant part:

> The order approving or disapproving the plan should be entered within 30 days after the end of the final period allowed for comments on the proposed plan unless the Commission or the hearing officer, by written order, allows a longer period for good cause shown.

The staff needed more than thirty days to gain a full understanding of the issues presented herein and make an informed recommendation to the Commission. The Commission agrees that this constitutes good cause for an extension of the time provided in Rule 1104 for the entry of this Order.

III.

Accordingly, IT IS ORDERED that:

A. Pursuant to Rule 1104 of the Fair Fund Rules, 17 C.F.R. § 201.1104, that the Distribution Plan is modified as described above, and approved with such modification;

B. Pursuant to Rule 1105 of the Fair Fund Rules, 17 C.F.R. § 201.1105(a), that Boston Financial Data Services, Inc. is appointed as the Administrator of the Plan in accordance with the terms of the Plan;

C. The bond requirement of Rule 1105(c) of the Fair Fund Rules, 17 C.F.R. 201.1105(c), is waived for good cause shown; and

D. In accordance with Rule 1104 of the Fair Fund Rules, 17 C.F.R. § 201.1104, and for good cause shown, the time for entering this Order approving the Plan has been extended, *nunc pro tunc*, through the date of this Order.

By the Commission.

Nancy M. Morris
Secretary