



**Legal Aid Reforms Proposed by the Carter Report –
Analysis and Commentary**

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Contents

Executive Summary	1
1 Introduction.....	12
2 Background.....	14
3 Issues.....	18
3.1 Major reorganisation of CDS supplier market.....	18
3.2 Consolidation of contract areas and firm relocation.....	22
3.3 Flat cost trends	24
3.4 Fixed fee levels and revenue neutrality	28
3.5 Long term sustainability and firm profitability.....	32
3.6 Working practices – suppliers, LSC and professional bodies.....	37
3.7 Own solicitor work – choice and competition.....	39
3.8 Equal access and small firms	41
3.9 Transition arrangements.....	42
3.10 Quality assurance and self-regulation.....	44
3.11 Viability of market model – effective competition.....	45
4 Data analysis.....	49
4.1 Market reorganisation and firm size.....	49
4.2 Scale of boundary area reorganisation	54
4.3 Cost trends.....	57
4.4 Potential travel costs savings.....	69
4.5 Impact of proposed fees	72
4.6 CDS firm profitability	75
4.7 Carter model of firm profitability.....	77
4.8 Distribution of solicitor firm work across contract areas	79
5 Issues and risks – main points	80

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Abstract

This report comments on the proposals of the Carter Review for reform of legal aid procurement. These comments focus in detail on the implications for criminal defence services although they also cover some broader implications for the overall delivery of legal aid, including civil legal aid. The Carter proposals are an important step for reform of a system that has been a concern for both government and practitioners. These are far-reaching reforms that need to be considered carefully. As well as potential benefits they include significant risks to the long term provision of legal aid services that could threaten the proposals' objectives. This report summarises key issues arising from the report of the Carter Review, some of the risks involved and some recommendations that may be taken into account during the detailed design of the new arrangements. This is based on detailed analyses of cost and other data.

Executive Summary

- 1.1 This report reviews some key features of the proposals of the Carter Review for reform of legal aid procurement. The Carter proposals cover all aspects of legal aid: criminal defence services (CDS) and community legal services (CLS) (civil, family and immigration) performed by solicitors and barristers. The current analysis is concerned with solicitors' work and focuses primarily on proposals for criminal defence services, including police station, magistrates' court and crown court work, which are presented in most detail in the Carter Report. Many of these concerns apply equally to civil legal aid services, especially as many firms perform both types of work. Overall concerns relate to the long term sustainability of provision, accessibility for the client and the effectiveness of a 'market-based' approach. There are significant risks in these and other areas. The success of the Carter reforms will depend on the sensitivity with which the proposals are put into practice.
- 1.2 The Carter Report, published in July 2006, is the outcome of a review process initiated in July 2005. The recommendations, accepted by the Government, are currently the subject of public consultation, with responses to be made by October 2006. Following the outcome of the consultation the final proposals are due to be

implemented over a three year period, starting in April 2007 and proceeding in stages over the following three years, with completion to steady state for all criminal and civil work by 2010/11. The Carter Report sets out principles for reform in all areas, with most detail for criminal legal aid. Details for civil, family and immigration legal aid are contained in the Consultation Paper published by the Department of Constitutional Affairs (DCA) and the Legal Services Commission (LSC) simultaneously with the Carter Report.¹ Many implementation details remain to be clarified during the consultation period.

- 1.3 The Carter proposals imply a fundamental restructuring of legal aid procurement using a market-based approach. The stated aims of the proposals are essentially to ensure sustainable, high quality legal aid services at an affordable cost. The proposals include the use of fixed pricing, block contracts, consolidation of contract areas and eventually price competitive tendering. These proposals are most fully developed for the Criminal Defence Service (CDS) with equivalent proposals for Community Legal Services (CLS).
- 1.4 The proposals are an important step in addressing what has long been a concern of both government and practitioners. Legal aid is a complex area and care will be needed to ensure that the aims of sustainability, quality, cost and efficiency of the justice system are achieved and the existing structure is not damaged.
- 1.5 This report outlines key issues that will need to be considered in the consultation process and the detailed implementation for success. These comments are founded in part on detailed analyses of revenues and work patterns over the past few years. Main concerns include the following:
 - a) *Major reorganisation of legal aid firms*: Depending on how the proposals are implemented, they are likely to involve large-scale reorganisation and relocation of CDS firms, with consolidation of medium and larger firms and many small firms merging or leaving the market. Considered at the office level (a natural focus for location and capacity analysis), the current analysis indicates that about 63% of all offices may be below the minimum contract size of 200 cases per year – about 1,700 of the total 2,700 solicitor offices, performing 21% of total CDS work. These small

¹ Carter Report (2006), Lord Carter's Review of Legal Aid Procurement, 'Legal Aid: A market-based approach to reforms', published 13 July 2006. DCA/LSC (2006), Legal Aid: a sustainable future – consultation paper', published 13 July 2006.

offices would need to merge or leave CDS work. At a minimum, to meet the 200 case target, about 1,100 small offices would need to merge into larger offices – about two thirds of the current small offices and 8% of total CDS capacity. At the other extreme, if the remaining 37% of larger offices (which perform 79% of CDS work) were to expand their capacity by 20% (as may ultimately be allowed in the contract bidding process) this could eliminate virtually **all** the small offices. In either case, part of the 21% of capacity currently in small offices could be lost to CDS with some solicitors unable or unwilling to transfer to other firms.

For comparison, a firm level analysis of the impact yields similar results. Currently, there are over 2,200 firms and about 2,700 offices performing lower CDS work. Analysis shows that about 58% of firms perform below 200 cases per year – amounting to about 1,300 firms performing 17% of total CDS work. To meet the 200 case target a minimum of about 800 of these small firms would need to merge into larger firms, representing about 6% of capacity. Thus, while some of the small offices might be consolidated within a single parent firm, which might be simpler than merging independent firms, there would remain significant impact. Even in such cases there could still be relocation problems, especially for individual solicitors.

Apart from the impact on solicitor firms, a real risk is that supply might be disrupted and create local supply imbalances, making it unclear at this point whether there will be enough capacity to provide services in all areas. This may be aggravated by the outcome of the preferred supplier process which is expected to reduce the number of qualified firms and could add to regional variations in supply. For these reasons, local and regional differences in provision might occur, involving potentially 'unfilled' contracts, specific unforeseen problems (e.g., accessibility, local disruption of the supplier base) that may need to be dealt with on an exception basis, and ultimately the potential for 'two-tier' coverage and quality.

Since many firms perform both criminal and civil work these changes will impact on all legal aid, with spill-over effects on CLS work.

Flexibility in contract caseloads, scheduling of the implementation plan and fee levels may be needed to ensure continued coverage. This may only be clear during roll-out. Adjustments will need to allow for firm and regional differences and other transition problems to avoid potentially lasting harm to legal aid provision.

- b) *Consolidation of contract areas and firm relocation:* Plans include consolidation of CDS police station schemes into significantly larger boundary areas. Larger areas would provide sufficient cases to support a population of competing larger suppliers and may be simpler to administer. However, changes may disrupt local work patterns and will need to be determined on a detailed area by area basis. Implementing minimum contract areas of a size indicated in the Carter Report of about 2,000 (or more) cases per scheme would reduce the number of areas by up to two thirds, from the current 313 to 100. Currently 68% of police station schemes are below this level, accounting for 26% of cases. This consolidation adds to the challenge to firms and individual solicitors to consolidate and relocate closer to the main police stations in an area, putting additional pressure on firms to restructure or leave the market.
- c) *Flat cost trends:* One of the main premises of the Carter reforms has been that costs of legal aid have been rising excessively. It is correct that total legal aid costs have increased significantly over the past decade. However, it is also important to recognise that the increases do not apply to all areas of legal aid or over the most recent period. In the past three years, 2002-06, costs in most areas of criminal and civil work have increased only slowly if at all, and on a per case basis have often decreased. During 2002-06 total legal aid cash payments have risen at a rate of 2.1% per year. Within this CLS payments have risen at 0.7% per year and lower CDS payments (excluding crown court) have fallen at -1.6%. Within lower CDS, police station attendance costs have risen at an average 4.4% per year, but adjusted for higher case loads risen only at 0.4% per year. Magistrates' court costs have fallen by 0.1% per year and per case by 0.5%. After allowing for inflation these each represent net decreases in real per case costs. The main area of increase has been in crown court and higher court costs, which (combining solicitors' and barristers' costs), have increased at an annual rate of 7.4%, or 8.1% per

case. LSC administration costs have also increased at an annual rate of 10.6% during the period.

More specifically, travel and waiting costs, stressed in the Carter Report as a potential for cost savings with larger contracts, have also often been declining when measured on a per attendance basis. Travel costs per attendance at police stations during 2001-05 declined at a rate of 1.3% per year, waiting costs per attendance rose at 4.3% For magistrates' court the figures were declines of about 3% and 1% respectively.

This does not mean that there are no problems for CDS or CLS costs or that firms are operating as efficiently as possible. Rather, the problems are different. It appears that firms, with flat fee rates for several years, are generally not increasing costs in most areas of work and may be facing reduced revenues, and hence profits, per case. This affects their long term viability.

This underlines concerns such as generally low profit rates, low recruitment of young solicitors and the ageing profile of legal aid practitioners. These imply that the problems are deeper than costs and are likely to require a thorough review to tackle them – as indeed the Carter Report states. The challenge is to devise a system to enable firms to become more efficient and profitable. However it also implies that the current supply system may be in a fragile state and there are risks that unless the reforms are carefully implemented the provision of legal aid work may be damaged with lasting effects.

- d) *Proposed fee levels and revenue neutrality*: Fixed fees provide incentives for firms to reduce costs and are administratively simpler than *ex post* fees. They also have implications for work patterns and scale of work since firms need to be able to average revenues over an assured number of cases. These considerations form the basis for the proposed market-based structure with fewer, larger firms and contracted case loads. However, for these changes to work, it is critical that the proposed fee schemes are revenue neutral during the risky high-cost transition period until firm structures stabilise and efficiencies are possible.

The proposed fee levels for lower CDS work are only 'revenue neutral' up to a point, in that they assume one-off reductions in costs from 2007-08 onwards due to lower travel costs for lower work and other efficiencies for higher work. The reductions the first year of transition, 2007-08 are £23m for lower, with further reductions of £5m in 2008-09 (for magistrates' court costs associated with the introduction of graduated fees) and nil in 2009-10.² Reductions for crown court litigators costs are £24m in 2007-08 and a further £7m in 2008-09 and £7m in 2009-10. To complete the picture, crown court advocacy costs are forecast to be reduced by £36m in 2006-07, with projected reductions in the following three years of transition of nil in 2007-08, £19m in 2008-09 and £18m in 2009-10. Spending for civil and private family cases is projected to increase by £12m in 2007-08, fall by £13m in 2008-09 and be flat in 2009-10. The proposals also project savings in LSC administration costs of about £30m per year by 2010, which may partly depend on the new arrangements being simpler in practice than currently.

Firm earnings should be seen as a package of expected earnings from police station, magistrates' court and crown court work. Assumptions about travel costs lead to reductions in total revenues by 6% for police station and 4% for magistrates' court in 2007-08.³ There is a further 1% reduction due to reduced magistrates' court costs in 2008-09 and nil in 2009-10. Crown court litigators revenues are expected to reduce by about 8% in 2007-08 with further reductions by 3% in 2008-09 and by 3% in 2009-10. The combined effect on CDS firm revenues is likely to be reductions by about 5% in 2007-08 and further 1% falls in 2008-09 and 2009-10. These are cash figures – real revenues after inflation would fall faster. This may add pressures on firms in the difficult restructuring period.

Also there are regional differences in the impact. Reductions differ by region. For police station work, the average revenues are likely to fall by 10% for London and by 5% outside London (apparently intended to rebalance revenues). There are wide differences between individual regions, ranging from changes of -15% to +3%. During implementation,

² Carter Report (2006), Annex 6.2, pp. 195-198.

³ Carter Report (2006), Annex 6.2, p. 195.

fee levels may need further review according to the underlying cost bases, such as by geographic region or working requirements outside firms' control. If the number of exceptions is large this could challenge the proposed cost savings.

- e) *Long term sustainability and profitability:* The most basic question for the reforms is whether they can lead to a healthy and sustainable legal aid sector in the long term. Behind this is the question of whether legal aid can be profitable and competitive compared to other areas of legal services. For long term sustainability fees should permit firms to make normal profits at market equivalent rates, after including potential efficiencies. Current profits from CDS work are lower than in comparable sectors, as follows. Recent published research shows that once due allowance is made for notional equity partner salaries (in this case using estimated salaries in a range £60,000 for small firms up to £68,700 for large firms) and other 'hidden' costs such as return on equity and rent on premises where applicable, average profits on revenues in CDS firms may be as low as 2% profit to -6% loss, depending on firm size.⁴ These compare unfavourably with typical market-determined profit rates in broadly equivalent service industries, such as independent financial advisor services or insurance brokerage, which may be in the 10%-15% range.

Sustainability of quality supply includes attracting new solicitors and other fee earners to reverse the problem of the 'ageing supplier base'. Students are currently reluctant to enter a career in legal aid – a survey of student solicitors has shown that while 60% may wish to enter legal aid, only 21% actually do enter, the reasons being the perceived low salaries, limited career prospects and poor working conditions.

A major risk for the reforms is that following a long history of limited firm profits and related problems, the transition to a new structure may be disruptive, as described above. Many experienced practitioners and firms may leave legal aid work and prospects for long term performance may not be attractive enough to attract new recruits. This could do lasting harm to sustainability and leave the system in little better condition than at

present. To avoid such an outcome the implementation will need careful design and monitoring. This includes sensitive implementation in the short term to reduce the risk of hard-to-reverse disruption of the supplier base and also ensuring adequate financial returns for firms in the longer term. Fees may allow for differences between regions or other distinctions in the underlying cost base.

- f) *Working practices – suppliers, the LSC and professional bodies:* The proposals imply significant changes in business practices for all parties, including suppliers, the LSC and the professional bodies. These may involve costs as well as efficiencies. Firms may need assistance to make necessary changes during the transition period. The changing nature of the business also has an important impact on career prospects for those entering the profession and the attractiveness of legal aid work for new solicitors.

In particular the administration of legal aid by the LSC is likely to change significantly. While the introduction of fixed and graduated fees throughout the system and other rationalisation of administrative processes should simplify the basic administration of legal aid, other aspects such as managing the price competitive tendering auction process may add complexity in other areas. This includes monitoring post-auction contract performance and managing the relationships with outside bodies taking over some of the current LSC responsibilities. Also, depending on issues that may become apparent during the roll-out, there may be exceptions and adjustments to the basic arrangements that will need planning and monitoring. These possibilities may alter the focus of administration and offset some of the potential LSC administrative cost savings projected in the Carter Review.

- g) *Own solicitor work – choice and competition:* Own solicitor work is a vital component of legal aid work, notably at the police station level, to help ensure client choice, competition and quality. The proposals permit some own solicitor work within a firm's case quota. The system will need to ensure that these provisions are adequate and effective.

⁴ Drawn from Otterburn Legal Consulting (2006), "Lord Carter's Review of Legal Aid Procurement: 2005 and 2006 Surveys of Criminal Firms", April 2006, and LECG analysis.

- h) *Equal access and small firms*: Related to the re-organisation of the market this should continue to ensure equal access by clients from black and minority ethnic (BME) backgrounds and others to high quality services. This may be currently provided by small firms which are most likely to be threatened by the reforms. The key issue is client access, rather than BME representation amongst suppliers, which may be neutral to the changes. This is an unknown area. For example, it is not tested whether BME clients seek BME solicitors or whether other factors are more likely to affect their access to legal aid, such as local and regional differences in supply. More information is needed.
- i) *Transition arrangements*: After years of restricted rates and low profits much of the *supplier* base is fragile and susceptible to lasting harm if the transition is not carefully implemented and evaluated. Key factors will be revenue neutrality and business practice issues, as discussed above. Qualified suppliers may need additional assistance, financial and managerial, in making the changes.
- j) *Quality assurance and self-regulation*: Responsibility for quality assurance is to reside with the professional bodies. Care will be needed in designing *these* arrangements to ensure that the responsibility for the balance between quality and price is maintained.
- k) *Viability of the market model – effective competition*: It is important to recognise the limits to the application of the market model to legal aid. This can never be a fully free market when the government remains the sole procurer of services, where the end client is likely to be ill-informed about the quality of the service and is not paying directly. There are elements of the market that may be used to advantage – such as the incentives for cost reduction with fixed fees, ability of firms to plan their business with assured contracts, and potential price and volume competition in tendering. However, the government must remember the limitations. In particular there are several concerns about the effectiveness of price competitive tendering, due in the final stages of the reforms. Issues to be addressed include the following:
 - i) *Supplier market power and fewer firms*: There are limits to potential competition with the shift to fewer, larger firms. This may create local

supplier market power that can restrict price falls. Conversely in some areas there be insufficient number of suppliers available to compete effectively for contracts. The number and size of firms per area may also be affected by the need to meet representation or other objectives, further limiting the potential for market competition.

- ii) *Government as monopsonist*: The government will remain the sole (monopsonist) purchaser of legal aid services. If it does not like the prices determined by the market it may be tempted to bypass them and continue to place caps on prices. For the system to work, and firms to make market-determined returns, the government may need to be prepared to accept what the market generates .
- iii) *Better information*: A significant side-benefit of having fewer, larger firms and greater transparency may be that there should be better information on costs and prices for all parties. This may raise confidence in the system and its ability to offer value for money, and in government and suppliers working in partnership.
- iv) *Administration costs*: Price competitive tendering is likely to involve some new administration costs which have not been addressed adequately in the Carter Report. The expected savings in LSC administration due to simpler price structures and greater use of information technology may be offset by new costs of running auctions and monitoring firm performance. These costs reduce the potential for simpler, less costly administration.

1.6 In each case, the current report presents key risks and recommendations for mitigating risks. It also details a number of individual analyses of the revenue and cost data used in identifying and quantifying the above risks.

1.7 The Carter proposals are an important step for reform. These are far-reaching changes that need to be considered carefully. As well as potential benefits they include significant risks to the provision of legal aid services that may threaten the objectives of sustainability, quality, cost and access. This report identifies a number of key areas which will require flexibility and attention to local and regional conditions for

successful implementation, paving the way for a healthy partnership of shared responsibility between government and suppliers. However, coming after years of concern it is important the reforms are made to work. If implemented without careful attention to the risks, the reforms could disrupt legal aid provision, running the risk of leaving it in little better state than now.

1 Introduction

- 1.1 The report of the Carter Review proposes far reaching changes in the provision of Legal Aid services in England and Wales.⁵ The review has been undertaken in response to concerns about the cost, sustainability and value for money of legal aid, as well as the ability of the system to continue to meet other objectives such as human rights commitments, equal access and flexibility. Total legal aid costs have increased significantly over the past decade. This has not been the case for all types of legal aid and more recently in many areas, including much lower Criminal Defence Service (CDS) work and areas of Community Legal Service (CLS) work, costs measured on a per case basis have in fact increased only slowly if at all. However, despite initiatives in several areas there remain serious concerns that costs may continue to rise, that cost drivers are not well understood and that quality and long term sustainability are at risk.⁶ As well as the total budgetary impact a more fundamental concern is whether the current system is organised in a way to provide best quality services for its costs. The system is complex and as it has evolved it has been difficult to assess its effectiveness or potential for improvement.
- 1.2 Various reforms have been introduced over recent years in specific areas of concern - such as very high cost criminal cases (VHCCC) - to tackle individual problems. Rather than continue to deal with issues piecemeal, the Carter Review was set up to consider the whole of legal aid procurement – criminal and civil, family and immigration – and propose changes. The fundamental changes that have been proposed rely on greater use of market forces to offer incentives and opportunities for suppliers to provide more cost effective and predictable services. They also may make services simpler to administer and provide more transparent information on costs and capabilities.

⁵ Carter Report (2006), Lord Carter's Review of Legal Aid Procurement, 'Legal Aid: A market-based approach to reforms', published 13 July 2006. DCA/LSC (2006), Legal Aid: a sustainable future – consultation paper', published 13 July 2006. Available at: <http://www.dca.gov.uk/consult/legal-aid/sustainable-future.htm> ; <http://www.legalaidprocurementreview.gov.uk/publications.htm>

⁶ "There have been several attempts in recent years to improve the efficiency of the legal aid system, but these have proved insufficient to halt the increase in legal aid spending, especially on criminal defence services." Carter Report, p. 3, para 3-6.

- 1.3 The most far reaching of the Carter proposals relate to criminal legal aid. Given the scale of the proposed reforms, legal aid suppliers are obviously concerned about their impact. The reforms have the potential to affect almost every practising criminal legal aid firm and individual solicitor in some way - in many cases very significantly. The core changes in CDS procurement include fixed pricing for all work, capacity-based contracts awarded to 'preferred suppliers' and eventually price competitive tendering. Depending on how they are implemented, the proposals will affect the structure of the profession, the size and number of firms providing legal aid, their location, working practices, career paths and profitability. The administration of the system by the LSC and the quality assurance role are also due to change, with a simplification of administration and billing, and a shift towards self-regulation. The reforms may have implications for the rest of the justice system, which will need to make some adjustments to ensure the reforms are effective. The proposal is to introduce these reforms in stages over the next three years, which, considering the scope of the changes, implies a rapid transition.
- 1.4 The need for reform and the objectives of the Carter Report are widely acknowledged. There remain questions about the extent to which the aims and potential benefits of market processes can be achieved in practice. These concern both the detailed design of the market arrangements – the structure of the reforms – and the transition process by which they are introduced – which if overly disruptive could cause lasting harm. Both aspects involve risks that the implementation may not achieve the market-based ideals and could disturb the system unacceptably, and hence fail to resolve the underlying issues of cost, quality and sustainability.
- 1.5 This report considers the Carter proposals for CDS services, especially changes in the organisation of police station, magistrates' court and crown court work. The comments focus on these areas.
- 1.6 Section 2 of this report summarises key elements of the Carter proposals for CDS services as they affect police station, magistrates' court and crown court work. Section 3 then identifies a number of key

issues that are likely to be a concern for the profession and the government in the Carter proposals. For each issue it identifies risks in the design and the implementation of the Carter proposals according to the details of how the general objectives are put into practice. These are supported by various quantitative analyses of current (2004-05) revenues and other firm characteristics, described in detail in the following section. It then makes some recommendations for mitigating these risks that will need to be considered as the scheme unfolds. Section 3 summarises the analysis of cost and other data developed to identify and support of the comments (?). Section 5 summarises the main issues, risks and recommendations.

- 1.7 The current round of consultation and discussions with key stakeholders on the Carter reforms prior to the next stages of detailed design and implementation should provide an opportunity to review these concerns.

2 Background

- 2.1 Lord Carter's Review of Legal Aid Procurement was initiated in July 2005 with the publication of 'A Fairer Deal for Legal Aid'. The outcome of this review process has been the Carter Report, 'Legal Aid: A market-based approach to reforms' published in July 2006. The associated DCA/LSC Consultation Paper, 'Legal Aid: a sustainable future', was published simultaneously with the Carter Report.
- 2.2 Following publication of the report and consultation paper the review moved into the public consultation stage, with public responses required by October 2006. Following the outcome of the consultation the final proposals will move to implementation, planned in stages. They are due to be implemented over a three year period, starting in April 2007 and proceeding in stages over the following three years, with completion to steady state by 2010/11.
- 2.3 The Carter report sets out general principles for reform in all areas of legal aid using a market-based approach and provides further details for criminal legal aid. Details for civil, family and immigration legal aid, including proposed fee levels, are contained in the consultation paper.

Many implementation details remain to be clarified during the consultation period and as the reforms roll out.

- 2.4 The stated aims of the proposals are a legal aid system that ensures client access to quality advice and representation, a sustainable high quality supplier base, value for money and an effective justice system.
- 2.5 The major factors setting the context for the review are identified as:
- a) “maintaining access to good quality and efficient justice;
 - b) operating in a complex multiparty justice system, that should provide access to justice for all and especially for the most vulnerable in our society;
 - c) a public service delivered by the private and Not-for-Profit sector that provides value for money, quality and client choice; and
 - d) delivering justice, within fixed and compartmentalised budgets, which supports the aims of the justice system.”⁷
- 2.6 In the words of the report: “The aim of the review can be summed up as securing value for money without compromising quality or access to legal advice.”⁸ The reform package “would need to balance two criteria for achieving this aim: sustainability of good quality, efficient suppliers ...and managing within a budgetary envelope.”⁹
- 2.7 Focusing on criminal defence service (CDS), key components of the proposals include the introduction of fixed or graduated fees at all levels, capacity-based contracts for police station work with a commitment to follow cases through to completion, and larger contract areas. Combined with the preferred supplier initiative this is expected to lead to fewer and larger suppliers. Provided competitive market conditions develop as intended the reforms will extend to price competitive tendering with contracts allocated on basis of price

⁷ Carter Report, p. 17, para. 7.

⁸ Carter Report, p. 21, para. 35.

⁹ Carter Report, p. 21, para. 36.

- 2.8 The expectations voiced in the proposals are that fixed fees for police station and magistrates' court work, including an element for travel and waiting costs, should provide incentives for firms to seek more efficient lower-cost ways to provide services, where feasible.¹⁰ This is combined with capacity-based contracts to provide the means for firms to plan for efficiency and spread cost variations over a known case load. Although contracts may not be awarded initially based on capacity - largest first - - the effect, when combined with the need for firms to qualify as preferred suppliers, is likely to be that average firm size for successful suppliers will grow significantly. Simultaneously, new boundary areas will be defined that in most areas, though not all, will be considerably larger than current police station schemes, grouping more police stations and magistrates' courts in a contract area. The aims are essentially that, where appropriate, there will be significantly fewer firms, with larger case loads, organised in fewer, larger contract areas.
- 2.9 Fixed fees, fewer, larger suppliers and periodic contract awards also promise to simplify the administration of the system and save costs.
- 2.10 Provided this restructuring takes place effectively and conditions for competition between firms are favourable, the reforms will then introduce price competitive tendering to award contracts. Price tendering potentially encourages firms to bid for work based on their 'true' costs, providing further incentives to reduce costs and prices. This market-based allocation may further simplify the administration of the contract awards.
- 2.11 These changes will be introduced in stages over approximately a three year period. The key dates for lower CDS work, subject to any revisions that may be agreed as a result of the consultation process, are as follows.¹¹

¹⁰ "There should be a wholesale move towards fixed pricing for work. Fixed pricing rewards efficiency and suppliers who can deliver increased volumes of work. However, pricing should be graduated for more complex work so that cases genuinely requiring more expertise and effort are priced fairly." Carter Report (2006), p. 3, para 12.

¹¹ The major steps for the introduction of the new procurement schemes between July 2006 and 2010-11 are summarised in Carter Report, p. 68, para. 120, Table 3.1; Annex 6.1, p. 191-194. Completion of the move to community legal advice centres and networks and to best value tendering for new civil contracts is planned for 2010-11.

- Peer review to identify preferred suppliers will start in July 2006 and roll out over the next two to three years, targeted for completion in April 2009.
- Revised standard fees for magistrates' court work and fixed fees for police station work, including travel and waiting costs, are to be introduced in April 2007.
- Graduated fee scheme (a variant on fixed fees that has been in use for advocates doing crown court work for some years) for crown court litigators will be introduced in April 2007.
- Graduated fees are intended to be introduced for magistrates' court work in April 2008.
- New boundary areas and new working arrangements for capacity-based General Criminal Contracts will be introduced simultaneously in April 2008.
- Peer review (a key element in establishing preferred supplier status) will be completed by April 2009 .
- 'Best value' price competitive tendering will be introduced for police station and pricing of other CDS work in waves starting October 2009, January 2010 and April 2010.
- Best value tendering for very high cost criminal cases (VHCCC) will be introduced October 2007, following introduction of new trial estimation procedures in January 2007 and new contracts in April 2007.¹²

2.12 The Carter proposals are an important step for reform of CDS provision that has long been a concern for both government and practitioners. The proposals' core reliance on greater use of market forces has the potential to achieve the aims of reliable access to quality services, improved value for money and long term sustainability.

¹² Carter Report, pp 80-82, paras 75-95.

- 2.13 The key components of the proposals, including greater use of fixed fees, larger contract areas, fewer suppliers and capacity contracts, may provide incentives and means for firms to reduce costs by taking advantage of larger scale and the opportunity for more effective business planning. Provided the reforms can ensure effective competition between suppliers, price tendering for contracts will be introduced, extending the potential for lower costs and efficiency. The reforms should also make procurement simpler and cheaper for the justice system to administer than the current system. Because of the lower complexity, it may ensure greater transparency and predictability of costs and prices for both sides of the procurement process.
- 2.14 However, there are significant risks attached to this major reform of CDS provision. Care will be needed in the detailed design and implementation of the proposals to ensure that the potential overall benefits are achieved. These issues are discussed in the following section of this review.

3 Issues

- 3.1 The following describes a number of issues that are vital to the success of the Carter proposals. It also highlights a number of key potential risks, depending on how the reforms are defined in detail and how effectively the transition from old to new regime is managed. These are not intended as the only issues of concern for both suppliers and government. There are likely to be further specific concerns applying in a local context and in particular areas of work. These concerns follow from an analysis of the CDS proposals and, to a more limited extent, the CLS. Further study is likely to raise additional questions. The issues are described in summary, as are the associated risks and recommendations for mitigating the risks. These issues should be addressed during the forthcoming consultations and as experience is gained with the new system.

3.1 Major reorganisation of CDS supplier market

- 3.2 The proposals represent a major reorganisation of the supply of CDS services. They are likely to have lasting impact on almost every CDS

firm and solicitor in the country, in their size and location and in their business practices. The proposals aim to move towards a system with fewer, larger firms performing the bulk of CDS work for each contract area including police station, magistrates' court and crown court work. They will be contracted for a given area where they will be assured a share of work. There will be limited scope for working outside that area. This will require major structural changes in the profession, which has the potential to disrupt significantly CDS service provision during the transition period and be costly for firms.

- 3.3 It is hard to overestimate the scale of the changes in the structure of the CDS profession. Analysis of the proposals shows that, to meet contract size targets alone, a large proportion of smaller firms will be too small to bid for a contract and even medium firms will need to consolidate and grow to reach the size targets. Contracts will be awarded by volume and although there will also be an aim to ensure a sufficient number of suppliers to maintain competitive conditions it is likely that ultimately only a few large firms (perhaps around six per area) will get a contract.
- 3.4 The preferred supplier initiative which is based on peer review, will itself reduce the number of firms able to bid for contracts as only those firms meeting specific standards will be eligible. It is hard to predict which firms will not meet the specified targets, although they are probably more likely to be small firms that are unable to meet a range of criteria. However, it is unlikely that the eliminated firms will overlap precisely those unable to meet size requirements, adding to the overall capacity match problem.

LECG has made an analysis of the current work loads by firms for lower CDS work. This considers effects at the solicitor office level, as the natural focus for location analysis, also offices are identified by a unique solicitor office number in the data. There are currently about 2,700 solicitor offices involved in CDS work representing over 2,200 firms.¹³

¹³ "The Legal Services Commission currently contracts with over 2,200 suppliers for criminal defence work. The smallest 17% (almost 400) of these firms do less than 1% of the work". Carter Report, p. 74, para. 34. This is consistent with LECG figures, which identify 2,247 solicitor firms performing police station work in 2004-05.

This analysis shows that a large percentage of smaller offices will need to merge or leave the CDS market if the minimum case load limits are applied. Currently 63% of the total number of offices are small with below 200 cases per year, performing 21% of CDS work. This consists of about 1,700 of the 2,700 offices performing CDS work in 2004-05. All these offices would need to restructure to meet the 200 case minimum. At a minimum, if all small offices merged their CDS work with other small offices to meet the 200 case target, about 1,100 small offices, representing 8% of total capacity (i.e., solicitors), would need to 'close' and merge into other small offices. Many of the small offices might not be able to merge, for various reasons, and might chose to leave CDS work – their staff might be able transfer to larger firms or offices, alternatively their capacity might be lost to CDS. Without detailed examination of individual firm conditions it is not clear how many of these small offices and firms might exit the market completely. For example, if half the small offices decided to exit CDS work then 850 offices might close, representing about 10% of capacity. The outcome will only be known during roll-out.

At the other extreme, if the remaining larger offices (37% of the total and representing 79% of CDS capacity) with above 200 cases per year are able to expand their capacity bids by 20% over current, this could provide enough total capacity to exclude all the small offices. The extent to which the small offices' capacity is lost will depend on specific market conditions and there are likely to be local differences in outcomes. Which outcome applies may only be clear during roll-out.

Some of the expected reorganisation might involve consolidation of offices within a firm, which might be simpler than merging two independent firms, but even in such cases there would still be significant relocation problems, especially for individual solicitors unable or unwilling to move. For comparison, a firm level analysis of the impact yields similar impact results. Analysis shows that of the 2,200 firms performing lower CDS work, about 58% perform below 200 cases per year – about 1,300 firms performing 17% of total CDS work. To meet the 200 case target, a minimum of 800 of these small firms would need to merge into larger firms, representing about 6% of capacity.

See: 4.1 Market reorganisation and firm size

- 3.5 The restructuring implies that almost all firms will be affected, either exiting criminal defence services work altogether, consolidating with larger firms or growing by hiring, training or allocating more staff. Larger size will not be enough, the larger firms will also have to bear in mind the value of having their offices closer to their lead police station and focusing work in a single contract area to be able to reduce costs further. Apart from changes in work management (see below) this relocation, or concentration on a single contract area, may be a significant challenge and cost for firms. In many cases it may be hard to relocate, due to concerns such as local business contacts or other private work, further restricting the number of firms that can bid for contracts.
- 3.6 The changes will include many individual solicitors changing firms, leaving smaller firms or switching firms as they relocate closer to their contract area. Some may choose to leave CDS work. This is a special concern as the number of qualified CDS solicitors is relatively fixed, taking several years of experience for a practitioner to be most effective. Partly these may be replaced by less qualified staff (as expected under Carter, with higher leverage of qualified solicitors). The prospect of solicitors leaving CDS work is a matter of great concern, given the acknowledged importance of experience in the area, and the potential for causing lasting harm to CDS services.
- 3.7 These concerns raise large question marks about the impact on CDS capacity. The reforms might precipitate a reduction in experienced solicitors available for CDS work. Apart from the impact on firms, the bottom line concern is that sufficient qualified professionals may not be available to fill contracts in all areas. Flexibility and detailed adjustments, such as in contract caseloads, scheduling and even fee levels, may be needed by location to ensure continued CDS coverage. This will only be clear during roll-out and after peer review.

Risks:

- 3.8 The proposals may not allow sufficiently for the effect of local conditions on the ability and speed with which firm changes can occur in different areas. The changes require a significantly different structure of the profession with some level of consolidation and relocation likely for the majority of firms. There are likely to be local differences in the extent of reorganisation and also in the speed with which firms can reorganise and the costs. The detailed impact will need to be considered in each area before setting the contract process in motion.
- 3.9 The key risks are that in some cases the reorganisation may be too costly for firms to consider, leaving contracts unfilled and services disrupted. Solicitors may leave the market and hiring and training replacements may take a long time and be costly. This could leave a shortfall in the number of practitioners from which it would be hard to recover.

Recommendations:

- 3.10 The Carter proposals represent major changes in market organisation. The problems that may occur cannot be fully anticipated and will be location specific. This calls for a more flexible approach that carefully identifies differences and takes full account of them during transition and in settling the final structure.

3.2 Consolidation of contract areas and firm relocation

- 3.11 The boundary or contract areas are also likely to be much larger than current police station schemes in terms of cases and numbers of police stations and magistrates' courts. The current police station schemes for organising and allocating police station work (and subsequent magistrates' court and crown court work) are to be consolidated into substantially larger contract areas. The purpose is to provide scope for economies of scale in relation to travel time made possible with large volumes of work for a single provider focused in a single area.
- 3.12 This involves similar concerns to those related to the increase in average firm sizes. Consolidating schemes may be disruptive. There are especially likely to be local differences in the ability to consolidate

geographic schemes, which have developed for historical reasons allowing for local characteristics. The transition process to fewer, larger contract areas may itself be disruptive and will need to be carefully designed area by area.

The consolidation of boundary areas is likely to reduce the approximately 313 police station scheme currently to about 100 boundary areas. Currently 68% of police station schemes are below this level, accounting for 26% of cases.

See: 4.2 Scale of boundary area reorganisation

- 3.13 It is reasonable to project that travel costs could be reduced by the changes to larger scale contract areas and fewer, larger firms providing services. Travel costs are a significant component of total police station and magistrates' court costs, and fixed fees (including an element for average travel and waiting costs) provide firms with an incentive to reduce travel costs where possible. However, this is not just a case of re-drawing boundary lines.
- 3.14 An important consideration is that consolidation of police station schemes is unlikely to have any direct effect on costs unless it is accompanied by reorganisation of the work loads between police stations within the contract area, as well as magistrates' courts and possibly crown courts. To achieve potential economies of scale this would also need to be accompanied by significant restructuring of work distribution (e.g., by centralising work in lead police stations and by relocating solicitor offices). This may be disruptive and costly. The new contract areas would need to 'mimic' existing large police station schemes, focused around a lead or hub police station, rather than a collection of otherwise unchanged police station schemes.

Econometric analysis of the determinants of travel costs, using data from all the police station schemes, confirms that larger boundary areas and fewer firms on duty rotas are significantly associated with lower

travel costs. For example, with the average boundary area sizes and firm numbers proposed in the Carter Report, travel costs could halve. This indicates a potential for travel economies from larger scale. However, it does not follow that these economies will automatically result from larger boundary areas and fewer firms. Rather, there may be potential savings if consolidated areas match all aspects of current large areas, which will take time to adjust.

See: **4.4 Potential travel costs savings**

- 3.15 This implies that the potential cost savings from larger contract area and fewer, larger firms can only be achieved if the work operations within the contract area are also revised, which would require co-operation with all the many partners in the criminal justice system. This aspect is not developed in the Carter report.

Risks:

- 3.16 Potential economies of scale from consolidating contract areas will need to be accompanied by parallel changes in work loads within the contract area to be fully effective. This will require coordination.

Recommendations:

- 3.17 This is an area which needs careful area by area review and flexible introduction of the changes. One size will not fit all regions or police station schemes.

3.3 Flat cost trends

- 3.18 One of the main premises of the Carter reforms is that costs of legal aid have risen excessively over a long period. It is correct that total legal aid costs have increased significantly over the past decade. However, it is important in assessing the proposals to recognise that the increases do not apply to all areas of legal aid, or over the most recent period. In the three years 2002-06, in most areas of criminal and civil work, total costs have increased only slowly if at all, and on a per case basis have often decreased.

- 3.19 Looking at total legal aid costs in broad categories, during 2002-06 total legal aid cash payments have risen at a rate of 2.1% per year. Within this CLS payments have risen at 0.7% per year and CDS payments (excluding crown court) have fallen at -1.6%. Within CDS, police station attendance costs have risen at a 4.4% rate, but adjusted for higher cases loads only at 0.4%. Magistrates' court costs have fallen at -0.1% per year and per case at -0.5%. After allowing for inflation these each represent net decreases in real per case costs.
- 3.20 The main area of increase has been in crown court and higher court costs, with an annual rate of increase of 7.4% or 8.1% per case. Crown court and higher court costs include both solicitors' and barristers' costs, for litigation and advocacy. They include some reported reductions in costs following the introduction of case contracts for very high cost criminal cases in 2003.¹⁴
- 3.21 Meanwhile, over the same period (2002-06), LSC administration costs have been increasing at a rate of 10.6% per year.
- 3.22 A similar picture emerges when detailed cost components for police station and magistrates' court work are analysed. Attendance costs for police station and magistrates' court have also been relatively flat or declining, especially on a per attendance basis. Of particular interest is the fact that travel costs per attendance have not increased. These costs have been cited in the Carter review process as an example of cost savings potential from larger scale. Although we agree that there may be potential travel cost savings from larger scale such as larger boundary areas (as discussed above in Section 3.2) it does not appear that they have been increasing significantly under the current system. This implies at least that there has been no appreciable change in travel patterns by firms over the period.
- 3.23 The data analysis of police station attendance costs (including travel and waiting) for the period 2001-05 for which data have been made available show that on a per attendance (claim) basis these costs have actually reduced at a rate of about 1.4% per year from 2001-02 to 2004-

¹⁴ The very high cost case scheme was introduced in 2000. Individual case contracts were introduced in September 2003.

05. Police station travel costs per attendance have declined at a rate of 1.3% and waiting costs have increased at a rate of 4.3%.

3.24 LECG analysis shows that core magistrates' court attendance costs (per attendance including travel and waiting) for the period 2001-05 have decreased by about 1.7% per year. The per attendance costs have decreased most for non-standard fee work (about 6% decrease per year), then higher standard fee (3% decrease per year) and are least for lower standard fee (1% decrease per year). Total magistrates' court travel costs for the period 2001-05 have increased at an annual rate of about 12% over the 2001-05 period and waiting costs at 13% increase. However, on a per attendance basis average magistrates' court travel costs have declined by about 3% year and waiting costs by about 1% year decrease.

3.25 These results are consistent with research findings reported in Cape and Moorhead (2004), which concluded that for CDS costs over the last decade: (a) crown court expenditures have increased the most, driven by an increase in the number of cases and the average cost of cases; (b) police station expenditure is the next highest area of cost increase, driven by increases in volume, and also by increases in average case costs, and (c) magistrates' court costs are the most stable part of the criminal defence budget. Increases in police station costs were believed to stem in part from changes to the criminal justice system, which have also delivered stable prices since 2000-01. In all cases other drivers of average case costs were not clear.¹⁵

Although total costs for legal aid work have risen over the recent period 2002-06, in most areas of work, other than crown and higher court work, they have been relatively flat or have declined, especially when measured per attendance (figures as above). Also, looking at detailed attendance costs for police station and magistrates' court these have also been relatively flat or declining, especially on a per attendance

basis. In particular, travel costs per attendance have not increased (figures as above).

See: **4.4 Cost trends**

- 3.26 This does not mean that there are no problems for CDS or CLS costs or that firms are operating as efficiently as possible. Rather it indicates that firms, with flat fee rates for several years, are not significantly increasing costs and in fact are likely to face reduced revenues per case. This contributes to concerns such as generally low profit rates, low recruitment of young solicitors, ageing solicitor profile and others as discussed below. These imply that the problems are deeper than costs and are likely to require a thorough review to tackle them – as indeed the Carter Report states.¹⁵ However it also implies that the current system may be in an economically fragile state and there are risks that unless carefully implemented the provision of legal aid work may be damaged with lasting effects.

Risks:

- 3.27 The recent history of non-increasing costs and revenues in many areas of legal aid imply that firms may have become increasingly stretched over the past few years. If the Carter proposals are not implemented carefully with full consideration for the additional burdens of restructuring, a large percentage of firms and solicitors may be forced to exit the market, with lasting harm to legal aid provision.

Recommendations:

- 3.28 This underlines that the current system may be in an economically fragile state. The reforms will need to be implemented sensitively taking

¹⁵ See: Cape and Moorhead (2004) "Demand induced supply?: Identifying cost drivers in criminal defence work", report to the Legal Services Commission. At: <http://www.lsrc.org.uk/publications/camocrim.pdf> . For a survey of new and published research into the current legal aid market for solicitors' services available to the Carter Review, see LSC (2006), "The Legal Aid Market for Solicitors Summary of New and Published Research", June 2006. At: <http://www.legalaidprocurementreview.gov.uk/docs/lams-summary.pdf>

¹⁶ "Fundamental change must be made in the way legal aid services are procured ... There have been several attempts in recent years to improve the efficiency of the legal aid system, but these have proved insufficient to halt the increase in legal aid spending, especially on criminal defence services. ... [T]he scale of the continued rise in spending is not the result of individual or collective wastefulness. It is the result of systemic weaknesses in the way legal aid services are procured and therefore inefficiencies in the way those services are delivered." Carter Report , p. 3, para 3-6.

fully into account the characteristics of different firms, regions and service areas, to avoid potential lasting damage to legal aid provision.

3.4 Fixed fee levels and revenue neutrality

- 3.29 The fee levels that firms can expect for future work are vital to the sustainability of firms during the transition period and their ability to survive and earn reasonable profits in the long term. The Carter Report includes proposed new fixed fees for police station work and revised standard fees for magistrates' court work to be introduced in April 2007. Further changes are planned with the introduction of graduated fees for magistrates' court work in April 2008.
- 3.30 The proposed fees are based on current average costs per case and include an allowance for travel and waiting costs, which will in future be part of the fixed fees and not charged on a per hour basis as at present. However, it appears that although average core fees (profits costs) have been kept revenue neutral overall, the proposal assumes that firms will achieve some efficiencies in travel and waiting costs. In addition, for magistrates' court fees there has been some rebalancing of travel costs between lower standard fee and higher standard fee work, to encourage greater use of lower standard fees.
- 3.31 The result is that for both police station and magistrates' court work there is likely to be a reduction in total firm revenues. Assuming similar work patterns to the present, the Carter report estimates that the impact in Year 1 (2007-08) when the fixed fees are introduced will be a reduction of £11 million or 6% reduction for total police station costs and £13 million or 4% reduction for total magistrates' court costs. For both areas together the estimated reduction is £23 million or 4%. There is an additional small effect in Year 2 (2008-09) for magistrates' court revenues when graduated fees are introduced. Otherwise there is no additional impact in Year 2 (2008-09) and Year 3 (2009-10), after which time price competitive tendering is due to be introduced. However, these are nominal revenues. Allowing for inflation these imply an additional 2%-3% per year decrease in real revenues, depending on the inflation rate.

- 3.32 LECG analysis has confirmed these estimates in general terms (limited to 2004-05 data) for police station and magistrates' court costs.
- 3.33 In addition the Carter Report estimates that savings in crown court litigators' work will amount to decreases of total costs by 8% in 2007-08, a further 3% in 2008-09, and 3% in 2009-10. For civil and private family changes in total costs are projected to be +3%, -3% and 0% for the three years 2007-10, and for public law children cases +4%, +5% and +5%.
- 3.34 This raises three important concerns. First, fees are being cut ahead of the system reorganisation that is expected to give firms an opportunity to cut costs. The potential for travel cost savings depends largely on the reorganisation of firms and contract areas to focus larger volumes of work in a single area. There may be travel cost savings possible with larger scale, but these can only be achieved once these changes have taken place. Fixed costs are due to be introduced in April 2007, a year ahead of the introduction of new boundary areas and working conditions. In practice, firms are unlikely to reorganise until they are sure to have contracts so the travel savings are unlikely to be possible until later.
- 3.35 Secondly, this squeeze on revenues comes at a time when the firms are likely to be making significant investments in preparing for the new system. The only possibility for immediate savings is that fixed fees may encourage firms to reduce travel and other costs even before reorganising. As the Carter Report concedes, many of these costs are not in the control of the firms, so that there is little opportunity to cut costs and any reduction in revenues will cut into profit margins. Yet profit margins for CDS firms are thin (see **Section 3.5** below) and any reduction in revenues may threaten the firms ability to make the transition.
- 3.36 Third, reductions in crown and higher court earnings reduce the ability of firms to use these cases to offset lower earnings elsewhere. The effect on firms should be seen as a package. The reductions in cost are highest in crown court work, with projected reductions over the three year period, 2007-10, by 14% compared with a total of 6% reduction for

police station and 4% for magistrates' court, or 4% average reduction for both combined. Crown court work is the area where costs have been increasing most quickly recently (see **Section 3.3** above) compared with lower work where costs have been roughly flat. There has been significant success in reducing the rise in cost of very high cost cases (VHCCs) introducing case contracts rather than *ex post facto* billing and further savings are expected as forecast here once full cost contracting is introduced in October 2007.

- 3.37 While the prospects of controlling unnecessary crown court costs are welcome, the effect on CDS firms' total income must also be taken into account when considering the impact on firms. CDS firms consider the whole revenue stream when undertaking CDS work as a 'package' of police station, magistrates' court and crown court work. Low earnings in lower work are often offset by the prospect of higher earnings in a few crown court cases. The Carter proposals require firms to have the capability to follow cases through to the crown court as needed but the projected savings means that the short term impact in 2007-08 on firm CDS earnings is more than a 4% reduction. Crown court revenues represent about a third of total firm revenues so that on average firm earnings would be reduced by about 5%, with further reductions by 1% in 2008-09 and 1% in 2009-10.
- 3.38 As far as can be judged from the information available, the figures in the Carter Report appear to reflect accurately the impact of the new fixed fees for police station and magistrates' court. The crown court figures are more difficult to assess due to the complexity of the comparative costing analysis. It has been assumed in this analysis that the fixed fees do not include disbursements.¹⁷ Disbursements for additional costs such as translators amount to about 4% of total police station costs and 3% of total magistrates' court costs. It is assumed that disbursements continue to be paid separately from the fixed fees.

An analysis of the impact of the proposed fees for police station and magistrates' court work appears to confirm the expenditure profiles in

the Carter Report, Appendix 6.2, as far as is possible using the available 2004-05 cost data.

See: **4.5 Impact of proposed fees**

Risks:

- 3.39 A main risk is that the fixed fee levels may be imposed well before firms have had a chance to achieve potential efficiency savings from large scale operation.. It is not known what efficiency savings may be possible in practice or how long the adjustment process may take before firms are able to reduce costs. There are also likely to be differences between geographical areas depending on local conditions.
- 3.40 The new fixed fees for combined police station, magistrates' court and crown court work are targeted to include cash reductions in total firm revenues in the first three years of transition by about 5% in the first year, then by a further 1% and 1% in the following two years. In real terms, after inflation of 2% per year, these represent reductions in revenues by about 7% in the first year then by 3% in each of the next two years. These reductions are being introduced ahead of the structural reorganisation that should give firms the opportunity to reduce costs by greater efficiency. This will reduce profits for firms that are already likely to be marginally profitable, at a time when they will have high costs of re-structuring to prepare for the new system. This may significantly disrupt the supplier base during the transition with potential lasting harm to the provision of CDS services.

Recommendations:

- 3.41 Additional consideration will be needed for the assumptions behind the proposed fixed fee levels and the ability of firms to achieve the assumed reductions in their internal costs that would be needed to remain profitable in the face of reduced earnings. This also needs to be taken into account in considering interim financial and other support for the managed transition. Consideration may be given to an option to adjust

¹⁷ Carter Report, Annex 6.2, p 196, para 6. For crown court fees: "Disbursements are not included here. ... The Review has not addressed this area of cost ...".

fees in the interim period, depending on feedback, and set these at levels that are truly revenue neutral.

3.5 Long term sustainability and firm profitability

3.42 The basic question for the reforms is whether they can lead to a healthy and sustainable legal aid sector in the long term. This depends in turn on the question of whether legal aid is profitable and competitive.

3.43 Fee levels must be set to ensure sustainability and high quality both during the transition period and in the long term. They should not, for example, be set at levels that reduce current revenues at a time when already stretched firms are facing high costs of restructuring (as above). Fees must be set at levels to preserve the supplier base during the transition. Given the substantial costs firms are likely to face, any additional pressure could not be widely supported.

3.44 In the long term the Carter proposals are aimed at providing opportunities for firms to grow and reduce costs with larger volumes of work and able to plan for a stable future. The combination of fixed fees, large scale volume and greater certainty is aimed at providing firms with incentives for reducing costs and planning for investment. Fee reductions should not be considered until there is evidence that firm restructuring is successful and costs are falling. For long term sustainability, fees should permit firms to make normal profits at market equivalent rates, after including potential efficiencies. These profit targets may be set with reference to other areas of legal services for private clients..

Studies of profitability

3.45 In the current situation published research shows that most CDS firms, for example, are at best marginally profitable, once all costs are allowed for.¹⁸ Current profits from CDS work are lower than in comparable sectors, e.g. financial services sector. Recent published research shows that once due allowance is made for notional equity partner salaries (in

¹⁸ Otterburn Legal Consulting (2006), "Lord Carter's Review of Legal Aid Procurement: 2005 and 2006 Surveys of Criminal Firms", April 2006. At: <http://www.legalaidprocurementreview.gov.uk/docs/otterburn-lca-survey-2005-research-2006.pdf>

this research using estimated partner salaries in a range from £60,000 for small firms up to £68,700 for large firms) and other 'hidden' costs such as return on equity and rent on premises where applicable, average profits on revenues in CDS firms may be as low as 2% profit to -6% loss, depending on firm size. These compare with market-determined profit targets in broadly equivalent service industries, such as independent financial advisors and retail insurance brokerage, typically in the 10%-15% range.

- 3.46 The same research points out that many firms perform both criminal and civil legal aid work, as well as in many cases private legal work. Profit levels for civil and criminal legal aid work are comparable to each other but both are significantly lower than profits for private work. This indicates that firms' CDS and CLS work is to some extent interconnected, and that at the firm level there are likely to be available alternatives to legal aid work, should it become less attractive, by expanding private work where possible.

Based on the results reported in the Otterburn Report, once all implicit costs of business are accounted for in making a comparison with other market-determined profitability rates, criminal firms are at best making low profits on average, in a range of about 2% to -6% depending on size.¹⁹ The smallest firms may be marginally profitable or effectively loss making, and even the largest firms may have only modest profits.

See: **4.6 CDS firm profitability**

Attracting new solicitors

- 3.47 Sustainability of quality supply also includes attracting new solicitors and other professionals to reverse the problem of the 'ageing supplier base'. Students are currently put off embarking upon a career in legal aid – a survey of student solicitors has shown that while 60% said they were attracted by legal aid work, only 21% actually ended up doing it legal aid

¹⁹ Otterburn (2006).

. The main reasons given are the perceived low salaries, limited career prospects and poor working conditions.²⁰

3.48 This confirms concerns from previous surveys for the long term sustainability of CDS supply which has been part of the motivation for the Carter review. The implications of this research are that the supplier base is in a fragile state and while it continues for the moment it could be disrupted with permanent harm if the Carter reforms are not introduced sensitively.

3.49 A major risk of the reforms is that following a long history of limited profits and related problems, the transition to a new structure may be disruptive and prospects for long term performance may not be attractive enough to keep many professionals and firms from leaving legal aid work. This could cause lasting harm to sustainability and leave the area in little better condition than at present. To avoid such an outcome the implementation will need careful design and monitoring, including ensuring adequate returns to firms. Fees should allow for differences between regions or other distinctions in the underlying cost base.

Carter model of CDS firm profitability

3.50 The Carter Report includes models of firm profitability to help predict how representative quality firms might perform under the new arrangements.. Depending on firm size and structure these models predict profitable outcomes measured in terms of profit per equity partner. Depending on firm size and structure these models predict profits per equity partner in a range from about £36,000 for a single practitioner firm to about £122,000 for a large firm with about 47 fee earners, outside London (£55,000 and £151,000 in London). With potential efficiency savings of 5% in overheads and other fixed costs, these figures rise to about £37,000 for a single practitioner firm to about £144,000 for a large firm with about 47 fee earners, outside London (£57,000 and £177,000 in London).

²⁰ The Law Society (2004), "Career Choices in Law", Research Study 50, February 2004; p.10.

- 3.51 The results are obviously sensitive to the assumptions on which the models are based, such as work loads, representative costs and other items. Also the potential for efficiency savings needs to be justified. These assumptions will need to be reviewed for reasonableness alongside the range of problems that may face firms in actual working conditions to determine the extent to which the model predictions can be achieved in practice.
- 3.52 For comparison purposes, it is helpful to consider what these results imply in terms of other measures of profitability. Profit per equity partner is a conventional measure of profitability in partnerships but other measures such as net profit margin as percentage of revenues are also important, especially when comparing performance with returns in other service industries. For such comparisons, net profit should allow for 'hidden costs' such as notional salary for working equity partners (where equity partners are included as fee-earners but not as salary costs) and other costs such as return on equity and rent on premises, which do not appear to be included in the Carter models. This conforms to the method used by Otterburn (2006) for assessing firm profitability, as above.
- 3.53 When these notional costs are taken into account, the models imply net profits that may be below those achieved in other service industries. For example, allowing a notional salary for working equity partners (who are assumed to have chargeable hours) equal to those assigned for salaried partners (£76,5000 outside London and £85,000 for London) leads to profit margins in a range -4% to 5% for firms with f 5 to 47 fee earners, outside London, and 1% to 6% in London. Even with savings in overheads and other fixed costs of 5%, the model predicts that profit returns might rise to -2% to 7% outside London, and 4% to 8% in London.
- 3.54 These are similar to the actual profit figures derived from surveys, and seem to confirm the generally low profitability of the CDS sector. Even the best of these returns are below typical targets for market-based firms, which may require profit before tax (PBT) of around 10%-15%.

However, further analysis of the models is needed to establish whether this is a correct interpretation.

If allowance is made in the model for 'hidden' costs such as notional salaries for equity partners and other costs then the model generates profit measures below 6% for large firms while smaller firms may be loss making, by up to -4%. This provides a measure of profitability that may be compared with typical profit rates in other industries, such as financial services, where rates of 10%-15% are common.

See: **4.7 Carter model of firm profitability**

Profitability implications

- 3.55 As discussed above, in **Section 3.3**, while total legal aid costs have increased significantly over the past decade, this has not been the case for all costs, especially for the most recent years. In some areas, including police station attendances and magistrates' court attendances, costs adjusted for higher case loads costs have been flat or decreased. Adjusted for inflation real costs in these areas have fallen. As above, this does not imply that costs are not a problem, since flat per case legal aid charges are a likely consequence of capped fee rates rather than flat internal costs to firms. It helps confirm that for some types of work suppliers' profits may have been squeezed, especially after allowing for inflation, which is consistent with the findings of other research that most CDS firms are only marginally profitable allowing for all costs.
- 3.56 Fees for police station, magistrates' court and crown court work should be reviewed after allowing time for transition to the new structure. For long term sustainability future fees should ensure firm profitability at normal market rates. Fees should also allow for potential cost efficiency savings in the new system and for the achievement of other aims for access and quality.
- 3.57 Comparability analysis shows that market-determined profitability rates in roughly equivalent industries (e.g., insurance brokerage, independent financial advisors) are higher than those currently achieved in CDS.

These rates are typically 10% to 15% net margin on revenue, before tax. These may be seen as indicators of rates needed for long term sustainability in a market environment. These compare with rates for legal aid CDS work reported in Otterburn (2006) of about -4% to 2% once due allowance is made for notional salaries for working partners, rent on premises and return on firm equity.

Risks:

- 3.58 The main purpose of the reforms should be to provide firms with incentives and means for reducing costs – which fixed fees and contracted volumes may be able to do. The market reforms should be allowed to work and not pre-empted by administered prices set below what firms can afford. A risk is that if CDS services are provided on the same terms as other legal work, firms may insist on comparable returns, and the government, as purchaser, should be prepared to accept this.

Recommendations:

- 3.59 Fees may be reviewed once experience is gained with the new system. There is likely to be greater transparency and visibility of costs and performance with fewer, larger firms to observe and better information on which to set fees and determine whether they represent value for money.

3.6 Working practices – suppliers, LSC and professional bodies

- 3.60 The proposed arrangements represent a very different way of working for the supplier firms. They will contract to do larger volumes of work at fixed fees. This volume of work will be more certain than currently, although not guaranteed, and firms will be able to plan their operations for the long term.
- 3.61 There is likely to be less own solicitor work in future (see below) and firms will work primarily in a single contract area rather than the more diverse working, often over several police stations, at present. This ‘geographic range’ may be especially a feature of own solicitor work. In regions other than London, solicitors are effectively limited to duty work

for a single police station scheme within a reasonable travel time of their main office. In the new arrangements long duty rotas and extensive own work would be replaced by a few contract holders in a given contract area. There would be limitations on out-of-area own solicitor work to a share, such as 20%, of contracted volume - to be counted within this total not in addition to it. It is not clear how own solicitor work would apply across contract areas when firms bid prices in competitive tendering.

At present solicitors' firms (identified by office) generally work across a large number of police station schemes. Most of this work is on a small scale. Even so, work within a police station scheme is not especially concentrated in a few firms – the top three firms typically account for around 50% of total police station work in a scheme.

See: **4.8 Distribution of solicitor firm work across contract areas**

- 3.62 These changes in business practice are additional to changes such as the move to larger firm size and fixed fees in that they require a different commercial approach, in which new management techniques will be needed. Planning for a large scale business is likely to be a major change for many firms and need a new level of expertise. Adding price tendering creates the need for further significant expertise and carries risks. The greater predictability and transparency of the proposed system should improve service, other things being equal, but this does not come without its costs. A concern may be how fast and effectively firms can progress to this new level of management. Also, this adds a level of costs borne by the firms, rather than the LSC as previously, which should be taken into account in assessing fees. With price competitive tendering, costs of preparing bids would automatically be taken into account by the bidder so would raise prices.
- 3.63 These changes are to be matched with parallel changes in the administration of the CDS by the LSC and responsibility for quality assurance moving to the professional bodies. The costs of quality

regulation are essentially being transferred to the profession (see below).

- 3.64 Further issues concern responsibility for overall performance of the CDS. This includes the question of what happens, for example, if contracts cannot be filled or a large supplier fails. Currently with a fragmented supplier base ready to take on more work, this situation does not occur. With a more rigid structure in which firms are encouraged to match capacity to demand there may be, paradoxically, less flexibility.

Risks:

- 3.65 The risks are that the new working practices requiring additional responsibilities such as more extensive planning, training and business management introduce costs that are not considered in the Carter report.

Recommendations:

- 3.66 Attention should be given to management costs as part of the costs of the new system. This especially affects transition assistance. Costs such as marketing and preparation of tenders will also need to be acknowledged as a component of price competitive tendering.

3.7 Own solicitor work – choice and competition

- 3.67 Own solicitor and out-of-area work may be vital for competition as a route for firms to enter new areas and challenge incumbents. It is also important for ensuring client choice. Establishing a presence in a new market may be a key to entry. This is formalised in the Carter proposals by requiring previous work in an area as a condition for a contract bid.²¹ Own solicitor work may be seen as a reward for effort and reputation. If this 'entry route' is not effective, it is likely to be harder for firms to enter a new area, since they typically may need to do it on a large scale to win

²¹ "[A] minimum threshold for all contracts should also be introduced with the possible exception of some rural areas. The threshold should be set at a low level. For example, the volume of police station work that one dedicated professional criminal practitioner could undertake in a year, £50,000 or 200 cases. ... For example, to gain access to a new scheme, a firm could have to have delivered a minimum level of between 1 and 5% of work at that scheme in the previous year ... in addition to having delivered £50,000 of work nationally." Carter Report, p. 73, paras. 30-31.

a contract. This may severely limit potential competition between firms, which the proposals rely on.

- 3.68 Own solicitor work is an important part of CDS provision. It is a way for firms to establish a reputation and grow, it provides choice for the client and it is a focus for competition. It requires active marketing of a firm's services rather than being allocated work (once a contract has been won). In short, it is a prime example of the market place at work in CDS services. Yet scope for own solicitor work, especially the ability to enter other contract areas, is limited under the Carter proposals. This may compromise objectives to ensure effective price competition. It may also limit effective client choice, another key component of market competition.
- 3.69 Potential entry is often seen in economics as one of the most effective forces of competition. Another important aspect of competition is innovation, which is related to entry. This is an additional focus of competition along with winning the original contract. As discussed below, a concern is that competition between firms in a contract area may become limited over time. Once a few large firms are established in an area it may be hard for an entrant to launch a bid, which would need to be at large scale, to have a chance of success. There might be effective competition for share between the firms but entry might be problematic.
- 3.70 It is also the case that limitations on own solicitor work may restrict client choice directly.
- 3.71 Ideally there would be unrestricted ability to compete for own solicitor work, as currently. This would keep incumbents under pressure to maintain standards at the risk of their market share being eroded. Instead, the proposals restrict client choice of own solicitor, primarily to firms that have a contract in the area or up to 20% of their contracted capacity for out-of-area work. Admittedly with unrestricted own solicitor work there may be a conflict between ensuring contract holders achieve their contracted capacity and allowing competing firms to take work away from them. The 20% limit within the boundary of the firm's total

contracted volume goes some way towards ensuring choice and competition. It may not be enough.

Risks:

- 3.72 By restricting client choice of own solicitor the proposals may be weakening an important element of market competition. With less scope for own solicitor or out-of-area work, firms will find it more difficult to enter new areas and so increase their business by greater efficiency and innovation. The main focus of competition becomes the contract stage and once contracts have been awarded incumbents will be less challenged.

Recommendations:

- 3.73 For reasons of competition and choice some flexibility may be needed to review how the out-of-area own solicitor work progresses.

3.8 Equal access and small firms

- 3.74 Equality of access by clients to CDS services may be affected by the elimination of small firms and the increase in average firm size. Published research by MDA (2006) indicates that to the extent that black and minority ethnic (BME) clients are typically represented by BME solicitors, and those solicitors are most likely to practise in small firms, then a reduction in the number of small firms may adversely affect the choice available to BME clients. as well as other clients. In London the proportion of black and minority ethnic solicitors is higher in small firms than large, so that to the extent that BME clients wish to use BME firms, they are likely to be adversely affected relative to other clients.
- 3.75 The Carter Report acknowledges the potential for concern in this area but maintains that the proportion of BME solicitors should not be adversely affected by the reforms.²² The Report also recommends monitoring of the situation as the reforms are rolled out.
- 3.76 Perhaps the main unknown is what will be the effect on BME client access to legal aid services. It has not been tested whether BME clients seek out BME solicitors as such or whether access is likely to be

determined by other variables such as the service conditions in the area. Regardless of the ethnicity of the supplier the question may be whether local and regional differences in supply may adversely affect access for some groups. This is another risk for the future.

3.77 This is an important area which cannot be dealt with adequately in this report due to lack of detailed information. For example, without further data it is not clear whether the possibility of BME solicitors relocating to larger diversified firms might provide BME clients with an equivalent choice to that which they currently have with small specialised firms. Flexibility may be needed to review how BME and other clients and areas with specific demands have effective choice of representation, either prior to the introduction of the new system in specific areas or as experience is gained with the system.

3.78 Similar possibilities occur for potential advice deserts in rural areas, which might not be covered effectively within larger contract areas with larger firms.

Risks:

3.79 Risks are that unequal access and possibly advice deserts in certain areas may result from concentration of CDS services in larger contract areas and fewer, larger firms.

Recommendations:

3.80 More information is needed on how CDS services are demanded by clients from minority backgrounds, and whether the choice from the client side might be restricted unfairly by the reduction in the number of small firms. Measures such as targets for recruitment of BME or other solicitors in larger firms might alleviate these concerns.

3.9 Transition arrangements

3.81 An effectively managed transition is critical to the success of the reforms. Attention to the transition process and the level of financial and other support discussed in the proposals may be inadequate to cope

²² Carter Report, pp. 107-115, paras. 75-94.

with the far ranging changes being proposed and the fragile state of the supplier base.

- 3.82 The Carter reforms involve major changes in the structure of the supply and procurement of CDS services, affecting the number and size of firms, contract arrangements with LSC, fee structures and levels, and others. It is critical that the transition process goes smoothly to ensure continuity of CDS provision and long term sustainability. A risk is that changes might be enacted one-size-fits-all, when there are likely to be various requirements in different circumstances. The transition needs detailed planning and 'local' consultation, and needs to be sensitive to feedback on how it is progressing.
- 3.83 The majority of firms is likely to have to restructure and/or relocate to some extent to continue in CDS work. They will have a different relationship with LSC and a different quality assurance regime. These are major changes and firms need to have access to support if the transition is to be smooth. The initiatives for transition support are limited.
- 3.84 The Report envisages some grant aid support to provide advice to firms that wish to consolidate. The amounts are up to £3,000 per instance for expert managerial and financial advice. The total cost of this support is expected to be no more than £4m.²³ Similar funding up to £3,000 per firm in matched funding will be made available to firms to help them upgrade their information technology, with total funding available of £6m. These funds are to be administered by the Law Society. Firms requiring more substantial financial support during the transition are expected to be able to obtain this commercially on the basis of their future business plans.
- 3.85 A concern for the system as a whole is what fallback positions are available at the different stages of implementation if supply fails. Currently if a solicitor is not available for police station assistance it becomes an immediate problem to find an alternative. If a firm holding a large contract decides to leave the market, or not enough suitable firms

²³ Carter Report, pp.120-121, paras.130-138.

bid for a contract, it may not be possible to find a substitute firm. The new system is unpiloted and there are bound to be unexpected problems as it is introduced.

Risks:

- 3.86 Risks are that the problems of managed transition may not have been given sufficient attention compared with that devoted to designing and describing the end result target. The scale of direct financial support of around £10m to assist firms in the transitioning firms is modest compared to the scale of reforms and the attendant risks.
- 3.87 In addition it is not clear what fall back positions may be available for the system as a whole in introducing the new arrangements.

Recommendations:

- 3.88 Further consideration may be needed to consider the scale of transition, the problems firms may face. The introduction of these untested changes should be monitored

3.10 Quality assurance and self-regulation

- 3.89 Responsibility for quality assurance is to be transferred to the professional bodies (Law Society and Bar Council). They will monitor quality according to guidelines set by the LSC. There appears to be separation of responsibilities, in that the LSC remains responsible for ensuring value for money in defining the standards and letting the contracts while the professional bodies conduct quality audits and may be responsible for updating standards as conditions change.
- 3.90 Self-regulation may be effective in monitoring performance to ensure solicitors meet specified quality standards; the professional bodies have done this throughout their history. However, they can not be responsible for ensuring value for money or deciding whether a given quality level is economically worthwhile. This risk of responsibility falling in a gap may be increased if the professional bodies bear the cost of monitoring quality, and may have limited resources to review standards once they are set.

3.91 Firms will have incentives to cut costs to win contracts and make profits and may do so by reducing quality. Because of the separation, a possibility is that they may do so until quality hits a lower threshold and the quality standard becomes a minimum standard rather than a value for money standard. However, there may be grades of quality defined (as in the peer review system) that can relate value to costs.

Risks:

3.92 A risk is that a transfer of responsibility for quality assurance to the professional bodies may leave responsibility for value for money tradeoffs undefined. This depends on how the quality assurance responsibilities are defined.

Recommendations:

3.93 Consideration may be needed to ensure that quality standards do not become minimum standards and that value for money may still be judged.

3.11 Viability of market model – effective competition

3.94 The core of the Carter proposals is the use of 'market-based' processes to provide incentives for lower costs and sustainable high quality provision. Introduction is in three stages: the introduction of fixed fees, the award of capacity-based contracts to a smaller number of preferred suppliers and the introduction of price tendering to replace administered prices. Each stage is dependent on the successful implementation of the earlier stage. The process is planned to take place over a period of three years.

3.95 It is important to recognise the limits on the application of the market model to legal aid. This can never be a fully free market where the government remains the sole procurer of services and the end client is likely to be ill informed about the quality of the service and is not paying directly. There are elements of the market that may be used to advantage – such as the incentives for cost reduction with fixed fees, ability of firms to plan their business with assured contracts, and potentially price and volume competition in tendering – but the

government must remember the limitations. These limits imply not only that attention is needed in designing and implementing the 'market-based' model, but also that there will remain significant governmental responsibilities for managing legal aid. In particular these apply to the final stage of the Carter reforms, the conditions under which competitive tendering can be effective in completing the process and replace the current system of prices and volumes of work set by government.

Competition with fewer, larger firms

- 3.96 A first issue is the extent to which competition between firms can be relied on to reveal firms' true costs and reduce prices. Firms will have incentives to bring down costs with fixed prices. With price tendering they may lower costs further and pass part of the reductions on as lower prices to gain market share.
- 3.97 A problem is that the proposals may create larger firms with local market power, with some market power to raise prices, or resist further falls, to ensure above-normal profits. Market power concentrated in the hands of a few may arise because a firm that has failed to achieve a contract in the first round may find it hard to bid next time – it will have lost its fee earners and will need to compete with firms that have been working in the market since the last round. Although there may be competition initially it may gradually fall away. The proposals believe that a small number of suppliers, four to six, may be sufficient to ensure competitive conditions. This may be true initially but it may not be capable of being sustained over time.
- 3.98 Conversely in some areas there be insufficient number of suppliers available to compete effectively for contracts. Those that are available may try to set high prices.
- 3.99 A most effective indication of competition is the ability to enter a market. Under the proposals entry may be difficult for a new firm as it will need a high capacity bid to win a contract. Entry via own-solicitor out-of-area work is important but the restrictions on the volume of this work to 20% of a firm's contracted volume, and included within that volume rather than in addition to it, limit the scope for using these entry routes.

3.100 This raises concerns about competitive tendering. The small number of firms in each area and the limited opportunity for entry may reduce exposure to competition. This may be compared with the current situation with a fragmented supplier base with no ability to set prices. Also, in a market environment firms will want to earn a commercial return.

3.101 Whether this scenario of insufficient competition and seller market power is likely will depend partly on how effectively the administered contract stages work during the roll out of the reforms, which can only be seen with experience.

Government as sole (monopsonist) purchaser

3.102 A second issue is the role of the government as sole purchaser of CDS services. Markets have two sides, buyers and sellers. In this case the government is a monopsonist purchaser supplied by several solicitor firms in each area.

3.103 Although the proposals intend that markets set prices, for the reasons above they may be at levels higher than government expectations. The temptation for the government if it does not like market prices may be to continue to administer prices. Firms, however large, may have little choice but to accept these. Alternatively contracts may find no takers. In that case the system may not be much further along than at present, in terms of ensuring firms a fair return and the government a sustainable high quality service.

3.104 This implies that the government must be convinced that the conditions are right before introducing price tendering and it must also be prepared to accept market prices if these are set competitively.

Better information

3.105 Despite these risks there are likely to be important additional positive aspects to the change in relative market positions, with the suppliers having more power than now. Both government and profession should have clearer information on costs and performance with fewer, larger firms involved in the delivery of CDS services. The parties should be

able to negotiate from more balanced positions and with better information than at present. Firms in the current fragmented supplier base are pure price takers, being dependent on fees set according to government budgets. Flat fee rates over a period of years have benefited neither side interested in long term sustainability and investment. There may be considerable potential benefits from the new system in this respect.

Administration costs

- 3.106 The Carter proposals also anticipate a reduction in administrative complexity and costs. Savings are expected in LSC administration costs of up to £30m per year by 2010 (compared to total costs of £98m in 2005-06) due to rationalised processes and information technology changes.²⁴ Fixed prices and fewer firms should simplify billing and once contracts are awarded many aspects may not need to be revisited until the next contract. Quality assurance responsibility is to be shifted to the professional bodies.
- 3.107 However, much of the apparent simplicity in administration may be the result of shifting responsibility from processing and auditing claims to contract writing, award and post contractual monitoring. If contract writing and monitoring turn out not to be administratively simpler and more predictable than *ex post facto* billing, then overall costs may not fall as anticipated. This is mostly a risk for competitive tendering. The auction of contracts in particular is likely to involve considerable administrative costs related to designing and running the tenders. The responsibility for quality and ensuring value for money does not go away, rather some of it is still required *ex ante* in assessing tenders.
- 3.108 There are also questions of monitoring performance in relation to commitments and possible sanctions. Because contracts will only be awarded periodically it is unlikely that market forces alone can ensure performance and this will have to be monitored carefully as in most other tenders.

²⁴ Carter Report, p. 123, para. 151.

Risks:

- 3.109 Risks include the concentration of market power in the hands of a significantly reduced number of suppliers, and the temptation for the government as sole purchaser to over-ride market forces if it does not like the results. This could put the system back to the current, with extensive confusion and costs in the interim. These risks may be offset by a clearer relationship between government and suppliers based on better information and more balanced negotiating positions.

Recommendations:

- 3.110 The introduction of price tendering should only be considered once the first stages of the new system are seen to work well and there is sufficient competition, and information available to the LSC, to ensure effective market tendering.

4 Data analysis

4.1 Market reorganisation and firm size

- 4.1 To understand better the potential impact of minimum case load limits in the proposed contract system, LECG has reviewed the distribution of case work by different solicitor firms using 2004-05 revenues data, supplied by the LSC. The primary analysis summarises the distribution of police station cases by office. As the natural focus for a location analysis and also determined by the available billing data, the unit of analysis is here identified by solicitor firm office using the unique office ID numbers in the LSC data. Some firms may have more than one office. A unit of measure at the office level is likely to be more relevant than by firm name where firms cannot easily transfer work between offices or individual solicitors cannot transfer between geographic locations. The total number of solicitor offices identified here is 2,718 compared with 2,247 solicitor firms performing police station work in

2004-05.²⁵ This is consistent with the figure of over 2,200 firms holding contracts with the LSC for CDS work reported in the Carter Review.²⁶

4.2 Results indicate that currently about 63% of solicitor offices have below 200 cases per year (1,718 offices) amounting to 21% of total cases. In other words, 1,000 offices currently have under 200 cases and would be excluded from bidding for contracts unless they merge or expand. A further 25% of firms have between 200 and 500 cases per year, with an additional 37% of total cases. The remaining 12% of offices perform more than 500 cases per year, amounting to the final 42% of total cases. Only 2% of offices have over 1,000 cases per year, performing 12% of total cases. These results are summarised in **Table 1**.

Table 1: Minimum firm size summary for police station work (200 cases limit) (2004-05)

Name	Total solicitor offices*	% Firms working below limit (200 cases)**	%	%	PS earnings /case at limit (200 cases)	Total earnings / case at limit (200 cases)***
			Work firms below limit (200 cases)	Work firms below limit (100 cases)		
1 East	189	63%	19%	44%	£257	£1,094
2 East Midlands	183	63%	22%	38%	£242	£1,178
3 London	465	60%	18%	42%	£291	£1,013
4 Merseyside	66	59%	19%	33%	£245	£895
5 North East	173	66%	20%	49%	£245	£973
6 North West	332	63%	22%	43%	£249	£1,029
7 South East	152	62%	24%	36%	£279	£952
8 South	156	63%	22%	43%	£266	£1,041
9 South West	216	62%	20%	46%	£255	£968
10 Wales	231	71%	28%	49%	£250	£957
11 West Midlands	270	62%	22%	37%	£235	£924
12 York & Humber	231	58%	17%	41%	£239	£1,008
<i>Not assigned</i>	54	93%	68%	83%	£235	£554
Total	2,718	63%	21%	43%	£256	£988
London	465	60%	18%	42%	£291	£1,013
National	2,253	64%	22%	43%	£249	£983

* Solicitor offices identified by ID number (firms may have more than one office)

²⁵ Firms are identified by firm name in the data. Any potential over-counting of firms due to minor variations in names has been corrected for.

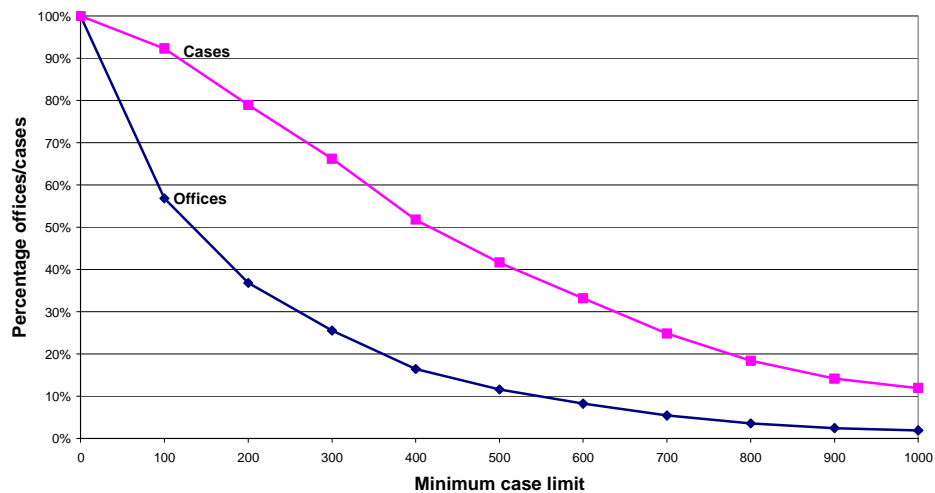
²⁶ Carter Report, p. 74, para. 34.

** 200 cases are the illustrative size of a contract unit (Carter Report, p. 73, para. 30)

*** Total earnings from police station, magistrates' court and crown court work for cases started at police station.

4.3 The cumulative percentage of total offices and share of total case work for firms (i.e., solicitor offices) with case loads above the given limits are shown in **Figure 1**. Reading from the graph, this shows that firms (identified by solicitor offices) currently with above 200 cases per year account for 37% of the number of offices and 79% of the total cases (the mirror of the 68% and 21% figures respectively in Table 1). Offices currently with above 100 cases per year account for 57% of the number of offices and 92% of the total cases.²⁷

Figure 1: Solicitor offices above case limits - police station work



4.4 The Carter proposals will result in fewer, larger firms performing CDS work. It is not clear at this point what firm size distribution will result from Stage 2 of the Carter reforms with the introduction of capacity contracts, larger contract areas and peer review. If the minimum firm size permitted to bid for contracts is 200 police station cases per year (equivalent to one fee earner dedicated full time to police station work) then, applied at the office level, this implies that about 63% of offices with 21% of volume will need to reorganise. The offices may either consolidate, grow or exit CDS work and their capacity taken by other

²⁷ The large number of small firms shown here is consistent with the illustration in the Carter Report (p. 74, para. 34) that the smallest firms 17% (almost 400) of firms do less than 1% of the work.

firms expanding. In the latter case up to 20% of solicitors/fee earners must relocate to larger offices or leave the market.

- 4.5 One way of estimating a lower limit for the number of firms that might need to restructure rather than exit CDS work if the 200 case limit were applied is to assume that all offices below 200 cases reorganise (in practice by consolidation or personnel shifts) into a number of offices with 200 cases each. For 2004-05, 1,718 offices out of 2,718 total performed less than 200 cases, amounting to 124,498 cases in all. If these cases were performed by firms with just 200 cases each this would imply 622 offices, with 1,096 offices closing (by merger). In other words about two thirds of the small firms would 'close'. Coincidentally, in 2004-05, 1,174 offices had below 100 cases (43% of total firms and 8% of total capacity). These might be the most likely candidates to close. If so, at a minimum, about 1,100 firms and about 8% of capacity would need to transfer to other firms.
- 4.6 These are minimum figures, assuming all small offices merge with other small offices to meet the 200 case target. For example, if half the small offices were unable to merge then 850 offices would close – their staff might be able to transfer to larger firms or might decide to leave CDS work. However, without detailed examination of individual office conditions it is not clear how many of the approximately 1,700 small offices and 21% of capacity might leave the market.
- 4.7 This is not the full picture because many of the medium and large firms currently above 200 cases may be able, and be expected, to expand. If firms are permitted to bid for contracts at 20% above their current case load, then the larger firms currently with over 200 cases, who account for 78% of total work, could expand to take **all** the market from the smaller firms.²⁸ Not all firms will be able to expand. On these figures, the actual outcome might to be somewhere between the two limits (i.e., all small firms leave the market versus all small firms merge until they reach minimum size).

²⁸ This would be especially the case if preference were to be given to large volume bids, which is not currently part of the Carter proposals.

- 4.8 Some of the expected reorganisation might involve consolidation of offices within a firm, which might be simpler than merging two independent firms, but even in such cases there would still be significant relocation problems, especially for individual solicitors unable or unwilling to move.
- 4.9 To consider whether this changes the basis result, a firm level analysis of the impact has been performed. This yields a similar scale of impact. Analysis shows that of the 2,247 firms performing lower CDS work in 2004-05, about 58% perform below 200 cases per year. This amounts to 1,301 firms performing 17% of total CDS work. To meet the 200 case target, a minimum of 795 of these small firms would need to merge into larger firms, representing 6.5% of capacity.
- 4.10 This may be compared with reported estimates that “about 400 of the 2,700 firms providing criminal defence services would have to merge or shut.”²⁹ The above figures indicate that a minimum of about 1,100 offices (43% of the total) might need to merge into other offices, representing about 8% of capacity. At the firm level, a minimum of 800 firms (35% of the total) might need to merge, about 6% of capacity. In all, about 1,700 offices (63% of total) representing 21% of capacity would need to make changes, either to merge or exit CDS work.
- 4.11 Also it is not clear what the minimum contract unit size needs to be in all areas, and these may differ. For example, for a large contract area of about 6,000 cases with a target of 6 firms per area, then the average firm size would rise to 1,000 cases (about 5 fee earners dedicated to police station work).³⁰ Assuming a distribution of firm sizes and consolidation limited in some locations by other considerations, 500 case per year may be a realistic lower limit for firm size. Currently about 90% of offices and 60% of work is in offices with less than 500 cases. To bring all these offices to 500 cases per office would require about

²⁹ “Legal aid curb on £1m lawyers ‘may shut small firms’”, Telegraph, Joshua Rozenberg, 14/07/2006. At: <http://www.telegraph.co.uk/news/main.jhtml;jsessionid=KOZBYJIHW3KSBQFIQMFSFFOAVCBQ0IV0?xml=/news/2006/07/14/nlaw14.xml&sSheet=/news/2006/07/14/ixuknews.html> . Note also: “The smallest 17% (almost 400) of these firms do less than 1% of the work”. Carter Report, p. 74, para. 34.

³⁰ “There should be at least four to six suppliers working in each area to deal with potential conflicts of interest, although the exact number may be subject to local factors.” Carter Report, p. 72, para. 18.

40% of fee earners to switch employers (20% from small firms currently below 200 cases and 20% from medium firms with 200-500 cases).

4.12 The actual pattern of firm closure and consolidation depends on the options open to individual firms. Their ability to consolidate depends on firms' individual circumstances, local market conditions, geography, and many other factors. The size distribution varies between regions, and the outcome of the peer review process will inevitably eliminate some firms, possibly especially the small firms. Many firms may be ineligible as preferred suppliers for CDS work as a result of their rating in peer review. In addition there is also likely to be relocation of firms and solicitors to focus on a particular contract area, so that changes at the office level also need to be considered at overall firm level.

4.13 The criteria for awarding contracts and the minimum contract unit size in each area are yet to be determined. However, this analysis indicates that even with a relatively small minimum contract size, equivalent to one fee earner assigned full time to police station work, there is likely to be a significant impact on the number of small firms and on the share of work currently being performed by those firms.

4.14 All these variables cannot be foreseen at present. They will only become clear with detailed assessment during the roll-out process. It is possible that in some areas there may not be sufficient qualified suppliers to meet the size and performance targets, including aims such as representation for diverse clients. Contract terms, supplier caseloads, duty scheduling and processes for handling exceptions will need to be flexible to allow for these differences.

4.2 Scale of boundary area reorganisation

4.15 LECG analysis of the proposed boundary area reorganisation compares the impact of boundary area sizes of up to 6,000 cases per year with the current situation which shows an average of about 2,500 cases per year per police station scheme. The Carter proposals would imply about 100 contract areas compared with about 313 police station schemes currently. On average about 3 current police station schemes would

need to be merged into one contract area. The number would vary from region to region according to local characteristics.

- 4.16 The Carter Report considers much larger average boundary areas sizes than currently. It is not yet clear what final boundary area sizes might be, and the Carter Report makes it clear that these areas will be determined on a case by case basis depending on local conditions. However, the examples given in the report for the preferred grouped duty schemes imply areas that generate between 6,000 and 9,000 police station claims.³¹
- 4.17 As an illustration we consider the impact if police station schemes were consolidated into boundary areas with a size range of 2,000 - 6,000 cases. This is an average area size smaller than those suggested in the Carter Report, but as an illustration this may be a reasonable illustration of a lower boundary for the impact, given that consolidation of schemes may not always be feasible given differences in local conditions. A target of 2,000-6,000 would mean that across the country 68% of current police station schemes would need to merge into larger areas. These account for 26% of cases. There might also be a few very large schemes split into areas of 6,000 cases, although the Report seems to accept large areas and even the current largest police station scheme (about 13,000 cases) might not be split. These results are shown in **Table 2**. There are additional differences between regions.
- 4.18 The net result (with these size range targets) would be that the current 313 police station schemes might be merged into about 110 boundary areas. If no current very large schemes are split then the figure might be 100 overall. Equally, if the lower limit is higher than 2,000 cases there would be fewer boundary areas.
- 4.19 This is not a complete analysis as it identifies police station schemes that will need to consolidate into large schemes, without considering whether some of the current medium size schemes might merge with each other to form an area over the 2,000 case target, or the final size distribution after the mergers. More detailed mapping analysis would be

³¹ Carter Report, p. 149, para 22.

needed to determine the actual boundary areas according to local conditions. However, it identifies the scale of reorganisation likely to be involved.

- 4.20 As a check, the total police station work load recorded in the data for 2004-05 was 566,421 cases. If this were aggregated in boundary areas of at least 6,000 cases each this would imply a maximum of about 92 areas.

Table 2: Police Station Scheme Consolidation (<2,000 cases)

All England & Wales:						
Action	PSS			Cases	%	PSS final
	now	%	Cum %			
Extra small (<500) [merge]	77	24.6%	24.6%	11,528	2.0%	0
Very small (500-900) [merge]	33	10.5%	35.1%	24,007	4.2%	0
Small (900-2000) [merge]	103	32.9%	68.1%	147,113	26.0%	0
Large (2000-6000) [retain]**	89	28.4%	96.5%	283,310	50.0%	89
Split (>6000)	11	3.5%	100.0%	100,463	17.7%	21
	313	100.0%		566,421	100.0%	110
London area only:						
Action	PSS			Cases	%	PSS final
	now	%	Cum %			
Extra small (<500) [merge]	0	0.0%	0.0%	-	0.0%	0
Very small (500-900) [merge]	1	3.1%	3.1%	519	0.5%	0
Small (900-2000) [merge]	8	25.0%	28.1%	12,805	12.4%	0
Large (2000-6000) [retain]	21	65.6%	93.8%	70,281	68.1%	21
Split (>6000)	2	6.3%	100.0%	19,554	19.0%	5
	32	100.0%		103,159	100.0%	26
National (ex-London):						
Action	PSS			Cases	%	PSS final
	now	%	Cum %			
Extra small (<500) [merge]	77	27.4%	27.4%	11,528	2.5%	0
Very small (500-900) [merge]	32	11.4%	38.8%	23,488	5.1%	0
Small (900-2000) [merge]	95	33.8%	72.6%	134,308	29.0%	0
Large (2000-6000) [retain/grow]	68	24.2%	96.8%	213,029	46.0%	68
Split (>6000)	9	3.2%	100.0%	80,909	17.5%	16
	281	100.0%		463,262	100.0%	84

Note: Relates to police stations 1C and 1D claims in 2004-05.

* Criteria to split exceptionally large PSS:

3,000-6,000 solicitor offices = 1 PS

6,000-12,000 solicitor offices = 2 PS

12,000-15,000 solicitor offices = 3 PS

* Large PSS retained and grow by acquisition of smaller PSS.

4.3 Cost trends

4.21 Although the overall costs of legal aid have increased over the past decade, this does not give the full picture. In recent years, over which current justice system reforms have applied and for which cost data are readily available, many categories of legal aid costs have risen only slowly or not at all. This is especially the case when adjustments are made for higher case loads. To understand this better this analysis has summarised cost trends for legal aid costs in broad categories and for individual cost components (profit, waiting and travel) for police station and magistrates' court CDS work. These are presented below.

Overall cost trends for legal aid

4.22 To understand the context for legal aid reform, LECG has reviewed the recent cost history for legal aid in the major categories of CLS, CDS, crown and higher court (managed by the CDA rather than LSC), and LSC administration costs. The total costs for police station and magistrates' court data are also presented. These cover the period 2000-06 using LSC data from the Annual Reports.

4.23 The results are presented in **Tables 3.1–3** and **Figures 2.1–5**.

4.24 The tables show that during 2002-06 total legal aid cash payments have risen at a rate of 2.1% per year. Within this CLS payments have risen at 0.7% per year and CDS payments (excluding crown court) have fallen at -1.6%. Within CDS, police station attendance costs have risen at a 4.4% rate, but adjusted for higher cases loads only at 0.4%. Magistrates' court costs have fallen at -0.1% per year and per case at -0.5%. After allowing for inflation these each represent net decreases in real per case costs. The main area of increase has been in crown court and higher court costs, with an annual rate of increase of 7.4% or 8.1% per case. The very high cost case (VHCC) costs include the effect of the introduction of the VHCC case contracting in September 2003, which has been successful in reducing costs by £112.5m over 2003-06 compared with what they would have been under the previous *ex post facto* system.

Table 3.1: Total Legal Aid costs (2000-06)

	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06
Payments (net) (£m):						
CLS total	792	735	813	898	846	831
CDS payments	450	508	526	534	510	501
Total LSC	1,242	1,243	1,339	1,431	1,356	1,197
Crown Court and higher courts	422	474	569	645	682	696
Total	1,664	1,717	1,909	2,076	2,038	2,028
LSC administration	72	72	73	90	103	97
Acts of assistance ('000s):						
CLS total	1,137	1,005	1,017	925	856	996
CDS payments	2,173	1,697	1,517	1,584	1,464	1,489
Total LSC	3,310	2,702	2,534	2,509	2,320	2,485
Crown Court and higher courts	116	115	124	124	116	122
Total	3,426	2,817	2,658	2,633	2,435	2,607
Avg cost/assistance (£):						
CLS total	696	731	799	971	988	834
CDS payments	207	299	347	337	348	337
Total LSC	375	460	528	571	584	482
Crown Court and higher courts	3,638	4,123	4,602	5,202	5,903	5,724
Total	486	609	718	789	837	778
Avg annual growth (%):						
Payments:				2000-06	2001-06	2002-06
CLS total				1.0%	3.3%	0.7%
CDS payments				2.3%	-0.3%	-1.6%
Total LSC				1.4%	1.8%	-0.2%
Crown Court and higher courts				13.0%	11.7%	7.4%
Total				4.4%	4.5%	2.1%
LSC administration				6.7%	8.8%	10.6%
Cost/assistance:						
CLS total				4.0%	3.5%	1.5%
CDS payments				12.5%	3.1%	-1.0%
Total LSC				8.6%	4.1%	0.5%
Crown Court and higher courts				11.5%	9.7%	8.1%
Total				12.0%	6.9%	2.8%

(Source: LSC Annual Reports)

Table 3.2: Community Legal Service (CLS) costs (2000-06)

	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06
Payments (net) (£m):						
CLS Licensed Work (net) cost*	560	476	483	514	490	547
CLS Controlled Work cost**	232	258	330	384	356	284
CLS total cost (£m)	792	735	813	898	846	831
Acts of assistance ('000s):						
CLS Licensed Work assists	276	225	205	215	202	195
CLS Controlled Work assists	862	780	813	710	654	801
CLS total assistances	1,137	1,005	1,017	925	856	996
Avg cost/assistance (£):						
CLS Licensed Work cost/ast.	2,033	2,113	2,363	2,388	2,428	2,807
CLS Controlled Work cost/ast.	269	331	405	541	543	355
CLS total cost/assist	696	731	799	971	988	834
Avg annual growth (%):					2000-06	2002-06
Payments:						
CLS Licensed Work (net)					-0.5%	4.4%
CLS Controlled Work					4.5%	-4.6%
CLS total					1.0%	0.7%
Cost/assistance:						
CLS Licensed Work (net)					7.6%	6.3%
CLS Controlled Work					6.4%	-4.2%
CLS total					4.0%	1.5%

* 2000-04 Civil representation (net)

** 2000-04 Legal Help

CLS total cost = licensed + controlled costs

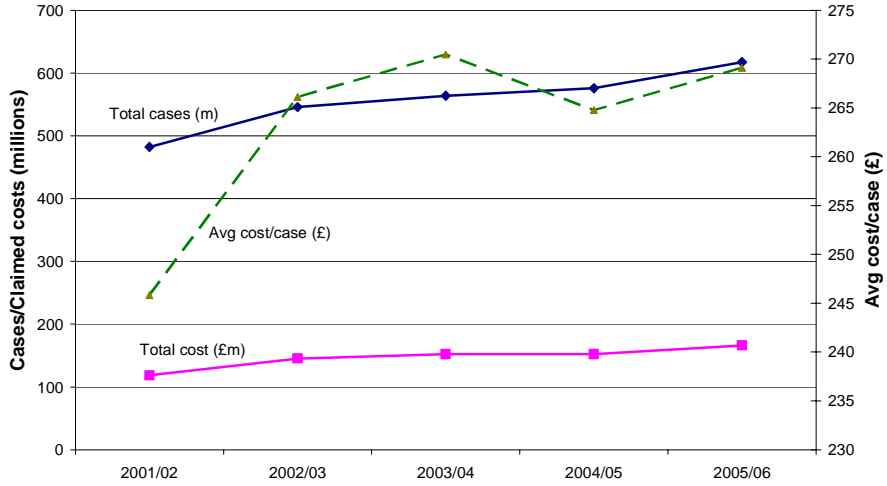
(Source: LSC Annual Reports)

Table 3.3: Specific CDS cost trends (2001-06)

	2001/02	2002/03	2003/04	2004/05	2005/06
Police Station attendances:					
Total cases ('000s)	482,373	545,901	563,811	575,814	617,362
Total claimed (£m)	118,586	145,274	152,495	152,461	166,138
Avg cost/case (£)	246	266	270	265	269
Avg annual growth 2002-06 (%)					2002-06
Total cases ('000s)					4.4%
Total claimed (£m)					4.8%
Avg cost/case (£)					0.4%
Magistrates' courts:					
Cases ('000s):					
Lower standard fees	352,452	449,921	467,474	459,233	462,695
Higher standard fees	59,408	91,866	87,086	82,566	87,059
Non-standard fees and exempt	14,535	32,818	33,187	30,065	31,553
Second claims def. sentencing	-	921	1,526	1,609	1,487
Total cases	426,395	575,526	589,273	573,473	582,794
Claimed (£m):					
Lower standard fees	114,925	154,849	160,781	157,938	157,924
Higher standard fees	48,785	79,741	76,369	74,227	78,527
Non-standard fees and exempt	23,720	61,774	60,740	56,052	58,784
Second claims def. sentencing	-	243	393	418	418
Total claimed (£m)	187,430	296,608	298,282	288,634	295,653
Avg claim/case (£):					
Lower standard fees	326	344	344	344	341
Higher standard fees	821	868	877	899	902
Non-standard fees and exempt	1,632	1,882	1,830	1,864	1,863
Second claims def. sentencing	-	264	258	260	281
Avg claim/case (£)	440	515	506	503	507
Avg annual growth (%):					2002-06
Total cases					0.4%
Total claimed (£m)					-0.1%
Avg claim/case (£)					-0.5%
Crown and higher courts:					
Total cases ('000s)	115	123.7	124	115.6	121.5
Total claimed (£m)	474.1	569.3	645	682.4	695.5
Avg claim/case (£)	4,123	4,602	5,202	5,903	5,724
Avg annual growth (%):				2001-06	2002-06
Total cases ('000s)				1.4%	-0.6%
Total claimed (£m)				11.7%	7.4%
Avg claim/case (£)				9.7%	8.1%

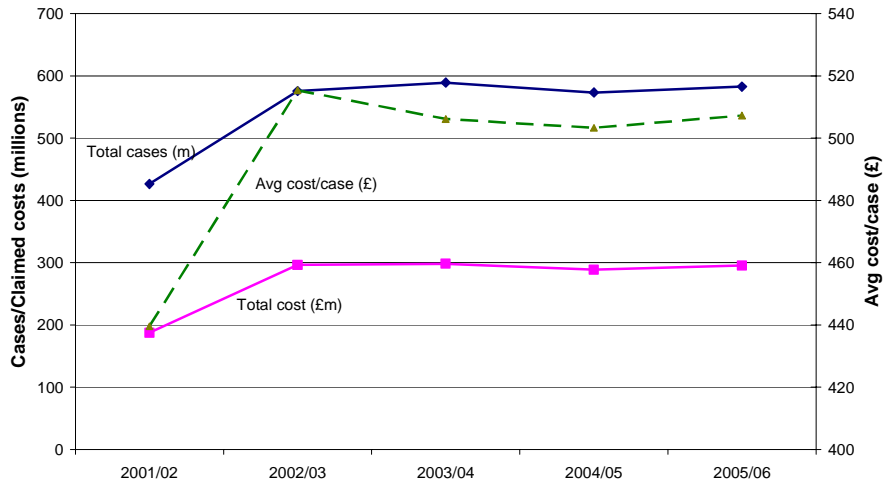
(Source: LSC Annual Reports)

Figure 2.1: Police station attendance costs (2001-06)



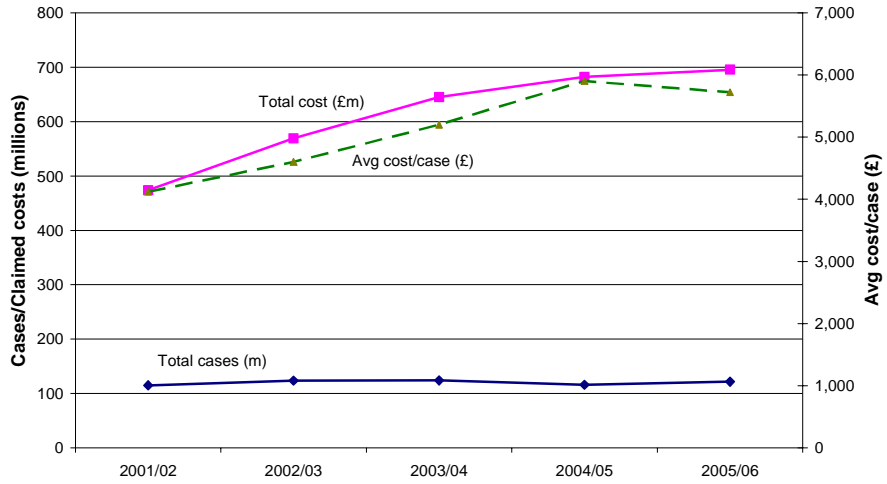
(Source: LSC Annual Reports)

Figure 2.2: Magistrates court costs (2001-06)



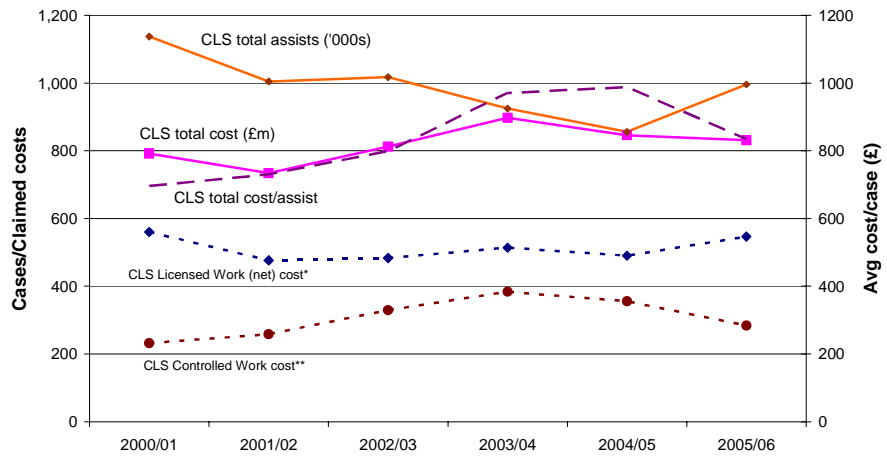
(Source: LSC Annual Reports)

Figure 2.3: Crown court & higher court costs (2001-06)



(Source: LSC Annual Reports)

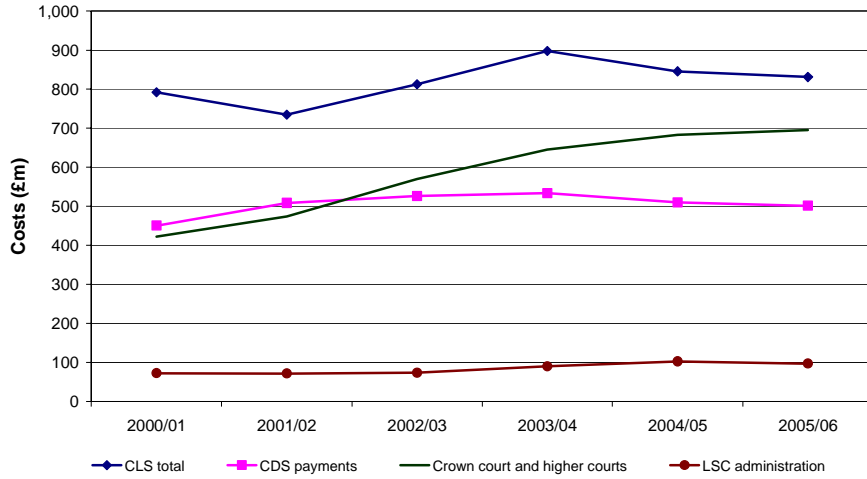
Figure 2.4: Community Legal Service (CLS) costs (2000-06)



(Source: LSC Annual Reports)

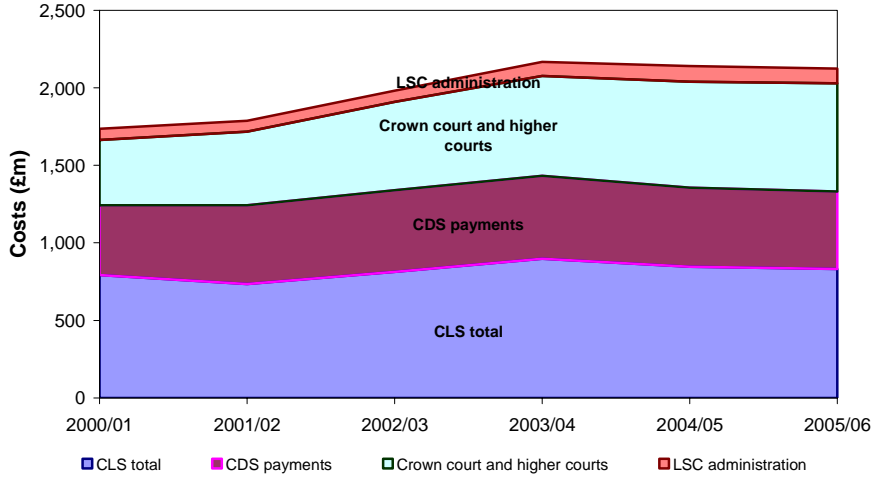
CLS total cost = licensed + controlled costs
 * 2000-04 'Civil representation (net)'; ** 2000-04 'Legal Help'

Figure 2.5: Legal Aid component cost trends (2000-06)



(Source: LSC Annual Reports)

Figure 2.6: Legal Aid total costs (2000-06)



(Source: LSC Annual Reports)

Component cost trends for police station and magistrates' courts

- 4.25 LECG has also reviewed specific costs trends for the components of costs for police station and Member States CDS work. Over the most recent few years costs for police station and magistrates' court work have increased only slowly, if at all. When adjusted for higher attendances the cost per attendance have been flat or decreasing. This is based on extensive data analysis of detailed cost data for all police station and magistrates' court cost claims over 2001-05.
- 4.26 An analysis of costs for 2001-05 shows that after allowing for increased case loads, costs per item of service for core costs for police station and magistrates' court attendances have been approximately flat since 2001. Total police station attendance costs have increased by about 30% over these four years, while cases have increased by about 23%. However, more recently, from 2002-05 only, police station costs increased only very little, about 5%, while cases have increased by about the same. The data analysis of police station attendance costs (including travel and waiting) for the period 2001-05 for which data have been made available show that on a per attendance (claim) basis these costs have actually reduced at a rate of about -1.4% per year from 2001-02 to 2004-05. Travel costs per attendance have declined at a rate of -1.3% and waiting costs have increased at a rate of 4.3%.
- 4.27 Total costs also include telephone assistance and other costs, so that this is consistent with the view that overall police station costs have risen slightly. The cost history for police station work per attendance is shown in **Table 4.1**.

	Profit Costs	Travel Costs	Waiting Costs	Disbur. Costs	Total Costs	No. claims	No. attends.
2001/02	87	22	4	4	118	480,992	625,008
2002/03	105	28	6	6	145	561,909	756,664
2003/04	108	30	7	7	152	579,279	811,099
2004/05	106	30	7	9	153	590,721	853,849
% Growth	22%	36%	72%	111%	30%	23%	37%

* Claims 1C, 1D

Source: LSC dataset, LECG

4.28 The trend for history for (?) police station work per attendance is shown in **Table 4.2**.

	Profit Costs	Travel Costs	Waiting Costs	Disburs. Costs	Total Costs
2001/02	131	20	11	5	167
2002/03	128	19	12	6	165
2003/04	123	19	12	7	160
2004/05	119	19	13	7	158
% Growth	-9.0%	-3.5%	15.1%	36.9%	-5.3%

* Claims 1C, 1D

Source: LSC dataset, LECG

4.29 There is a similar picture for magistrates' court costs. The Carter Report notes that magistrates' court costs per case (excluding travel and waiting) have increased during 1997-98 to 2005-06 by 6% in cash terms.³² More recently, however, between 2003-04 and 2005-06 costs have been decreasing in real terms (as above). Detailed LECG analysis shows that core magistrates' court attendance costs (per attendance including travel and waiting) for the period 2001-05 decreased by about -1.7% per year. The per attendance costs have decreased most for non-standard fee work (about -5% decrease per year), then higher standard fee (-3% decrease per year) and are least for lower standard fee (-1% decrease per year).

4.30 Total magistrates' court travel costs have increased at an annual rate of about 12% over the 2001-05 period and waiting costs at 13%. However,

³² Carter Report, p. 25, para. 27.

on a per **attendance** basis average travel costs have declined by about -3% year and waiting costs by about -1% year.

- 4.31 The total cost history for magistrates' court work is shown in **Table 5.1**.³³ The costs per attendance for different claim types for magistrates' court work are shown in **Tables 5.2.1–3**

Table 5.1: Total costs - magistrates' court - all claims (2001-05) £m*

Year	Profit Costs	Travel Costs	Waiting Costs	Disburs. Costs	Total Costs	No. claims
2001/02	149	16	17	5	188	425,198
2002/03	232	26	27	11	296	586,145
2003/04	235	26	28	13	303	601,480
2004/05	226	26	28	13	293	584,183
	77%	9%	10%	4%	100%	
% Growth	51%	58%	64%	134%	55%	37%

* Total for claims 2E, 2F, 2G

- 4.32 The costs per attendance for magistrates' court for different claim types are shown in **Tables 5.2.1–3**.

³³ Total costs and number of claims (cases) differ slightly from those in LSC Annual Reports, possibly due to different cut-off dates and adjustments in the Annual report figures.

Table 5.2.1. Average costs per attendance - magistrates' court – lower standard fees (2E)

£	Profit Costs	Travel Costs	Waiting Costs	Disburs. Costs	Total Costs	No. attend
2001/02	108	12	14	3	136	836,996
2002/03	101	11	14	4	130	1,186,539
2003/04	99	12	14	4	129	1,249,091
2004/05	101	12	15	4	132	1,197,696
% Growth	-6%	1%	5%	29%	-3%	43%

Table 5.2.2. Average costs per attendance - magistrates' court – higher standard fees (2F)

£	Profit Costs	Travel Costs	Waiting Costs	Disburs. Costs	Total Costs	No. attend
2001/02	146	17	16	6	185	263,431
2002/03	133	16	15	7	171	462,047
2003/04	125	15	15	8	163	469,455
2004/05	126	15	15	8	165	450,399
% Growth	-13%	-10%	-2%	27%	-11%	71%

Table 5.2.3. Average costs per attendance - magistrates' court – non-standard fees (2G)

£	Profit Costs	Travel Costs	Waiting Costs	Disburs. Costs	Total Costs	No. attend
2001/02	242	24	17	12	296	87,062
2002/03	218	21	16	15	269	231,954
2003/04	197	19	16	16	247	266,223
2004/05	191	19	16	16	242	250,463
% Growth	-21%	-21%	-10%	33%	-18%	188%

4.33 Trends in total costs and costs per attendance (by claim type) are also shown in **Figures 2.1 and 2.2.**

Figure 3.1: Total costs by claim type - magistrates' court

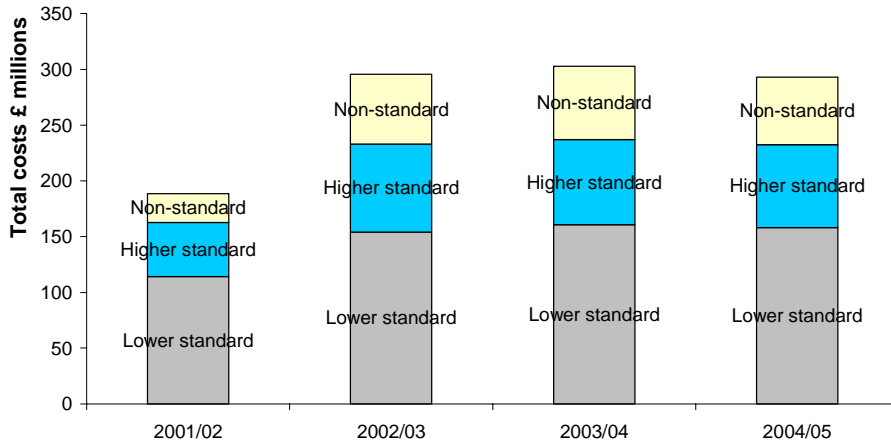
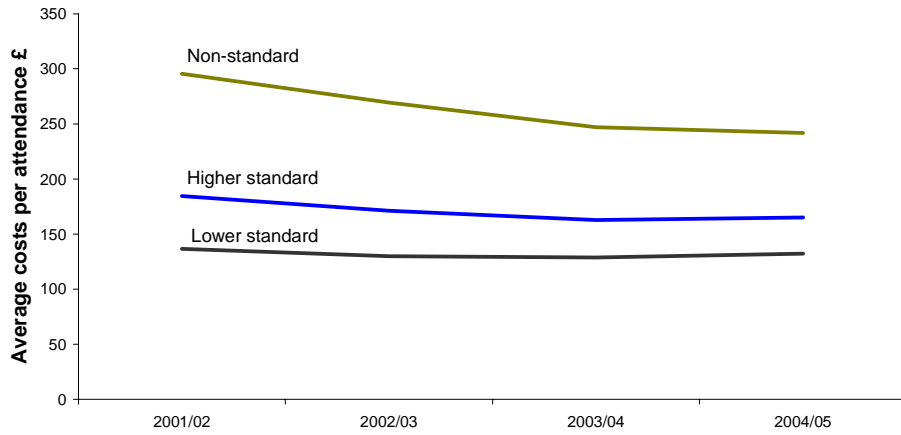


Figure 3.2: Average costs per attendance by claim type - magistrates' court



4.34 This questions the general view that CDS costs have been rising steeply in all areas. Adjusted for case loads, core attendance costs per attendance at police station and magistrates' court have been relatively flat in nominal terms over the most relevant period since 2001-02. Adjusted for inflation costs per attendance have fallen over this recent period. As above things are different in crown and higher court work, where costs have been rising at an annual cash rate of increase of 7.4% or 8.1% per case.

4.4 Potential travel costs savings

4.35 LECG has conducted a detailed econometric analysis of the travel costs for each police station and police station scheme using 2004-05 data to attempt to identify the key factors that determine travel costs. It attempts to show whether there are potential travel costs savings associated with larger boundary areas and fewer firms. The analysis uses all police station travel cost claims data for 2004-05, available at the police station level. It then attempts to identify statistically significant relationships between costs and other variables at the police station scheme level. Significant variables include the number of cases or attendances at the police station scheme area, the number of firms on duty rotas, the number of solicitor offices performing work for the scheme, and several other variables such as population density, case type and others. The analysis also allows for potential differences between regions.

4.36 The aim of the analysis has been to investigate whether differences in police station scheme structure, such as size and number of suppliers, are associated with different travel costs. This analysis has established that the most statistically significant determinants of higher travel costs at the police station scheme level are those schemes that have higher attendances per police station, fewer firms on the police station rota and fewer firms providing assistance. There are also differences between regions, and especially between London and the rest of the country.

4.37 These results support the view that larger schemes with fewer firms are less likely to suffer from duplicated or unnecessary travel and there may

be economies of scale in travel costs for larger 'more concentrated' schemes.

4.38 The strength of these effects can be used to forecast, for each region, how travel costs would change if contract areas were larger and there were fewer firms providing police station assistance.

4.39 As an illustration, assume as a target that each region consolidates its police station schemes into contract areas with about 8,000 attendances per year each (equivalent to about 6000 cases) compared to the current average of 2,662 (in 2004-05). This implies about 100 contract areas rather than the current approximately 310. Also, assume six contracted firms per area compared with an average number of firms on police station duty rotas of about 22 outside London and 203 in London currently. With these figures, total travel costs would reduce by about 50% nationally and 35% in London. Other combinations of area size and firm may be used to separate out the effects of boundary area size and eligible firm numbers. These results are shown in **Table 6**.

Table 6: Travel cost impact - larger PSS, fewer firms (2004-05) *

Region	Current firms/ PSS	Current PSS/ region	Current attend/ PSS	New: firms /PSS	New: PSS/ reg.	New: attend / PSS	Current travel costs £	New: travel costs £	Change %
1. The East	21	46	1,304	6	7	8,571	2,190,086	787,532	-64.0%
2. East Midlands	20	26	2,439	6	8	7,926	1,827,779	753,659	-58.8%
3. London**	203	32	4,969	6	20	7,950	8,824,083	5,728,705	-35.1%
4. Merseyside	22	6	2,768	6	2	8,303	546,261	221,026	-59.5%
5. North East	23	16	2,606	6	5	8,338	1,102,574	484,454	-56.1%
6. North West	27	35	2,657	6	13	7,154	2,638,873	1,156,730	-56.2%
7. South East	25	22	2,882	6	8	7,925	2,231,209	1,067,645	-52.1%
8. South	28	19	2,237	6	5	8,499	1,437,455	571,494	-60.2%
9. South West	22	25	2,395	6	7	8,552	1,761,366	725,855	-58.8%
10. Wales	16	29	1,675	6	6	8,096	1,416,498	524,676	-63.0%
11. West									
Midland	22	27	3,142	6	10	8,483	2,799,738	1,152,097	-58.8%
12. York/Humber	20	27	2,875	6	9	8,625	2,091,040	924,957	-55.8%
Totals		310			100		28,866,962	14,098,828	
Averages	37	26	2,662	6	8	8,202			-51.2%
London	203	32	4,969	6	20	7,950	8,824,083	5,728,705	-35.1%
Non-London	22	25	2,453	6	7	8,225	20,042,879	8,370,123	-58.2%

* New: Target attendances/area 8,000; firms 6; solicitor firm number reduction 50%]

** (London estimated separately)

4.40 These forecasted costs savings figures come with a big health warning. They indicate that savings may be possible for travel costs for contract areas that are larger and with fewer firms. The scale of these effects is likely to be high. Interestingly the figures are of the same order as those derived from the mapping exercise in the Carter Report for the North East, which suggest that by relocating firms closer to lead police stations firms may be able to cut travel times and costs by as much as 50%.

4.41 Because of the important proviso – that these are theoretical relations between size and travel costs that reflect location patterns built up over years of defining police station schemes and locating offices – these figures should not be used to forecast travel cost savings simply from re-drawing contract areas. Their value is merely to confirm that where schemes are larger, average travel costs are lower, with a similar effect for number of firms on a police station rota ('congestion'). Consolidating a number of police station schemes into larger contract areas will not automatically cut costs. There may be theoretical savings but these may

be only achievable if the consolidated area can 'mimic' the structure of current large schemes, with work concentrated at lead police stations and few suppliers. Changes on this scale would take time and a comprehensive reorganisation of area work patterns.

4.5 Impact of proposed fees

- 4.42 LECG has reviewed the impact of the Carter fixed fees proposed for police stations and the revised standard fee scheme for magistrates' court work. The aim has been to check the extent to which the new fees are 'revenue neutral' other than the assumed reductions in travel costs claimed to be achievable in the Carter Report.
- 4.43 Applying the new fee levels for police station attendance to actual cost data for 2004-05, with travel and waiting costs included in the fixed fee, implies that police station fees would decrease by £10m or 6% of total police station costs. This coincides with a decrease of £11m or 6% predicted by Carter using more recent data for 2005-06 for comparison.
- 4.44 Applying the new standard fee levels for magistrates' court work for lower, higher and non standard fee work for 2004-05 assuming the same billing patterns, we estimate that total revenues would decrease by £2m or 1% of total magistrates' and other lower court costs. This compares with a decrease of £13m or 4% for 2007-08 predicted by Carter. These results are shown in **Table 7**.

Table 7: Projected impact of proposed fees

	LECG estimates (2004-05 data)**				Carter Report estimates (projected data)***			
	Total costs 2004-05 £m	Total costs new £m	Change £m	%	Fcst costs 2006-07 £m	Est. costs 2007-08 £m	Change £m	%
Explained costs:*								
Police station	150	140	-10	-6%				
Magistrates' court	271	268	-3	-1%				
	420	408	-12	-3%				
Total costs:**								
Police station	172	163	-10	-6%	184	173	-11	-6%
Magistrates' court	325	322	-3	-1%	348	335	-13	-4%
	497	485	-12	-3%	532	508	-24	-5%

* Cost codes: Police station (1C); Magistrates' court (2E 2F 2G); proposed fees include travel and waiting costs, assume disbursements paid separately

** Source: LSC Annual Report 2004-05

*** Source: Carter Report Annex 6.2

4.45 LECG's prediction for the revenue impact for magistrates' court work may differ from those in the Carter Report because the new standard fees include some changes and rebalancing between standard fee bands, and between London and the rest of the country, which cannot be identified without further information. To the extent possible given the available data this confirms the figures in the Carter Report at a national level.

4.46 The impact on earnings for police station work by region is shown in **Table 8**. There are variations between regions. Also, there is a greater reduction in earnings in London compared to other regions. Identified costs are reduced by 10% in London compared with 5% outside London. This is consistent with an aim of rebalancing rates between London and the rest of the country.

Table 8: Projected impact of proposed police station fees (2004-05)

Code	Region	Total costs 2004-05 £m	Total costs new £m	Change £m	%
1	Avon & Somerset	3.2	3.2	-0.1	-2.4%
2	Bedfordshire	1.5	1.3	-0.1	-7.2%
3	Cambridgeshire	1.6	1.4	-0.2	-10.5%
4	Cheshire	2.5	2.2	-0.3	-12.7%
6	Cleveland	1.5	1.5	0.0	3.2%
7	Cumbria	0.8	0.8	0.0	-5.2%
8	Derbyshire	2.7	2.7	0.0	1.2%
9	Devon & Cornwall	3.9	3.5	-0.4	-9.1%
10	Dorset	1.0	0.9	-0.1	-6.9%
11	Durham	2.9	2.8	-0.1	-3.2%
12	Dyfed-Powys	1.0	0.9	-0.1	-8.3%
13	Essex	3.7	3.2	-0.5	-13.6%
14	Gloucestershire	1.3	1.2	-0.1	-7.1%
15	Greater Manchester	8.8	8.2	-0.5	-6.2%
16	Gwent	1.4	1.4	0.0	-0.3%
17	Hampshire	3.8	3.6	-0.2	-6.4%
18	Hertfordshire	2.6	2.2	-0.4	-14.9%
19	Humberside	1.8	1.6	-0.2	-10.8%
20	Kent	4.6	4.3	-0.3	-6.9%
21	Lancashire	4.3	4.0	-0.3	-7.3%
22	Leicestershire	2.3	2.1	-0.2	-7.3%
23	Lincolnshire	1.4	1.3	-0.1	-5.9%
24	Merseyside	3.0	3.0	0.0	0.9%
25	London	37.3	33.5	-3.8	-10.1%
26	Norfolk	1.5	1.6	0.0	3.0%
27	Northamptonshire	0.7	0.7	0.0	-1.1%
28	Northumbria	1.8	1.7	-0.1	-4.5%
29	North Wales	1.5	1.4	-0.1	-6.9%
30	North Yorkshire	1.3	1.3	0.0	-1.6%
31	Nottinghamshire	3.2	2.8	-0.5	-14.7%
32	South Wales	4.6	4.6	0.1	1.4%
33	South Yorkshire	2.7	2.5	-0.2	-5.7%
34	Staffordshire	2.5	2.3	-0.1	-4.3%
35	Suffolk	0.9	0.8	0.0	-3.6%
36	Surrey	1.6	1.5	-0.1	-8.7%
37	Sussex	4.9	4.7	-0.2	-4.5%
38	Thames Valley	4.3	4.2	-0.2	-3.9%
39	Warwickshire	0.7	0.7	0.0	-2.2%
40	West Mercia	2.7	2.6	-0.1	-4.2%
41	West Midlands	8.8	8.4	-0.4	-4.6%
42	West Yorkshire	5.7	5.9	0.2	3.4%
43	Wiltshire	1.3	1.1	-0.1	-9.8%
Total		149.5	139.8	-9.7	-6.5%
Total	London	37.3	33.5	-3.8	-10.1%
Total	Non-London	112.2	106.3	-5.9	-5.3%

4.6 CDS firm profitability

- 4.47 Recent surveys such as Otterburn (2006) and FreshMinds (2005) indicate that CDS work may be only marginally profitable once allowance is made for all costs.³⁴ It is significantly less profitable than comparable private work. This confirms earlier surveys. The Otterburn survey considered costs and profitability for different sized firms performing CDS work. This included new research on larger CDS firms and incorporated data for smaller firms from the FreshMinds survey and PKF report. The survey concluded that allowing for hidden costs of notional salary for working equity partners, return on firm equity and rent on premises, most firms were marginally profitable or unprofitable. Notional salaries for working equity partners used in this analysis ranged from £60,000 for the smallest firms to £68,700 for the largest, with no difference allowed for between London and outside London.³⁵ Notional profits ranged from a little over 2% positive for the most profitable group (moderately large firms with 13-40 fee earners) to about a 6% loss for the smallest firms (1-5 fee earners). These figures depend on whether a firm specialises in CDS work and other variables, but the basic results hold that the moderately large and large firms are just profitable and smaller firms are not.
- 4.48 The Otterburn report was not able to identify a model for a consistently profitable firm, although the medium to large specialist CDS firms appears to have the best prospects. Much depended on individual firm factors and the main consistency is that profitability appears to be generally low. Factors that appear to be associated with higher profitability include larger firm size, greater leverage of equity partners, greater use of lower cost unqualified staff for police station work (which is possible with bigger firms) and others. There is some evidence that very small firms may operate with lower than average overheads. However, this is unlikely to be a sustainable firm model for the long term because of the dependence on a few key fee earners working longer hours than peers in larger firms.

4.49 Based on the figures in the Otterburn report, current estimated earnings figures for different sized firms for CDS work are summarised in Table 9. These combine data from the FreshMinds survey for smaller firms (1-5 and 6-12 fee earners) with data from the additional survey of larger firms (13-40 and 40+) performed for the Otterburn report.

Table 9: Estimated firm earnings per fee earner (Otterburn 2006)								
	Per fee earner mean £'000s				%			
	1-5	6-12	13-40	40+	1-5	6-12	13-40*	40+*
Fees*	64.0	60.5	65.2	68.0	100.0%	100.0%	100.0%	100.0%
Salary costs**	49.9	44.2	42.6	42.5	78.0%	73.0%	65.3%	62.5%
Gross profit	14.1	16.3	22.6	25.5	22.0%	27.0%	34.7%	37.5%
Overheads**	17.9	18.8	21.1	24.8	28.0%	31.0%	32.4%	36.5%
Profit Before								
Tax	-3.8	-2.4	1.5	0.7	-6.0%	-4.0%	2.3%	1.0%

Source: smaller firms (1-5, 6-12): Otterburn Tables 2, 3; larger firms (13-40, 40+): Otterburn Tables 3, 18 and 19.

* Otterburn Table 3

** Based on % costs in Otterburn Table 2 (1-5, 6-12), Tables 18, 19 (13-40, 40*).

4.50 These results indicate that once all the potentially hidden costs are allowed for, especially for small firms, firm profits as a percentage of revenues are low on average. They range from a few percent positive for the most efficient firms, in the 13-40 size range to a few percent negative for the smallest firms. These profit returns are significantly lower than the market-determined rates in possibly comparable industries such as independent financial advisors or some types of insurance brokerage, where target returns in a range such as 10% - 15% are the norm.³⁶ These market returns may be a benchmark for legal aid firms.

³⁴ FreshMinds (2005), "Legal Aid Review: Firms Survey: Findings", 21 December 2005; Otterburn Legal Consulting (2006), "Lord Carter's Review of Legal Aid Procurement: 2005 and 2006 Surveys of Criminal Firms", April 2006.

³⁵ Otterburn (2006), p. 8, para. 2.9; p. 17, para. 4.5.

³⁶ As an example, Jelf Group plc, a corporate intermediary offering a range of corporate services in the areas of commercial insurance, healthcare, and financial services, earned PBT of 9% in 2005. See:

<http://www.londonstockexchange.co.uk/LSECWS/IFSPages/MarketNewsPopup.aspx?id=1149129&source=RNS>

4.7 Carter model of firm profitability

- 4.51 The Carter Report includes the results of detailed models of firm profitability for representative quality firms under the new fee arrangements.³⁷ Depending on firm size and structure these models predict profits per equity partner in a range from about £36,000 for a single practitioner firm to about £122,000 for a large firm with about 47 fee earners, outside London (£55,000 and £151,000 in London). With potential efficiency savings, such as 5% savings in overhead and other fixed costs, these figures rise to about £37,000 for a single practitioner firm to about £144,000 for a large firm with about 47 fee earners, outside London (£57,000 and £177,000 in London). With 5% efficiency savings in hours per case costs the predicted profits are between these two examples.
- 4.52 These examples do not make it clear that some of the implicit costs are 'hidden'. In the model, equity partners are assumed to earn fees, but the model does not include a notional salary for this work.³⁸ This contrasts with the profitability measure used in the Otterburn report which specifically includes notional costs for partner work and other potential hidden costs to measure profit before tax as % of revenues. Although profit per equity partner is a conventional measure for profitability in equity partnerships this makes it difficult to compare profitability with other types of firm.
- 4.53 If working equity partners are assigned the same notional salary as Salaried Partners of £76,5000 outside London and £85,000 in London as in the model (higher than the range £60,000 to £68,700 used in the Otterburn analysis), then the further analysis of the Carter model implies profit margins as a percentage of revenues in a range from -4% to 5% for firms with from 5 to 47 fee earners, outside London, and 1% to 6% in London. These results are shown in **Table 10.1**.

³⁷ Carter Report, pp. 104-106, paras. 55-63.

³⁸ LECG has reviewed a version of the model, which includes as input a figure for the total number of chargeable hours in a year for an Equity Partner (EP). For example: "Table 5.8 shows that profit per equity partner increases substantially as the structure of a firm changes. It shows that a provincial sole practitioner (who is assumed to work 1,600 chargeable hours per year), will earn substantially less than an equity partner in even a small provincial firm (£36,000 vs. £63,000)." Carter Report, p. 105, para. 57.

Table 10.1 – Model firms projected profit per equity partner and implicit profit %

No. fee earners	No. equity partner	Turnover (Provin.)	Profit per equity partner (Provin)	Turnover (London)	Profit per equity partner London	Profit with equity partner notional salary: Provin.	Implicit profit % Provin.	Profit with equity partner notional salary: London	Implicit profit % London
1	1	£64,397	£35,797	£88,852	£55,118	£-40,703	-63%	£-29,882	-34%
5	1	£299,111	£63,411	£361,137	£89,471	£-13,089	-4%	£4,471	1%
11	1	£643,045	£80,495	£768,296	£121,729	£3,995	1%	£36,729	5%
27	2	£1,637,489	£109,005	£1,904,323	£137,162	£65,010	4%	£104,324	5%
47	3	£2,878,785	£121,948	£3,337,213	£151,049	£136,344	5%	£198,147	6%
Notional salary (salaried partner)						£76,500		£85,000	

Source: Carter Report, p. 105, Table 5.8.

- 4.54 Clearly, the profitability depends on the implicit salary for working equity partners, and if this is above the profit per equity partner generated in the model then the firm will be loss making in comparative profit before tax (PBT) terms. However, an implication is that a provincial equity partner in a one-fee earner firm earns less profit (£35,797) than an associate salary in a larger firm (£46,350). A provincial firm needs to have about 11 fee-earners before equity partner profit (£80,495) is greater than salaried partner salary (£76,500).
- 4.55 Assuming savings that reduce overheads and other fixed costs by 5%, the model predicts that these PBT % returns might rise to -2% to 7% outside London, and 4% to 8% in London.

Table 10.2 – Model firms projected profit with 5% saving on overhead and non-fee earner costs

No. fee earners	No. equity partner	Turnover (Provin.)	Profit per equity partner (Provin)	Turnover (London)	Profit per equity partner London	Profit with equity partner notional salary: Provincl	Profit % Provin.	Profit with equity partner notional salary: London	Profit % London
1	1	£64,397	£37,227	£88,852	£56,805	-£39,273	-61%	-£28,195	-32%
5	1	£299,111	£70,561	£361,137	£97,904	-£5,939	-2%	£12,904	4%
11	1	£643,045	£96,225	£768,296	£140,282	£19,725	3%	£55,282	7%
27	2	£1,637,489	£128,310	£1,904,323	£159,932	£103,620	6%	£149,864	8%
47	3	£2,878,785	£144,352	£3,337,213	£177,473	£203,556	7%	£277,419	8%
Notional salary (salaried partner)						£76,500		£85,000	

Source: Carter Report, p. 106, Table 5.11.

4.56 In general these profit figures are higher than those reported in Otterburn (2006), which were about -4% to 2% for similar sized firms. However, they are below a range that may be typical for market-based service industry firms.

4.57 These are preliminary figures and further analysis of the model might change specific results, although not the principle.

4.8 Distribution of solicitor firm work across contract areas

4.58 LECG analysis of work patterns for police station and magistrates' court work shows that firms typically work over many police station schemes. An average of about 100 firms perform police station assistance within each police station scheme each year (84 Nationally and 240 in London, using 2004-05 data).

4.59 The work is concentrated in a few lead suppliers, so that about 25% of work is performed by the largest firm and 50% by the top three firms. This leaves a large number of firms that do only small or very small amounts of work in a given police station scheme each year. Most of the work for 'outlier' schemes appears to be occasional (possibly own solicitor). This is shown in **Table 11**.

Table 11: Distribution of firm work across police station schemes (2004-05)

Region	No. PSS	No. firms billing in region (inc. dupl.)*	No. firms over £50k/ PSS (inc. dupl.)	Avg. no. firms billing per PSS	% work top 1 firm	% work top 2 firms	% work top 3 firms
1 East	46	3,051	60	66	24%	39%	49%
2 East Midlands	26	1,675	49	64	28%	44%	54%
3 London	32	7,651	117	239	24%	40%	50%
4 Merseyside	6	548	18	91	23%	40%	52%
5 North East	16	1,085	28	68	23%	34%	43%
6 North West	35	3,483	62	100	27%	44%	56%
7 South East	22	2,133	77	97	29%	46%	57%
8 South	19	1,607	44	85	23%	37%	47%
9 South West	27	1,481	62	55	25%	42%	53%
10 Wales	29	1,678	41	58	25%	40%	51%
11 West Midlands	27	2,463	87	91	20%	32%	40%
12 York & Humber.	28	2,185	57	78	12%	20%	26%
<i>not assigned</i>	-	2,709	24	-	-	-	-
Total	313	31,749	726	101	23%	37%	47%
London	32	7,651	117	239	24%	40%	50%
Non-London	281	24,098	609	86	24%	38%	48%

* Number of firm/PSS combinations, includes duplicates where firms work in more than one police station scheme

4.60 From the firm's viewpoint, a significant proportion of a firm's work takes place over a number of schemes. On average each firm works over about 13 police station schemes (10 nationally and 15 in London). This spread does not seem to depend on firm size, in that even small firms performing £50,000 to £100,000 of police station work per year may work over about 15 schemes and larger firms work proportionately over larger number of schemes. Even the very smallest firms, below £50,000 of work per year, work over about 7 schemes.

4.61 This implies that there is scope for focusing each firm's work within fewer contract areas.

5 Issues and risks – main points

5.1 The Carter proposals involve major changes in the organisation of criminal and civil legal aid services. These will impact almost every firm

in the market. For CDS work there will be a large reduction in the number of firms and increase in average size, consolidation of work in fewer, larger firms and a different approach to remuneration and planning based on contracted capacity and fixed fees throughout the system.

- With such far reaching changes there is a risk of significant disruption of services. Design and implementation need to proceed flexibly allowing for differences in area characteristics and speed of adjustment.

5.2 Fees should not be reduced in anticipation of future cost savings at a time when firms will be undergoing costly and risky restructuring if they hope to stay in legal aid work.

- The CDS supplier base in particular is fragmented, diverse and not highly profitable. This fragile base risks being seriously disrupted if the reforms are not enacted without careful consideration of firms' diverse needs.

5.3 The transition process is critical and if pushed through without full consideration of the impact on suppliers could disrupt services – criminal and civil - with lasting harm.

- Proposals for transition support seem inadequate considering the impact of the changes.

5.4 Firms' business practices may need to be upgraded to meet the challenges of the proposed contractual arrangements. This may call for greater management sophistication from many firms with associated costs, which should be allowed for in the reforms.

- This is an area for transition support.

5.5 Limitations on own solicitor and out-of-area work may weaken an important source of client choice and of inter-firm competition. Own solicitor work may be a critical route for entry to a new area and should be encouraged.

- The proposed limitations on own solicitor work should be revisited.

5.6 Price competitive tendering is the final stage of the Carter reforms and in a sense the target for change. It may be threatened by two possible developments: (a) the creation of market power amongst large suppliers able to resist price reductions, and (b) the temptation for the government to continue to administer prices if it does not like market outcomes.

- It will only become clear whether market conditions have developed to a point where price tendering could achieve its aims once experience has been gained with the other equally radical reforms of capacity contracting, preferred supplier and fixed prices.

5.7 Positive aspects of price competitive tendering include the greater say practitioners are likely to have in legal aid planning with greater 'voice' under the new system and better information on costs and performance possible with larger specialised firms.

- Administrative costs for price competitive tendering are likely to be significant, especially as 'value for money' must be part of the tendering review.