CO/5941/2014

IN THE HIGH COURT OF JUSTICE
QUEEN'S BENCH DIVISION
DIVISIONAL COURT

BETWEEN:

THE QUEEN

on the application of

(1) LONDON CRIMINAL COURTS SOLICITORS ASSOCIATION
(2) CRIMINAL LAW SOLICITORS ASSOCIATION
(3) NELSON GUEST & PARTNERS
(4) PAYTON'S SOLICITORS

Claimants

-and-

LORD CHANCELLOR

Defendant

CLAIMANTS' SKELETON ARGUMENT
For Hearing, 15-16 January 2015

Save where specific reference is made to paragraphs of the Claimants' Statement of Facts and Grounds, this Skeleton Argument is intended to replace that document.

A. The Claim

1. In this expedited, rolled-up, claim for judicial review the Claimants challenge two decisions of the Lord Chancellor:

   (1) That there should be 527 contracts for criminal legal aid Duty Provider Work ("**DPW**") alongside the 1808 contracts for Own Client Work ("**OCW**") which were awarded in June 2014.

   (2) That a tender process for the DPW contracts would be launched on that day, with a date of submission for tenders of 29 January 2015 (together, "**the Decision**").

2. The Claimants are the two leading representative associations of criminal legal aid solicitors, and two criminal legal aid firms who will be affected by the Decision. The Law Society also brings parallel proceedings against the Lord Chancellor in respect of the Decision.

3. The background to this claim is set out in detail in the judgment of Burnett J in *R (London Criminal Courts Solicitors Association & Criminal Law Solicitors Association) v The Lord Chancellor* [2014] EWHC 3020 [CB/tab13]. In that case, the First and Second Claimants established that the Lord Chancellor had conducted a consultation in deciding, in February 2014, to tender for 525 DPW contracts which was so unfair as to be unlawful, because the Lord Chancellor had not permitted consultation upon two reports, by Otterburn Legal Consulting ("**Otterburn**") and KPMG LLP ("**KPMG**") which had formed the basis for his decision on the number of DPW contracts to be tendered. Burnett J quashed the Lord Chancellor's decision, which had been promulgated on 27 February 2014, on 19 September 2014. The Lord Chancellor commenced a re-consultation exercise on 24 September 2014 for three weeks to 15 October 2014. The Lord Chancellor's Decision, under challenge here, was then announced on 27 November 2014.

4. Although the Lord Chancellor does not always express in clear terms the effect of his decision to reduce the number of DPW contracts from 1600 to 527, Burnett J accepted (§16) that this would represent a drastic reduction of the number of criminal legal aid providers in England and Wales, forcing many longstanding and valued legal practices out of business within a relatively short period and raising serious concerns about access to justice:

> Rather than a single contract, there would be a dual contract arrangement. Duty Provider Work would be covered by one series of contracts. What was described as "Own Client Work" would be covered by another series of contracts. Own Client Work describes cases that come to a solicitor because a client has positively chosen to use a particular firm. The proposal was that the number of Own Client Work contracts would be unlimited, but Duty Provider Work contracts would be limited in number...The proposal gave rise to entirely understandable commercial concerns for solicitors, quite apart from those around access to justice. The view of the profession is that Own Client Work is dependent upon being replenished by encountering new clients as duty solicitor. Criminal solicitors are doubtful that any business could continue to prosper if reliant only on Own Client Work. Similarly, the collective view of criminal solicitors is that any firm losing the ability to undertake Duty Provider

> Work would be vulnerable to failure. The evidence provided by the claimants speaks in fairly apocalyptic terms of firms closing and individual livelihoods being lost. The evidence filed on behalf of the Lord Chancellor indicates that the overall quantity of work will remain the same whatever the contractual arrangements (indeed that is not in dispute) and speaks of consolidation of the market, restructuring of firms and increases in efficiency. Although the language is very different, each side is describing the same thing.

See also, to similar effect, Waddington 1st, §§16-23.

5. As Burnett J went on to find, the context for the Decision and its likely effects, imposed upon the Lord Chancellor onerous public law obligations and require careful scrutiny by the Court:

> the impact of the decisions upon any existing firm of solicitors which fails to secure a Duty Provider Work contract is likely to be very profound. It is questionable whether a criminal legal aid firm, or a department within a firm with a broader work base, could survive, or survive for long, on Own Client Work. The impact upon those who secure the contracts and upon access to justice if the assumptions underlying the KPMG calculations are wrong would also be serious. It was for these reasons that it became common ground that a high degree of fairness was required in these circumstances. (Judgment at §37)

The Lord Chancellor accepts, as he must, that the high intensity of scrutiny applied by Burnett J in relation to his 27 February 2014 decision, also applies to the Decision under challenge here (Detailed Grounds, §41).

6. The Claimants submits that, in persisting (with immaterial modifications) in his reliance upon the number of contracts recommended by KPMG, the Lord Chancellor failed to discharge the onerous obligations to which he was subject. In summary:

   (1) The theoretical model developed by KPMG is premised upon firms being subject to colossal burdens in growing to meet the capacity requirements of large DPW contracts and in making the efficiencies necessary to break even when operating a DPW contract. KPMG quite properly warned that their theoretical findings needed to be validated against real world factors, such as whether additional finance – vital for both growth and efficiencies – would in practice be available. Only very limited steps were taken by the MoJ to investigate the matters which KPMG had highlighted and what was done was wholly inadequate to verify the

reliability of the theoretical model as a basis for the Decision (and, in important part, was not drawn to the attention of the Lord Chancellor).

(2) There has been no analysis at all, by KPMG or anyone else, of the viability of the 527 DPW contracts when delivered by multiple firms acting as a consortium (as opposed to single, merged or joint venture entities). Yet that delivery model remains a very significant component of the Lord Chancellor's rationale for believing that firms can deliver the high volume DPW contracts now on offer, and indeed is the only "consolidation" model which remains open to any firm which had not agreed a merger or joint venture structure by 23 May 2014.

(3) Since the KPMG report was first published, further decisions by the Lord Chancellor have substantially reduced the scope for market consolidation to meet the demands of 527 DPW contracts. In particular (a) the rules of the OCW and DPW contract tender processes have prevented any firms from merging or otherwise forming new legal entities to perform a DPW contract unless they had done so by 23 May 2014, and (b) the Lord Chancellor has otherwise imposed a timetable for the necessary scaling-up/consolidation to occur which is unrealistic and will prevent many firms from doing what KPMG assumed, and the Lord Chancellor has suggested, that they would do. These obstacles in the way of market consolidation were not drawn to the attention of KPMG or separately considered by the Lord Chancellor during and following the re-consultation.

(4) The Lord Chancellor failed to engage with many of the most important points which were made by consultees in their around 4000 consultation responses, which were overwhelmingly contrary to his desired approach. He dismissed crucial aspects of these responses merely (and erroneously) on the grounds that they provided "no new evidence" or referred to current rather than future market behaviour and failed to grapple with key concerns expressed by consultees, for example, regarding the availability of investment finance and the legal, financial and regulatory difficulties of entering into delivery partnerships.

(5) KPMG's analysis and so the decision as to the number of DPW contracts was based upon certain assumptions as to market behaviour under the proposed new regime which fly in the face of all relevant evidence and are unsustainable. These

include that a viable contract will be one which generates 0.1% profit, that firms will give up 50% of their OCW in order to provide DPW and that firms have the capacity to grow organically (without merger etc.) by 20%. Unbeknownst to the Lord Chancellor himself, the 0.1% profit assumption did not take account of additional costs very likely to be incurred by firms (e.g. of finance, and of delivery partnerships), meaning that KPMG has in fact modelled a number of DPW contracts which – even with the achievement of substantial growth and staff cost efficiencies – will be run at a loss.

(6) The impact on KPMG's model of its highly controversial assumptions was not tested by KPMG and consultees were not given the opportunity to test them, as the Lord Chancellor did not himself obtain, and therefore refused to disclose to consultees, an executable version of KPMG's financial model. Therefore, he does not know, and consultees were unable to ascertain, what would be the effect of any one or more of the majority of assumptions being incorrect or inaccurate to any degree. Although recent evidence has revealed that the MoJ did conduct sensitivity testing of two of the assumptions, in relation to a limited category of firms, the disturbing results of that testing were suppressed and not drawn to the attention of the Lord Chancellor.

(7) Accordingly, the Claimants submit, the decision as to the number of DPW contracts (a) was not preceded by a degree of inquiry which was sufficient to enable the Lord Chancellor to make a decision which was fair and reasonable, (b) was not accompanied by a fair procedure, and (c) was beset by failure to take account of relevant considerations and by errors of reasoning and was unreasonable on its merits. This is a wholly unsatisfactory basis for a decision which has potentially profound consequences for solicitors and for access to justice.

(8) The other aspect of the Decision which the Claimants challenge, the two month deadline for the submission of tenders for a DPW contract, is wildly unrealistic for firms which require to gain access to additional capacity in order to bid. It is disproportionate and discriminatory in favour of the few largest firms who already have sufficient capacity.

(9) Taken together, the two aspects of the Decision will have the effect of driving many criminal legal aid firms out of business. In addition, the Decision is premised upon a calculation that even successful firms will have to give up some of their goodwill in order to survive. That represents an interference with the peaceful enjoyment of possessions of firms such as the Third and Fourth Claimants, contrary to Article 1 of the First Protocol to the European Convention on Human Rights ("**Article 1P**") which cannot be justified, in particular in the light of the unrealistic timetable to which moves towards consolidation have been subjected.

7. On 23 December 2014, Jay J granted the Claimants interim relief in the form of a suspension of the DPW tender process until the judgment of the Divisional Court is given. Access to the e-tendering platform which contains relevant tender information and allows for submission of tender documents has been suspended and the Lord Chancellor has confirmed that if he is successful in these proceedings, the tender deadline will be extended by the period of the suspension (so that it remains at nine weeks in total).

B. Relevant Facts

8. The Claimants seek to avoid lengthy repetition of the relevant background to this claim, which was set out in detail in the Statement of Facts and Grounds, §§9-69 and in the statement of Mr Waddington [CB/tab6]. Further reference to the detail of the evidence will be made in relation to the specific grounds of challenge set out below.

9. The Lord Chancellor's policy aim is to restructure the existing criminal legal aid market from 1600 Standard Crime Contracts under which firms carry out both OCW (advice and representation for clients who request their services) and DPW (advice and representation for clients who wish to use the duty solicitor at a police station or Magistrates' Court) for individuals entitled to legal aid. Following a consultation exercise which originally commenced on 9 April 2013, the Lord Chancellor concluded in 'Transforming Legal Aid – Next Steps: Government Response' [Vol2/tab16] ("**the February response**"), published on 27 February 2014, that he would adopt a dual contract model, whereby he would let an unlimited number of OCW contracts, but a

very significantly reduced number of, large, DPW contracts. In the February response, he set that number at 525 DPW contracts; a reduction of some two-thirds from the 1600 existing providers of DPW. A fee cut in legal aid of 8.75% was announced and came into effect on 20 March 2014. A further cut of 8.75% was announced for 2015, although it was then announced to be conditional awaiting the outcome of criminal justice reviews in March 2014.

10. These were the latest in a long series of reforms and cuts in the remuneration of criminal legal aid firms, which, together with recent significant reductions in volumes of work, have left firm finances in an extremely fragile state.

11. The Lord Chancellor's rationale for the dual contracting model is to force the pace of consolidation of the criminal legal aid market so that current fee reductions can be sustained, and further fee reductions can be made. See, for example, the Decision at §2.11:

> Consolidation of the market will give organisations the opportunity to access a larger share of work, enabling them to explore economies of scale which will in turn help to mitigate the fee reduction and give them the best possible opportunity to make a sustainable profit. There are a number of ways that organisations could achieve scale in order to undertake DPW, such as through mergers, joint ventures or delivery partnerships.

12. However, he has denied that he thereby intends to force smaller firms out of the market. Rather, he intends to enable smaller firms to remain in the market through OCW contracts, or as delivery partners (thereby enabling clients to continue to access valued legal advisors, consistent with his reasons for abandoning an earlier proposal for Price Competitive Tendering). A delivery partnership is a new type of consortium arrangement, developed in conjunction with the Law Society prior to the February response (under which there must be a formal agreement between partners, and the lead partner, which alone contracts with the LAA, is responsible for the actions of its partners). The February response stated the Lord Chancellor's expectation that "most successful bidders" for DPW contracts will be joint ventures or delivery partnerships [Vol2/tab16/§34(iv)]. Dr Gibby provided evidence on the Lord Chancellor's behalf in the first claim that the MoJ "believe the majority of applicants [for DPW contracts] would be formed" as delivery partnerships [Vol1/tab6/§148 and at §208].

13. In the consultation document which preceded the February response, the Lord Chancellor had resolved to base his decision as to the number of DPW contracts on independent research to be commissioned jointly with the Law Society (§3.33 [Vol1/tab9/p35]). During the subsequent consultation process, he gave a personal commitment to the Claimant associations that "he would accept the conclusions of the independent research" (Gibby, §204 [Vol1/tab6]). Two pieces of research were commissioned: qualitative research on the existing criminal legal aid market by Otterburn Legal Consulting ("**the Otterburn Report**") [CB/tab15] and a quantitative financial model produced by KPMG, using the data produced by Otterburn ("**the KPMG Report**") [CB/tab14].

14. The principal conclusions reached by Otterburn were summarised by Burnett J in §26 of his judgment and included, notably:

> (i) All firms surveyed had experienced significant falls in volumes in recent years;
>
> (ii) Margins in crime are tight and the effect of previous fee reductions had not yet been fully felt. The supplier base is not financially robust and it is very vulnerable;
>
> (iii) The fee reductions should take place after, and not before, the market had a chance to consolidate;
>
> (iv) Very few firms could sustain a reduction in fee levels of 17.5%; ...
>
> (viii) The approach should be different in rural areas where the market was already well consolidated;
>
> (ix) Some firms have the ability to grow rapidly, but the number is limited and their ability to do so is subject to financial constraints.
>
> (x) A 5% profit margin was the minimum needed for financial viability.

15. In relation to (ii), (iii) and (ix), Otterburn stated, further [CB/tab15/p7]:

> Due to the weak financial base, we conclude that few firms will be able to invest in the structural changes needed for a larger duty contract and recruit new fee earners.

16. Otterburn's conclusions on firm finances echoed those of an earlier report, by PA Consulting, which had been commissioned by the Lord Chancellor in 2013, but then suppressed (and which only came to light on disclosure in the first claim). PA

Consulting concluded that a 17.5% fee reduction was sustainable only for the top 25% of firms. They reported that firms were suffering "reduced levels of liquidity" [CB/tab16/p10], and that the ability of firms to absorb the fee reductions "will be constrained by the banks propensity to lend" [CB/tab16/p13].

17. For their part, KPMG created an economic model intended to generate a range of contract numbers which would be sustainable in the light of the capacity of the market to consolidate and the viability of winning bidders following the 17.5% average fee reduction [CB/tab14/p28]. The tension within the model was that larger and fewer contracts were assumed to improve the viability of the winning bidders, because of assumed economies of scale, but fewer bidders would be able to tender for the larger contracts because of the increases in capacity which were required to perform them. The more contracts to be let, the less the degree of market consolidation (that is, mergers, joint ventures and other firm expansions) that is required. KPMG's model therefore required assessment of two key elements, capacity and viability. They referred to the "capacity challenge" (the extent of market consolidation required to produce sufficient bidders capable of performing the DPW contracts) and the "viability challenge" (the extent of staff cost efficiencies which firms performing DPW contracts would be required to achieve in order to break even) [CB/tab14/p28].

18. A range of assumptions were adopted in KPMG's model, for example, that:

    (1) A market consolidation threshold of 25% was set, i.e. that it was realistic to assume that up to a quarter of the market in any procurement area could consolidate into bidding firms [CB/tab14/p31]. By "consolidation", KPMG meant "acquisitions, mergers, the establishment of a joint venture or alternative business structure, or increased use of self-employed independent contractors" [CB/tab14/p56]. No source was cited for the 25% consolidation threshold.

    (2) Firms could take on 20% more staff through organic growth (that is, without mergers or other more fundamental change) [CB/tab14/p32]. This assumption was derived from discussions with the Ministry of Justice ("MoJ" (judgment, §29).

(3) A DPW contract would be viable if it was capable of producing any positive profitability, i.e. a 0.1% profit [CB/tab14/p34]. No evidential source is cited for this assumption and Burnett J held that it was, by inference, a judgment of KPMG (§29).

(4) Firms would give up 50% of their OCW in order to take on DPW, and so would carry on doing 50% of that work alongside DPW work, earning fees accordingly [CB/tab14/p34].[1] The 50% OCW assumption was said to be derived from discussions with the MoJ. In fact, KPMG wanted to assume that 100% OCW would be given up; the Law Society was firm in its view that no practice would give up any OCW (i.e. 0%); the MoJ directed KPMG to compromise "for the sake of the modelling" at 50% (Burnett J, §28).

(5) Firms were currently carrying levels of latent staff capacity at 15% [CB/tab14/p32]. This assumption was derived from discussions with the MoJ (although KPMG noted in their report that "it is not possible...to make an assessment of...whether there may be excess capacity in the system"[CB/tab14/p26]).

(6) Firms could substantially "improve" staff cost efficiency by up to 20% (that is, for example, a firm with staff costs at 70% of revenue could "improve" that to 56%). This assumption was premised (*inter alia*) on firms using unqualified paralegals for a wider range of work [CB/tab14/p35].

(7) Volumes of legal aid work would continue at the level of 2012/13, so fees generated by DPW contracts should be estimated at legal aid spend in 2012/13, less the proposed 17.5% fee cut [CB/tab14/p32]. This assumption was also derived from discussions with the MoJ.

19. KPMG's initial analysis showed only a minority of areas in which a contract number could be generated which would require market consolidation of no more than 25% and

[1] Consequently, firms would have to grow less quickly to cope with a DPW contract because existing resources used to service own clients could and would be diverted. Also, viable DPW contracts could be smaller in size, as it was assumed that income from DPW fees would be supplemented by own client income.

staff cost efficiencies of no more than 20%, whilst producing more than one bidder for each contract [CB/tab14/p8]. But by abandoning these thresholds and altering the bases of the calculations in other respects – e.g. by breaking down London into 32 areas and assuming four rather than two new market entrants in each London area - they were able to produce total contract numbers for England and Wales of 432-525, with an average contract value of £360,000 - £420,000 [CB/tab14/p10]. This range would require market consolidation of, on average, 28.3% and staff cost efficiencies among winning bidders of, on average, 18.1% [CB/tab14/p10].

20. However, KPMG's recommendation as to contract numbers cannot be read in isolation. Their report immediately highlighted a number of areas where it could not provide sufficiently certain answers and where further work would be required to be done by MoJ (summarised on pp. 11-12, and set out in detail on pp. 56-59). KPMG could not assess the extent to which firms would in fact consolidate, although Otterburn had indicated significant barriers to mergers [CB/tab14/p11]. The extent to which the required level of consolidation would be achievable would be dependent upon a number of factors, which included, in particular [CB/tab14/56]:

(1) Difficulties in developing and negotiating the alternative business structures which would be required for consolidation (such as mergers and joint venture entities).

(2) Difficulties in securing regulatory approval for those alternative structures. It was at that stage unclear how the Solicitors Regulatory Authority ("**SRA**") would seek to regulate and approve these organisations (and in fact it remains unclear even now: Waddington 1st, §164).

(3) Difficulties in managing conflicts of interest between consolidating firms, which would require significant negotiation and due diligence.

(4) Difficulties in sourcing the funds for investment which firms would require in order to prepare for, and perform, the new contracts. KPMG noted that "any structural change within an organisation will likely incur investment costs…The scale of this cost has not been estimated".

(5) The need for sufficient time to implement a consolidation process: "[t]he complexity of issues noted on this page indicate that the time horizon for firms to design and implement a successful consolidation strategy may be significant" [CB/tab14/p56].

21. Specific warnings were given with regard to the availability of investment funding. Funding would be required by firms performing DPW contracts for three purposes: (a) to "fund increased working capital that arise as a result of larger contracts", (b) to "fund the investment required to achieve the staff efficiency levels" which were required by "the viability challenge" (for example, investment in new digital technologies to increase productivity) and (c) to "fund the costs of consolidation". KPMG stated that they had not sought to quantify the likely size of the funding which would be required but could only highlight risks at its availability. They noted that Otterburn had found that there was "limited cash available for investment" and substantial use of overdrafts, and that other sources indicated that both solicitors and financial services providers believed that firms "will struggle to obtain funding from lenders" [CB/tab14/p57].

22. KPMG also included warnings about the extent to which new market entrants would bid to perform DPW contracts. Their analysis had assumed that there would be two new entrants of sufficient capacity in each procurement area, two or perhaps four in each London area (the latter factor playing a crucial role in reducing the market consolidation requirement in London to palatable levels) [CB/tab14/pp10, 30, 50] but they were in fact deeply unsure as to whether that would occur. They noted that "the market does not exhibit the characteristics of an attractive investment opportunity" because work volumes were declining and "[m]arginally profitable contracts (as modelled in our analysis) are unlikely to generate high enough returns to encourage investment in the market" [CB/tab14/p58].

23. KPMG also explained that they had not considered in detail the "extent to which firms that are not awarded contracts will be able to survive in the market during the four to five year period until the next competition", with the result that by the third contract tender "the market may no longer be competitive under the same procurement terms" [CB/tab14/p58]. The impact of the procurement process on losing bidders was not

considered on the basis that it was out of KPMG's scope [CB/tab14/p59], but it was noted that "given the importance of duty provider work in enabling new client relationships, there is a risk that such work will not continue at current volumes and that some firms may choose to exit the market" [CB/tab14/p11]. It was also noted that "firms which are marginally profitable may not provide sufficient reward for equity partners to compensate them for their risk...In the longer term this may pose a threat to sustainability" [CB/tab14/p58].

24. Having set out a summary of other considerations they did not evaluate [CB/tab14/p11], KPMG expressly recommended that a variety of further matters be investigated by the Lord Chancellor [CB/tab14/p12]. These included: the capability of incumbents to grow (having regard to the availability of finance etc.); the likelihood of the procurement attracting new market entrants into a procurement area; to what extent required improvements in staff cost efficiency in each procurement area reflecting local conditions in that area; and the proportion of market consolidation which was in fact achievable. Although Dr Gibby has stated that the MoJ had investigated all of the issues highlighted by KPMG ([Vol1/tab6/§205]), that assertion is in no way supported by the evidence.

25. On any view, these constituted very considerable caveats upon the results produced by the KPMG Report. Most of these caveats, including those in relation to the availability of necessary investment funding, referred to the evidence provided directly to the Lord Chancellor in the Otterburn and the PA Consulting Reports [CB/tab16], both of which highlighted the fragility of the finances available to the criminal legal aid market, as well as challenges it faced (see the Statement of Facts and Grounds at §§15, 31; and Waddington 1st at §§83-85). KPMG also referred to a report produced by Deloitte for the Law Society in May 2013 (*The Government's proposed legal aid reforms* [Vol2/tab30]), which painted an equally serious picture of firm finances, and of the likelihood of obtaining investment capital [pp56-58].

26. Upon the profession being given the opportunity to comment on Otterburn and KPMG, the re-consultation generated 3942 responses in only three weeks. The vast majority of the responses were critical of the assumptions adopted by, and conclusions reached by, KPMG. The Lord Chancellor then asked KPMG to consider some of the re-consultation

responses and report if any changes should be made to the assumptions their Report had adopted ("**the KPMG November response**") [Vol2/tab29]. KPMG declined to change their assumptions, essentially because they believed that the weaknesses in their model had been sufficiently identified in caveats and qualifications which had been set out in their original report [Vol2/tab29/p4] (see above).

27. The Decision, on 27 November 2014, maintained reliance upon the KPMG model, and marginally increased the number of DPW contracts to 527 (through some changes, up and down, in certain London procurement areas). The second fee cut of 8.75% (scheduled for July 2015) was decoupled from the commencement of the new contracts (1 October 2015). The re-consultation and the Decision are described in more detail in the Statement of Facts and Grounds, §§30-39 and Waddington 1st, §§56-77.

28. The tender process run by the Lord Chancellor in relation to the unlimited number of OCW contracts opened on 25 April 2014 and closed on 23 May 2014. Of 1815 applications, 1808 were granted. The OCW Information for Applicants ("**OCW IFA**") [Vol2/tab31] set out that only the same specific legal entities holding an OCW contract would be invited to tender for a DPW contract in due course. The only flexibility to that rule was that the Legal Aid Agency ("**LAA**") permitted a firm to also bid for an OCW contract in the name of an entity which it intended to become. The DPW contract tender commenced, as announced in the Decision, on 27 November 2014 and was due to close (prior to the grant of interim relief) on 29 January 2015. The DPW Information for Applicants ("**the DPW IFA**") was published on 27 November and runs to some 150 pages [CB/tab23], including the technical tender information and weighting. The DPW contract itself was published at the same time [Vol2/tabs37-38]. The details of the tender processes and the requirements of the IFAs are set out in more detail in the Statement of Facts and Grounds, §§40-45 and Waddington 1st, §§114-138.

C. <u>**Breach of the *Tameside* Duty**</u>

The Legal Principles

29. In *Secretary of State for Education and Science v Tameside MBC* [1977] AC 1014, Lord Diplock set out the principle, at p.1065, that:

> The question for the court is, did the Secretary of State ask himself the right question and take reasonable steps to acquaint himself with the relevant information to enable him to answer it correctly?

30. The extent of the inquiry required by a decision-maker depends upon the context of the decision. In *R (Refugee Action) v Secretary of State for the Home Department* [2014] EWHC 1033 (Admin) a challenge was brought against the Secretary of State's decision that asylum seeker support funding for 2013-14 would be frozen, based upon her judgment of how much was necessary to meet their essential living needs. Popplewell J held that "The scope of investigation required for any given decision is context specific" and that the context in that case mandated a "careful inquiry" (§121). He decided that the Secretary of State had failed to comply with the *Tameside* duty: analysis conducted of data was asserted rather than evidenced, was anecdotal, or was "superficial and flawed" (§150).

31. In the present case, the context in which the duty arises is one where the Decision will profoundly affect the way in which the criminal legal aid market operates, the ability of individual firms to continue in business, and has significant potential implications for access to justice. That context calls for careful scrutiny of the Lord Chancellor's compliance with his duty to carry out a sufficient inquiry. Moreover, the Decision raises complex issues about the balance to be struck between financial pressures and the ability and willingness of the market to react in the manner desired. That too is part of the context which enhances the *Tameside* duty:

> The more difficult a decision is to take, and the greater the complexity of the issues faced by the person responsible for making the decision, surely the more important it is to take full advantage of every means by which he or she may be properly informed.
>
> (*R (Shaffi) v Secretary of State for Justice* [2011] EWHC 3113 (Admin), §71)

32. The *Tameside* duty is particularly apposite where the decision depends upon factual issues. If there is contradictory evidence in relation to those factual issues, detailed and focussed enquiries are required: *R (Usk Valley Conservation Group) v Brecon Beacons National Park Authority* [2010] 2 P&CR 14, §§44-51. Significantly, the duty has also been held to have been breached where an authority adopted one of a range of conclusions suggested by an expert report, contrary to a caveat which had been expressed in the

report. That was the position in *R (Mavalon Care Ltd) v Pembrokeshire CC* [2011] EWHC 3371 (Admin) where the Council had instructed PwC to assist it in updating an established model for the determination of care home fees. PwC applied a range of different rates of return without reaching a view as to which was appropriate (§§29-32). The Council breached its *Tameside* duty by adopting a particular rate of return without further enquiry as to whether it was appropriate (§§50-52).

Finance

33. There was very powerful evidence that (a) investment is crucial to the two-tier contract model, and (b) there is very little money available for investment and great difficulties in obtaining new money. KPMG pointed out that investment was necessary to fund firm growth,[2] to fund efficiencies in working practices and as working capital to enable the day to day operation of larger DPW contracts. In other words, both firm capacity and contract viability depended upon access to investment.

34. There was extensive evidence of the dire financial position of criminal legal aid firms even before the fee cut. The PA Consulting report was very clear on this. The Deloitte report concluded that "the ability of incumbent legal aid providers to move towards such new business models is constrained", listing the particular barriers to be: "a lack of access to capital to invest in new models and supporting infrastructure"; "insufficient time to conclude new arrangements such as joint ventures" and cultural challenges in changing business models. It also concludes that the market is "unlikely to attract new sources of finance or large numbers of new entrants" [Vol2/tab30].

35. The Otterburn Report [CB/tab15/pp5-8] presented an even starker picture. It concluded that:

> The finances of many crime firms are fragile. Most do not have significant cash reserves or high excess bank facilities...a number of respondents expressed the view that their bank would be unwilling to extent further credit to them;...
>
> If the first reduction in fees of 8.75% takes place before there has been any opportunity for the market to consolidate the participants indicated that their profitability would be significantly weakened before they had managed to secure additional income;...

[2] See the witness evidence of Nelson 1st, §§12-13, 15-17; Cox, §§14-15; Nelson 2nd, §§2-16.

> Margins in crime are very tight, especially in London, and the effects of previous fee reductions in crown court work have yet to be fully felt. The survey strongly suggests that the supplier base is not financially robust and is very vulnerable to any destabilising events, for example rejections of bills due to incomplete claims or errors by LAA staff leading to delays in payment by the LAA;...
>
> any fee reductions should take place after, not before, the market has had a chance to consolidate as firms will otherwise be weakened financially at the very time that they will need to invest in new staff and systems, and fund any redundancies. Fee reductions prior to market consolidation would make it more difficult for the market to restructure;...
>
> Due to the weak financial base, we conclude that few firms will be able to invest in the structural changes needed for a larger duty contract and recruit new fee earners.

36. Those reports were produced prior to the introduction of the 8.75% fee cut in March 2014, which weakened further the position of firms who are now required to spend to consolidate and become more efficient. The fragility of the current position of firms is only borne out by Ms Massey's reference to 85 providers having withdrawn from the market between April-November 2014 alone (i.e. since the first 8.75% cut): Massey, §179. The Lord Chancellor's alleged expectation that firms will be able to invest from reserves (Detailed Grounds, §89) is entirely at odds with the evidence.

37. Against that background, it is unsurprising that KPMG warned of the risk of investment not being available and recommended that this matter be investigated by the MoJ. There was no such investigation, the MoJ appears to have no idea of the practical realities faced by firms who need to invest to comply with his new model and indeed the 21 November 2014 Ministerial Submission (**"the November Submission"**), which preceded the Decision, did not alert the Lord Chancellor himself to the warnings and recommendations of KPMG and to the fact that these had not been investigated. It is the personal knowledge and consideration of the Lord Chancellor himself which matters, not the knowledge of his officials (see *R (National Association of Health Stores) v Secretary of State for Health* [2005] EWCA Civ 154, §§23-26). On that test, this and other relevant considerations (see below) were not taken into account by the decision-maker, contrary to public law.

38. The Lord Chancellor attempts to deflect the force of the PA Consulting and Otterburn reports by dismissing them on the grounds that they are concerned with the existing market and so do not account for the efficiencies, savings and therefore extra money

which will be available to providers of DPW contracts (Decision, §2.29). This approach ignores the obvious point that the vast majority of firms cannot access the brave new world of DPW contracts without first investing in scaling-up and staff cost efficiencies; otherwise, they will not have enough capacity to win a contract, or will not be able to perform a contract without making substantial losses. It also ignores the warning of KPMG that it is difficult to attract investment to enterprises which are only marginally profitable (that is, the contract numbers have been fixed on the basis that they will enable firms to break even, even after making substantial efficiencies). As Mr Nelson points out, his bank would not be prepared to lend to him even if he did win a DPW contact, or if it did lend it would be on such onerous terms as to make the deal unviable: Nelson 2nd, §§2-8. These difficulties would have become apparent to the Lord Chancellor if he had engaged directly with commercial lenders, but despite having told the Law Society that he would "meet with the financial institutions to discuss lending risks", he did not do so [Exhibit HM4].

39. Separately, the Lord Chancellor suggested in the Decision that he has acted in various ways to assist the financial position of firms. In each case, the steps taken have been exaggerated, and there has been no assessment of what effect they will have in practice on the problems identified by KPMG:

(1) The LAA has established a business partnering support network to offer information and advice on increasing capacity (Decision, §§2.19, 2.87). Mr Waddington has explained an attempt to contact this "network", which was been met by incomprehension and the response that it does not exist, which is consistent with the experience of the Claimant associations and their members: Waddington 1st, §90. Ms Massey explains that the "network" in fact consists of a dedicated email address (§186) but gives no evidence as to concrete steps which the LAA have taken to assist firms. The LAA's website likewise suggests that its Managing Organisational Change guidance will "be made available in the coming months": Waddington 1st, §90 [Vol2/tab46].

(2) The LAA has issued guidance on obtaining finance but this is so basic as to be patronising. Firms are well aware of existing theoretical options for finance; it is actual finance they need and cannot obtain: Nelson 1st, §16; Cox, §16.

(3) The MoJ has had discussions with the British Business Bank (Decision, §§2.20, 2.87), which is a government enterprise which aims to help SMEs access finance. It does not provide funding itself, but rather seeks to facilitate agreements between borrowers and private sector enterprises. Enquiries made by the LAA of the BBB for the purposes of these proceedings have revealed that it is unaware of any support having been sought by, or granted to, a commercial lender which was contemplating lending money to a legal aid firm.

(4) The Enterprise Finance Guarantee to be made available to the legal aid market (Decision, §§2.20, 2.87). This is not a loan, but a Government guarantee of 75% of a loan made by a commercial lender on their standard lending criteria. The borrower is not protected, but is charged a 2% fee by the Government to compensate for the guarantee, on top of the lending fees and interest. It is a particularly unattractive option for firms given their very tight margins: Waddington 1st, §89; Nelson 1st, §17. It would appear that no guarantees have been given.

(5) The Lord Chancellor places great reliance upon new interim payment provisions for Crown Court cases which were announced in February 2014 and introduced from 2 October 2014 (Decision, §2.21). This is not new or additional money; it is money to which firms are already entitled in any event, being paid at a slightly earlier stage. There are two triggers. The first is where a hearing is held at which a defendant pleads not guilty and directions are set, but this does not apply to either-way offences tried in the Crown Court. The second applies only to cases in the Crown Court, at the start of a trial listed for 10 days or more, entitling a payment for a one day trial. The latter of these payments is a very narrow category of case, and it is too early in the effectiveness of the payments to tell their use. There has been no investigation of (a) whether this limited improvement in the cash flow of some firms will make any practical difference to their ability to obtain investment finance (the Claimants doubt it), or (b) whether there is any correlation between firms who will benefit the most from this concession and those who are likely to need the most investment finance.

40. In short, and contrary to his commitment to adopt the recommendations of his independent research, the Lord Chancellor has adopted conclusions of KPMG which were provisional, and contingent upon further investigations, but without carrying out the investigations which KPMG believed to be necessary.

The capacity challenge

41. Apart from the need for funds for investment in consolidation, KPMG identified a number of other uncertainties which go to the extent to which firms are able to consolidate [CB/tab14/p56]. Save that the MoJ had limited dealings with the SRA, there is no evidence of any investigation of these matters. Evidence provided from Ms Massey, in notes of meetings with the SRA on 4 and 23 April 2014, indicates that the SRA needs to be notified of delivery partners and that a six month authorisation process was envisaged [Exhibit HM2]. In the light of the SRA's indication, the time needed for market consolidation was a particularly pressing consideration, which the Lord Chancellor inexplicably left alone.

42. One solution offered by the Lord Chancellor to the uncertainties highlighted by KPMG is the use of delivery partnerships, a (supposedly) flexible structure which avoids some of the complications associated with mergers and takeovers. But delivery partnerships bring their own difficulties, which the Lord Chancellor also failed to investigate (see further below).

43. The Lord Chancellor did carry out some further analysis of the extent of market consolidation achievable, albeit by attempting to measure how much additional capacity was required by the largest firms (and then assuming, without further analysis, that it was realistic to expect the requisite increases to be achieved). However, his disregard for his duty of candour has meant that the Claimants have not been able to subject the documentation to the scrutiny it deserves. Ms Massey's statement, due at 4pm on 7 January, was disclosed some three and a half hours late, and the accompanying exhibits were not provided until 09.11 the following day. Even then, the exhibits did not include the underlying primary documentation relating to the further analysis upon which the Lord Chancellor relies (despite clear indications at §100 and §169 of the statement that the draftsman of the statement intended there to be

disclosure) and this had to be requested. Those primary documents, in the form of spreadsheets with no commentary or explanation, were eventually provided at 14.15 on 9 January, less than 24 hours before the deadline for filing the Claimants' evidence in reply and this Skeleton. The Claimants reserve their position on the detail of the analytical work.

44. It appears from the evidence provided by Ms Massey that the Lord Chancellor relies on four pieces of analytical work "independently of and in addition to the KPMG Report" (Detailed Grounds, §71). This work was not an effort to pursue the specific points raised by KPMG and appears to have addressed, at best, one of four particular areas for investigation which they highlighted as "Next Steps" [CB/tab14/p12], and none of the "Other Considerations" which limited the reliability of the model [CB/tab14/p12].

45. The first piece of analysis is that set out in the February response at §34(iii) [Vol2/tab16/pp12-13] in relation to work done by the MoJ on 'market agility': Massey, §§89-95. This reflects material in the 14 February 2014 Ministerial Submission at §55 [Vol2/tab41] ("**the February Submission**"), and is simply restated without addition in the November Submission. It is wholly inadequate as an investigation into any of the matters raised by KPMG:

(1) The scope of the MoJ's work is very narrow. Far from testing the model, the work relies upon it in all material respects.

(2) The calculation uses <u>pre-fee reduction values</u> (Annex F, §3(a) [Exhibit WOW2]) when estimating the current capacity of firms. It therefore significantly underestimates the capacity which providers should now be taken to have available to perform DPW contracts.

(3) The analysis is inherently skewed in favour of showing a low level of growth by focussing on the very largest firms in each procurement area (if six bidders, the six biggest firms), who by definition will need to grow least, and does not focus on the inevitably much greater challenge facing the smaller firms, whom the Lord Chancellor also expects to be able to bid. Similarly, the results of the analysis portrayed by Ms Massey focus on average figures, rather than on maximum growth requirements. That there may be a small number of large firms who will

have to grow little or not at all tells us (and the MoJ) nothing, and serves only to mask the scale of the growth challenge for smaller firms.

(4) Adopting pre-reduction fees and focusing on average growth requirements also serves to obscure the extent of the growth challenge in particular procurement areas where fee reductions are to be substantially greater than 17.5%.

(5) The analysis focused on bidding firms, which were assumed to be the largest firms in any given area and so again ruled out of account the problems faced by the vast majority of criminal legal aid firms. Oddly, it assumed a tender process in which there was only one bidder per contract (and so no competition between bidders), which again helps to keep the focus on the smallest possible number of largest firms.

(6) Particular work was done on two London areas as revealed in Annex F to Dr Gibby's February Submission (although not referred to by Ms Massey), which gave a rather different picture of the capacity challenge. In neither area was there a single firm which had anywhere near the level of DPW income capacity that would be required to perform one of the new contracts (even without taking account of the fee cut). In London Area 1 the DPW contract threshold is £260k: the firm closest to that figure appears to have had a total DPW fee income of c. £170k. In London Area 2, the contract threshold was £460k, and the closest firm appeared to have a fee income of around £250k. Even after adding 50% OCW capacity and 15% latent capacity only one firm in the first area, and no firms in the second, could service the contract.

(7) The analysis adopts a figure of £83,000 (said to be based on the Otterburn Report, but not suggested there) as the estimated revenue a fee earner would generate. As Otterburn pointed out in its re-consultation response, this figure was generated by the MoJ, is pre-reduction, and it is unclear what it encompasses (DPW only, or DPW plus OCW). He explained that under the new fee levels, a fee earner would have to bill £96,000 just to cover the costs of the firm of employing him, and that one firm had a target of £125,000 in fees for each fee earner. He did not suggest that this latter figure – which was a target for fees generated from all work and

not just legal aid work - was an achievable figure, or that it was an appropriate value calculation for contracts [CB/tab21].

46. Separately, the MoJ considered the levels of growth required if a 17.5% fee cut were taken into account, based upon revenue figures which Otterburn had reported would be required by firms in order to survive under the new DPW regime: Massey, §§101-105. (This is the third piece of analysis Ms Massey details.) Ms Massey does not give the split of growth figures which resulted, but Dr Gibby did [Vol1/tab6/§131]. Rather than growth by one staff member, London firms would need an average of seven extra staff, urban firms five and rural firms two. There appears to have been no attempt to reconcile these figures with the "market agility" work referred to in the preceding paragraph. And nor were the results of this analysis, which were far more difficult for MoJ officials to ignore, ever communicated to the Lord Chancellor (they were not included in the February Submission and, as a result, not repeated in the November Submission either (§§91-93)).

47. The second piece of analysis, said to have been carried out in July 2014, is addressed by Ms Massey at §§96-100. No reference to it was made in the November Submission [Massey, Exhibit 1] and it was not considered by the Lord Chancellor. The Claimants are unable to understand and assess what has been done, how, or what assumptions have been involved. It is said to be similar to the market agility analysis, but indicative of fee earner growth at the firm level, across procurement areas. Of apparent particular importance (see Massey §§98-99), is the assumption that staff can be redeployed from an unsuccessful bid area to a successful one, achieving internal growth, and reducing the need to hire extra staff. This frames the analysis in a way which favours the Lord Chancellor's preferred approach but what is noticeably absent from the statement is any explanation as to how this exercise has been done. On what basis is a firm said to have staff assigned to a non-successful area? How does the MoJ know? What allowance is made for the costs of reallocation, such as closing offices and relocating staff, or making existing staff redundant and hiring new staff? Is the modelling hypothetical, or is it based on real data, and if so, what data? Or have the analysts simply applied an assumption that x% can be internally reallocated to the DPW contract, without any particular basis? The assumption is surprising, particularly given that KPMG's modelling including within it an expectation that OCW from out of the procurement

area will continue to be carried out, and they included income from such work within their calculations of current firm capacity [CB/tab14/p33].

48. Analysis was also undertaken to assess the consequences of successful bidder firms giving up 50% OCW, work which would likely return as DPW, although no underlying documentation describing this work has been disclosed (see Gibby, §§125-127 and Massey, §110), and it is not one of the four pieces of analysis upon which Ms Massey relies. This would apparently serve to increase contract values by £60,000, which was considered to be achievable without further analysis, even though, using the Lord Chancellor's preferred figure of £83,000 per fee earner, adjusted for the fee reduction, it amounts to a further expansion requirement of approximately one fee earner per firm.

49. This highlights a broader criticism of the statistical analysis carried out by the MoJ. It was not accompanied by any assessment of whether it was realistic to expect firms to grow to the extent indicated by the statistics, having regard to the considerations which KPMG had identified. Even one additional fee earner is a significant change where 24% of the market is comprised of sole practitioners and a total of 76% of it by firms with between one and five duty solicitors [Vol1/tab7/p16]; and the statistics in fact indicated a substantially greater growth requirement.

50. The Lord Chancellor does not otherwise appear to have investigated or analysed the numerous barriers to investment and consolidation highlighted by KPMG. The DPW range under the KPMG model would require market consolidation of, on average, 28.3% [CB/tab14/p10], which was particularly affected by London, but in a number of procurement areas the consolidation required was considerably higher (for example, 47% in Surrey, 40% in Kent, 35% in Essex) [CB/tab14/p44]. There is no evidence which suggests that the Lord Chancellor has analysed, as KPMG recommended, whether consolidation of, say, 47% in Surrey was actually achievable under the difficult market conditions currently prevailing.

The viability challenge

51. The availability of finance was also vital to the question whether or not firms could in practice achieve the levels of staff cost efficiency which were required for them to break even (after, of course, having exploited 15% latent capacity). But there were other

uncertainties critical to the viability challenge which were highlighted by KMPG and not investigated by the Lord Chancellor, in particular whether the efficiency improvements required by the model reflected the local context of each procurement area [CB/tab14/p12]. Nor was there any consideration given to whether it was in fact realistic to expect improvements of this magnitude under local conditions. In that regard, it is notable that KPMG's theoretical underpinning for assuming possible efficiencies was that some firms were already more efficient than others [CB/tab14/p35], but in rural areas it is the smallest firms which have the lowest staff costs ratio [CB/tab14/p21] and in urban areas it is medium sized firms [CB/tab14/p23]. Neither of these categories was expected, and modelled, to win DPW contracts because they would not be "incumbents of scale".

52. There was a specific failure to investigate the viability of contracts for delivery partnerships which, as already noted, have been central to the Lord Chancellor's strategy for the two-tier system. A notable feature of the KPMG model was that – in accordance with their understanding of market consolidation – the costs and rewards to be expected when performing a DPW contract were estimated on the basis that a single legal entity would be providing services: a larger, single firm such as a merged entity or a joint venture firm created by two or more existing providers. Viability assessment was done on the basis of single firms, with ratios calculating staff costs, fixed and variable overheads, for London, urban and rural areas respectively [CB/tab14/p33]. There was no attempt by KPMG to model the costs and benefits of a delivery partnership arrangement, whereby a number of firms, each with their own overheads, joined together in a consortium to perform a DPW contract. The Lord Chancellor was not informed of this significant gap in the analysis in either the February or the November Submissions.

53. It is, with respect, no answer to this omission for the Lord Chancellor to say that delivery partnerships are only one option of many and that it would have been impractical to model all possibilities (Detailed Grounds, §91; Massey, §141). They have been trumpeted by the Lord Chancellor as the principal option, and indeed are the only option remaining to the majority of firms, which did not agree a merger before applying for an OCW client (see below, §§59-63).

Other challenges associated with delivery partnerships

54. The Lord Chancellor has also failed to investigate a range of other difficulties which are associated with the formation of delivery partnerships. They are subject to almost all of the disadvantages of a merger process but without generating the economies of scale which a merger may be expected to produce. As the Otterburn Report pointed out [CB/tab15/p45]:

> Some firms may achieve critical mass through the creation of consortia however these are unlikely to create the more efficient financial structures required. They will be unable to re-structure the balance between equity and other fee earners, will not benefit from one set of systems and will have added an administrative task in liaising with the other firms in the consortium, and guaranteeing consistent performance, that someone will need to manage.

55. The process of formation of a delivery partnership must go through due diligence (IFA, §2.22) which, along with the negotiations and management time required, involves considerable expenditure: Waddington 1st, §§157-160. As Mr Nelson explains, not only was he unable to obtain further finance to fund the necessary costs of a delivery partnership, but discussions with his insurers indicated that it would be uninsurable: Nelson 1st, §§15-17. This is because the lead contractor is fully responsible under the contract with the LAA for everything done by delivery partners (IFA, §2.28), which itself poses real regulatory complications (Nelson 1st, §15). The MoJ has given no direct thought to this problem (Massey, §112) and has not engaged directly with insurers about it (Exhibit HM3). Firms face difficult negotiations about the allocation of duty shifts, the ability to convert DPW into OCW on their own account, and the agreement as to remuneration of the lead contractor for providing work and monitoring the work that is done: Payton, §9; Waddington 1st, §160. The Law Society's estimate is that the agreement of a delivery partnership will take 5-6 months [Vol1/tab7/p85]. It remains unclear how a delivery partnership will be regulated by the SRA: Waddington 1st, §164.

56. Yet the advantages of delivery partnerships are, it would appear, limited. They cannot be expected to generate the necessary efficiencies because they remain separate entities with separate obligations, and, as a result of the Lord Chancellor's own decisions, are to be of limited benefit in the DPW tender process. Firms cannot utilise the management experience of delivery partners to obtain points for their management team rating, or

the 50% increase in work they must be able to deliver (IFA Technical Envelope [CB/tab23/pp124-126, 133-134]), despite the fact that a delivery partner can perform up to 40% of the contract work.

57. Despite the Claimants having publicly pointed out the considerable barriers to delivery partnerships, the Lord Chancellor has provided no substantive response (see Waddington 1st, §156). He has merely asserted in the Decision that the difficulties are not as serious as have been alleged (Decision, §2.22). Ms Massey does not provide any evidence at all of investigations of these difficulties by the Lord Chancellor or indeed any explanation of that assertion in the Decision.

Difficulties caused by the design of the tender process

58. The Lord Chancellor's intention in reducing the number of DPW contracts by two thirds from the existing number is to force the market to restructure and consolidate in an "orderly" manner (Decision, §§1.7-1.8). Despite this purpose, no inquiry was made into the importance of, nor any apparent consideration given to, the inability of firms to merge or form joint ventures after 23 May 2014 and the requirement that any delivery partnership be put in place within the two month tender timetable.

59. One of KPMG's caveats as to the ability of firms to acquire increased capacity was that this would take significant time to achieve [CB/tab 14/p56]. Their report assumed that firms would be able to "grow through consolidation" right through to the "time of the bid", in order to have sufficient capacity to fulfil a DPW contract at the time of bidding [CB/tab14/p28]. That assumption did not match the Lord Chancellor's design of the tender process. The only firms which could tender for a DPW contract were to be ones which possessed an OCW contract in the name of that specific entity, and the deadline for knowing the existence and intended name of any new entity was 23 May 2014 when the OCW tender closed. The effect was that any consolidation which involved the creation of a new entity, such as a merger or a joint venture, had to have sufficiently progressed between the February response (27 February 2014) and 23 May for an OCW contract to be tendered for in its name. After that point, any subsequent mergers or joint ventures would not have an OCW contract and so would be ineligible for DPW bids. It would appear that KPMG were not informed of this, or asked to consider whether it

affected their modelling work. Nor indeed did the Lord Chancellor's officials point out to him, in the November Submission, this important limitation on market consolidation.

60. The Lord Chancellor's response is that firms should have been taking steps to consolidate at an earlier stage (Detailed Grounds, §79). This does not meet the point as to whether consolidation had in fact taken place before the OCW tender process closed,[3] but is difficult to square with a re-consultation on contract numbers having taken place with an open mind. Firms cannot sensibly seek to merge, or form delivery partnerships, and cannot reasonably be expected to devote the considerable resources necessary to this process, where they do not know the final contract values or contract numbers which they are consolidating in order to obtain. Nor did firms know the tender requirements which would be imposed in the DPW tender process. Some indications were given by the Additional Information document in April 2014 [Vol2/tab33/p1], but they were subject to being amended or added to at any time. Draft DPW contract standard terms and specifications were published in July 2014, but were incomplete. For example, they did not specify the percentage of work a delivery partner would be entitled to carry out. There was no indication, for example, of the values which would be awarded to particular types of case in particular procurement areas; the discovery on 27 November 2014 that additional points are available for recent experience of a terrorism case (IFA, p.114), or an extradition case in Central London (IFA, p118) would make an important difference as to the firms who would be preferred partners.

61. Even if it were accepted that firms should have been attempting to consolidate on the basis of the February response, the Lord Chancellor has failed to recognise the very considerable practical barriers faced. The evidence of the Claimants is clear that some firms did seek to explore options after February, but were unable to pursue them because of the lack of information as to the tender requirements (Cox, §§5-9), insuperable problems of finding appropriate partner firms (Nelson 1st, §§4-8) or simply the detailed level of negotiations which are required in such a short space of time (Payton, §§4-11). Mr Nelson's first statement provides a detailed explanation of the

[3] The Lord Chancellor can cite only a handful of examples of consolidation having occurred, but makes the unjustified assumption that they were prompted by the adoption of the dual contract model (see November Submission, §49 [Exhibit HM1]; Waddington 2nd, §102).

practical difficulties faced by his firm in exploring consolidation, which include the expensive due diligence obligations, the treatment of client accounts, the need for regulatory approval (taking 6-9 months), different computer systems and tax years and the inability to obtain further finance: §§9-19. The evidence indicates that mergers can take anything from three years (Deloitte) [Vol2/tab30/p45], to 8-13 months (Law Society) [Vol1/tab7/p69] (and see Waddington 1st, §142), to, at best, six months (Waddington 1st, §149; Nelson 1st, §14). Given the need to be able to tender for an OCW contract in the proposed name of the new entity by 23 May 2014, these timescales were simply not achievable.

62. There is no solution to be found in the ability of firms to novate their DPW contracts if they consolidate after having tendered. Clause 22 of the DPW Contract Standard Terms [Vol2/tab37/pp73-74] permits novation to a new entity, or a change in delivery partner, only at the absolute discretion of the LAA, and sets out a number of matters at clause 22.3 which will lead to consent being refused. This includes if the incoming party could have tendered for a DPW contract but did not, or did and was unsuccessful. Nor does the fact that there have been a handful of mergers/expansions (Massey, §106 states four, one of which has had to be corrected) undermine the argument that consolidation has been rendered unnecessarily impractical; consolidating moves are made all the time, for a variety of reasons.

63. The practical difficulties imposed by the Lord Chancellor's choice of tender criteria for the OCW and DPW tenders, and the very short tender window for the DPW tender, undermine the modelling upon which the Lord Chancellor relies. It was incumbent on the Lord Chancellor to inquire further with KPMG whether the practical procurement decisions he had made in April 2014 and was to make in November 2014 impacted on the viability of KPMG's model.

Failure properly to consider the consultation responses

64. In responding to a consultation, a decision-maker must grapple with the main issues which have been raised by consultees: see *R (Morris) v Newport City Council* [2009] EWHC 3051 (Admin), §38; and *R (Mackenzie) v Secretary of State for Justice* [2009] EWCA Civ 669, where a decision was quashed because the Secretary of State had "failed to

engage with the case being put forward by [the Claimant] in a significant respect": §34. A decision following consultation must extends beyond the mere repetition of assertion: *R v Ealing LBC ex parte C* (2000) 3 CCLRep 122. This duty is both an aspect of the requirement to carry out a procedurally fair consultation, and of the *Tameside* obligation to ask (and answer) the correct questions.

65. The Decision shows that the Lord Chancellor did not grapple with the important points being made to him, in almost 4000 consultation responses, concerning the inappropriateness of the assumptions adopted by KPMG and the need to give greater weight to the evidence collected in the Otterburn Report. The weight of 3942 responses, which were overwhelmingly contrary to the Lord Chancellor's approach, required careful and coherent answers. But his approach in the Decision was to dismiss responses out of hand on the basis that they provided no "new evidence about the viability of the dual contract model" (Decision, §2.6) and that respondents were not "thinking about the future and how they would respond to the demands of the new DPW system" (Decision, §2.78). This approach was entirely consistent with the evidence of Dr Gibby in the first claim that further consultation on Otterburn and KPMG "would have made no difference to the assumptions used for the final modelling of the KPMG report" [Vol1/tab6/§159], which the Lord Chancellor disavowed in submissions to Burnett J. It was also unlawful:

(1) Burnett J had expressly held that the people directly affected by the proposal, operating in the existing market, were best placed to inform the Lord Chancellor as to whether those predictive assumptions were likely to be correct: at §44. The Lord Chancellor's approach that responses they told him nothing new is inconsistent with that finding.

(2) It is common sense that the only clear evidence a firm can provide as to how it might act in a new market in the future will be squarely based upon how it has been able to act in past and current markets. As KPMG noted in their November response, there is no "evidence", as such, of the new market until it happens [xref/p4]. There is no logical reason why the views of consultees with lengthy direct experience of the criminal legal aid market about what would happen in the future should be dismissed as "assertions" (Massey, §16) or "just opinion"

(Massey, §150), in favour of the "economic modelling guesswork" of KPMG (Massey, §83), which has no such experience.

(3) Many of the assumptions made by KPMG were strongly related to the current position of firms. For example, the 15% latent capacity assumption referred to capacity "already existing within firms" [CB/tab14/p32]. It is difficult to understand why explanation as to why a particular firm is already working at full capacity (see for example, Mr Bird's statement in the first claim [Vol1/tab3/§81]) does not constitute new and relevant evidence. In fact, the Lord Chancellor wrongly proceeded on the basis that the latent capacity assumption was merely a prediction as to the future (November Submission, §§51-54).

(4) The Decision simply does not engage with crucial, specific, practical problems with the Lord Chancellor's preferred approach. For example:

(a) The objection that consortia posed "regulatory, insurance, economic and supervisory" barriers is acknowledged but dismissed without further explanation as not "insurmountable": Decision, §2.22. No further explanation is given for this conclusion and no attempt to address the issue can be found in the November Submission [Exhibit HM1].

(b) The Decision dismissed the Otterburn Report's finding that organisations would find it "difficult to survive a 17.5% fee reduction" before market consolidation, and the reliance of consultees on that finding, because it was made in the context of the existing market (§2.11). But Otterburn's point - that firms would not have the funds necessary to transition to the new market given their current financial position, and a further large fee cut [CB/tab15/p7] - was coherent and important, and cannot be so easily rejected.

(c) Otterburn's own response to the re-consultation strongly argued that the DPW tender assessment criteria of having one fee-earner per £83,000 of the contract value was flawed, not least because it did not take into account the fee reductions (which would reduce fee-earning capacity by 17.5% on average) [CB/tab21]. The Decision does not mention or engage with this at all, and the November Submission made by officials to the Lord Chancellor sets out the issue but does not seek to answer it [Massey, Exhibit 1, §36].

(d) Consultees, including the First Claimant, suggested that the necessary scaling up had been under-estimated in London because if the largest bidder was bidding in more than one area, a greater degree of scaling up would be required by other bidders [CB/tab18]. The Decision notes this point at §2.85 but does not address it.

(e) The Decision does not address at all the evidence in the PA Consulting Report prepared for the Lord Chancellor about the existing fragility of the market and relied upon by, amongst other consultees, the Law Society [CB/tab20/§§39-43]. This was a key document relating to the February decision to press ahead with the 8.75% fee cut prior to consolidation (February Submission, §§110-112 [Vol2/tab41]) and had an important bearing on whether firms could in fact meet the capacity and viability challenges set out in the KPMG report.

Failure to test the significance of KPMG's assumptions

66. KPMG's assumptions are highly controversial (per Burnett J, §28) and there is, on any view, a significant risk that one or more of them will turn out to be optimistic or otherwise incorrect. Where a decision is based on a financial model, which is inevitably sensitive to the assumptions which are entered into it, and those assumptions are controversial, the impact of any one or more assumptions being incorrect is an obvious relevant factor for consideration.

67. In the first instance, consultees should be permitted access to the executable model so that the impact of the different assumptions can be tested. The Lord Chancellor was asked to disclose KPMG's model during the re-consultation but unlawfully refused to provide it: Waddington 1st, §61. The present case is closely analogous to *R (Eisai Ltd) v. National Institute for Clinical Excellence & others* [2008] EWCA Civ 438, where the Court of Appeal held that the executable model used by NICE in evaluating the cost-

effectiveness of a drug should have been disclosed in order to ensure a fair consultation. This was so notwithstanding that the claimant had been provided with extensive information and was in a position to make an intelligent response to the consultation:

> 36. The robustness or reliability of the model is therefore a key question. For the thorough testing of reliability, there can be no doubt that a fully executable version is required...
>
> 66. The view I have come to is that, notwithstanding NICE's considered position to the contrary (to which in itself I am prepared to give some weight), procedural fairness does require release of the fully executable version of the model. It is true that there is already a remarkable degree of disclosure and of transparency in the consultation process; but that cuts both ways, because it also serves to underline the nature and importance of the exercise being carried out. <u>The refusal to release the fully executable version of the model stands out as the one exception to the principle of openness and transparency that NICE has acknowledged as appropriate in this context. It does place consultees (or at least a sub-set of them, since it is mainly the pharmaceutical companies which are likely to be affected by this in practice) at a significant disadvantage in challenging the reliability of the model. In that respect it limits their ability to make an intelligent response on something that is central to the appraisal process.</u> The reasons put forward for refusal to release the fully executable version are in part unsound and are in any event of insufficient weight to justify NICE's position. [emphasis added]

68. There was no universal principle that information coming from an independent expert should be disclosed. That was a relevant factor in favour of disclosure "but it was a combination of factors - including the requirement of a high degree of fairness, the crucial nature of the advice, the lack of good reason for non-disclosure, and the impact on the applicants - which led to what was on the facts a fairly obvious conclusion": at §30. Those factors are squarely in play here.

69. Most recently, in R *(British Dental Association) v General Dental Council* [2014] EWHC 4311 (Admin), the Administrative Court found a consultation exercise conducted by the GDC to have been unlawful for failure to disclose the underlying material relevant to the GDC's assertion that a higher registration fee was required from dentists to support the GDC's increased burden of complaint handling. Cranston J held, applying *Eisai,* that "consultees had to be put in a position to test the validity of the assumptions purporting to underlie the suggested fee increase, and why alternatives had been rejected, and to enable consultees to make an informed and intelligent response and, if minded to do so, propose alternatives...to enable them to test the robustness or reliability of the model behind what was being presented" (§36). See too: *R (Save our*

Surgery) v Joint Committee of Primary Care Trusts [2013] EWHC 439 (Admin), especially at §§112, 117.

70. The re-consultation exercise had sought responses concerning the Lord Chancellor's view that the KPMG analysis was a "sound evidential basis for the decision on the number of duty provider contracts to offer" [CB/tab17/§29]. Yet consultees were unable to evaluate the reliability of that evidential basis, because they could not interrogate the model. The situation is the same as that in *Eisai*, where the consultee could not "check whether there are variables to which the model is particularly sensitive and make informed representations accordingly…the consultee is left making shots in the dark, in circumstances where the light could so easily be switched on": at §50. The fact that the model is in the form of spreadsheets rather than a computer model (Detailed Grounds, §134) is irrelevant – the spreadsheets will contain formulae and reveal how the modelling works, as well as enabling alternative assumptions to be tested.

71. The Lord Chancellor argues that it is an abuse of process to allege that the non-disclosure of the executable model was unlawful, because the First and Second Claimants should have argued this before Burnett J (Detailed Grounds, §122ff) . As to this:

    (1) The Third and Fourth Claimants were not a party to those proceedings (nor indeed was the Law Society, which makes the same complaint in its parallel claim). It cannot possibly be said that it is abusive for them to make the argument now. The objection is therefore academic at best.

    (2) The Decision was a fresh decision taken by the Lord Chancellor. There is a fresh challenge to that Decision on fresh grounds.

    (3) Unlike *Eco-Power v Transport for London* [2010] EWHC 1683 (Admin), this is not the raising of an argument already unsuccessfully run, and it does not amount to a collateral attack on the judgment of Burnett J. There is nothing contrary to the public interest in seeking to ensure that a consultation exercise (even where it was a re-consultation exercise) is lawfully conducted.

72. Next, it was incumbent upon the Lord Chancellor himself to investigate the impact of the controversial assumptions upon the out-turn of the model and so to analyse the risks which he would be taking with the criminal justice system if he were to proceed on the basis of those assumptions. In the event, the Lord Chancellor unlawfully failed to ask KPMG to conduct this analysis or - with one possible exception - to do so himself. He thereby failed to inform himself of the magnitude of risk he is taking by adopting the contract numbers which the model has recommended.

73. In relation to the assumption that 50% OCW will be given up by winners of DPW contracts, the Decision expressly states that the model has not been re-run with a 100% retention (at §2.42). That was what the Lord Chancellor was told by his officials (November Submission, §45). But Ms Massey's evidence (§§169-175) is that alternative modelling was run in July 2014 which considered different variations of the 50% OCW and 15% latent capacity assumptions, including an assumption of 100% OCW retention. This is the fourth of the four pieces of analysis upon which she relies. Given the express assurance in the pre-action response letter [CB/tab24/§68] both that no alternative results from the modelling with different assumptions had been obtained, and that the Lord Chancellor did not possess an executable version of the model, the Claimants do not understand how this analysis was carried out. No explanation is given.

74. The modelling set out by Ms Massey, §173 shows that where 100% OCW is retained (but with 15% latent capacity) there is a growth requirement in 80% of firms, with an overall growth requirement of 43% amongst those firms. That amounts to an average of three new staff members (six in London). If the 15% latent capacity is also removed, that rises to an average of four new staff (seven in London) and an intimidating growth requirement of 51% applicable to 91% of firms. Again, these firms are "bidding firms", which are assumed to be the few largest firms in each procurement area, so the growth challenge for smaller firms which may wish to bid will be substantially greater. These growth requirements are, of course, in addition to those suggested by the analysis considered in §45 above, which proceeded on the basis that KPMG's assumptions were correct.

75. Therefore, it would appear that a limited attempt was made to model variations on two of KPMG's assumptions. But – like the other analysis (Ms Massey's third piece) which

suggested inconveniently large growth requirements - this analysis was not drawn to the attention of the Lord Chancellor. And there was no attempt to investigate whether the growth requirements suggested were achievable or not.

D. <u>Failure to reach a reasonable decision</u>

76. Standard public law principles dictate that a decision-maker must take account of all relevant considerations, must adopt reasoning which does not contain logical flaws (per Sedley J in *R v Parliamentary Commission for Administration ex parte Balchin* [1998] 1 PLR 1) or material errors (as to which, see *Gibraltar Betting & Gaming Association Ltd v Secretary of State for Culture, Media and Sport* [2014] EWHC 3236 (Admin), §100). He must take a decision which is reasonable in the circumstances. "Reasonable" in this context does not mean "irrational":

> The common law no longer insists on the uniform application of the rigid test of irrationality once thought applicable under the so-called *Wednesbury* principle.
>
> ...both reasonableness review and proportionality involve considerations of weight and balance, with the intensity of the scrutiny and the weight to be given to any primary decision maker's view depending on the context.

See *Kennedy v The Charity Commission* [2014] 2 WLR 808, §§51, 54 *per* Lord Mance; also *R (Sandiford) v Secretary of State for Foreign and Commonwealth Affairs* [2014] 1 WLR 2697, §66 *per* Lords Carnwarth and Mance).

77. Similarly, in *R (Lumsdon and others) v Legal Services Board* [2014] EWCA Civ 1276, the Court of Appeal noted that "[t]he intensity of a reasonableness review will vary according to its context" (§80) and held that the Divisional Court had been correct to apply "a "heightened" *Wednesbury* standard of review". That was because "[t]he court enjoys a high level of institutional competence and constitutional legitimacy when addressing challenges to the criminal justice process. This should be reflected in the applicable common law standard of substantive review" (§86). Exactly the same approach should apply in the present case, for the reasons recognised by Burnett J.

Unreasonable adoption of KPMG's assumptions

78. The Claimants recognise that financial modelling requires the adoption of assumptions which are predictive estimates only, based upon the market as a whole. The selection of those assumptions is, of necessity, a matter of judgment based upon the available evidence and relevant experience. This does not, however, entitle the Lord Chancellor to adopt assumptions which are contrary to the evidence available to him, and to common sense. The significant assumptions adopted in the KPMG Report are flawed and unsubstantiated; three in particular are challenged in these proceedings. Their adoption undermines the DPW contract numbers which the model produced.

79. The Claimants accept also that the various assumptions adopted by KPMG are not completely severable (Detailed Grounds, e.g. §105). It is, however, difficult to see how they can be critiqued otherwise than individually (as the Lord Chancellor did in the Decision). Moreover, focus on the cumulative effect of the assumptions does not enhance the Lord Chancellor's case, but highlights that in order to be able to meet the capacity and viability challenges of 527 DPW contracts firms must grow organically (without merger etc.) by 20% <u>and</u> exploit existing 15% latent capacity <u>and</u> make staff cost efficiencies of up to 20% <u>and</u> give up 50% OCW <u>and</u> volumes of work must remain constant <u>and</u> (after all that) be able to survive on 0.1% profit (notwithstanding other costs not taken into account). That cumulative picture only emphasises the colossal expectations being placed upon criminal legal aid firms, in order to make the Lord Chancellor's model work.

80. First, KPMG's model assumed that a DPW contract would be viable if it was capable of producing any positive profitability, i.e. a 0.1% profit [CB/tab14/p34]. No evidential source is cited for this assumption. It is unjustifiable:

(1) The Otterburn Report (and the PA Consulting Report) set out in detail the financial fragility of the criminal legal aid market (before the first 8.75% fee reduction). Most firms did "not have significant cash reserves or high excess bank facilities" and "Margins in crime are very tight, especially in London" [CB/tab15/p5, 7]. The market is not one which can live on its reserves if a 0.1% profit is achieved. It is a business necessity to be able to make provision for unexpected expenditure, or drops in income, and a 0.1% margin provides no room for such provision.

(2) The Lord Chancellor wants firms to consolidate in order to bid for the larger DPW contracts and restructure the market. Consolidation, be it a merger or a delivery partnership, requires investment funding. KPMG itself indicated that that "any structural change within an organisation will likely incur investment costs [and] .. the scale of this cost has not been estimated" [CB/tab14/p57]. No commercial lender will provide funding to cover those investment costs against a published financial model which assumes only a 0.1% profit: Waddington 1st, §97.

(3) The re-consultation response of Otterburn addressed this issue in the clearest terms [CB/21/2]. Referring to the need to assume at least a 5% profit margin:

> This profit is needed to provide working capital and the cash needed to run a contract. Without this firms would be highly vulnerable to any cash flow issues, and in particular would not be able to survive any delays in payments by the LAA, which, for various reasons can occur. We do not believe that a break-even figure would enable firms to remain in the market when developments in IT and changes introduced by the new contracts themselves will require increased investment. They would not be able to generate the working capital and reserves essential to run any business and would be highly likely to fail. We do not believe they would be viable businesses and may have difficulty obtaining bank finance as their business case would be so weak.

(4) The model does not in fact guarantee even a floor of a 0.1% profit, because the costs not accounted for by KPMG in the breakeven assumption include: investment costs to achieve growth, consolidation or staff cost efficiencies; necessary increases in working capital and the additional costs likely to be incurred by multi-firm consortia. Given those excluded costs, the breakeven assumption adopted represents, in fact, a significant loss for most firms. The Detailed Grounds do not address this point. Further, the MoJ expects firms to sustain variations in income arising from fixed fees and variable case mixes of plus or minus 3% (Gibby, §129 [Vol1/tab6]); this will also detract from the profit "floor". The November Submission does not inform the Lord Chancellor of these important shortcomings in the 0.1% assumption.

81. The Lord Chancellor's defence of this assumption is that 0.1% is a "floor" not an "aspiration", and that any level of profit is still a profit: Decision at §§2.53, 2.55. His Detailed Grounds fail to add anything to this meaningless assertion. The only policy

objection he takes to the suggestion that the model adopt the 5% average profit margin recommended by Otterburn is that there is no justification for an assumption that "providers should make a significant profit from work which is publicly funded": at §2.53. This is no answer at all to the reasonableness of the assumption. A 5% profit is not "significant", but is a necessity (as Otterburn explains) and a profit is not a profit at all or a "floor" where it fails to consider a range of costs which the Lord Chancellor himself expects firms to incur.

82. The Detailed Grounds argue that the 0.1% assumption is made by reference to the smallest bidder (§106) and that larger bidders may make more profit. However, as the KPMG Report makes clear, that bidder is "the smallest firm which [currently] had sufficient capacity to deliver the proposed contract" [CB/tab14/p34]. Any firm which has to grow or consolidate to reach the contract value (and spend the money to do so) will be consequently unlikely to make any profit at all. Since many areas have, on KPMG's analysis, only one or two incumbents of scale, the modelled firm is very often the largest or second largest in the procurement area [e.g. CB/tab14/p44]. Moreover, the Lord Chancellor's expectation that larger firms will earn greater profits than the smallest bidder is not borne out by KPMG's own figures, for example on rural firms, which show staff costs rising significantly as a percentage of revenue as the firm grows [CB/tab14/p21].

83. Ms Massey argues that the complaint about 0.1% profit mostly relates to firms coping with the initial change and not to the market in a "steady state" (§158). That is plainly wrong; the assumption makes no financial sense at any stage (although it is especially egregious where the market is being asked to invest to consolidate and scale-up). Her contention that "a provider that successfully restructures and secures a DPW contract is likely to have increasingly lower overheads and will start to realise efficiencies of scale" (§159(b)) betrays a misunderstanding both of basic economics and of the KPMG model. Restructuring to win a contract requires investment and additional finance costs and KPMG themselves stated that there was limited scope for savings on fixed overheads. Moreover, it will not be enough to "start to realise economies of scale": firms must make staff costs efficiencies of almost 20% from the start of a contract in order simply to break even. The fact that Otterburn reported a number of firms to be clinging on despite making losses does not support the Lord Chancellor (cf Massey, §159(e)) but provided a

further stark warning about the risks involved in proceeding with contracts which are (imperfectly) modelled only to break even.

84. Second, KPMG adopted an assumption that firms could take on 20% more staff through organic growth (that is, without mergers or other more fundamental change) [CB/tab14/p32]. This assumption was said to have been derived from discussions with the MoJ; no evidence for it has ever been provided. The Lord Chancellor seeks to defend the assumption on the flawed basis that the responses focussed on current market operation, rather than the restructured market. While the Claimants accept that a firm which has successfully tendered for a DPW contract is likely to benefit from a job market awash with solicitors from unsuccessful firms, that does not answer the practical difficulties with organic growth - in particular the further costs involved - which consultees relied upon:

(1) Any growth, before or after tendering, requires investment. That funding, as set out above, is not available in a financially fragile market, looking ahead to (at best) marginally profitable contracts.

(2) A firm has to be able to win a DPW contract before it can rely on that contract to further grow. A tender cannot be submitted which does not set out in detail the staffing that a firm will have to service the DPW contract, and its management experience (see below, §91). Investment has to be made or at least secured prior to tendering, under current market conditions, to allow for sufficient growth to submit a realistic tender.

(3) It remains the case that no evidence has been provided by the Lord Chancellor to answer KPMG's concerns about availability of finance or otherwise to support the organic growth assumption. The only evidence put to the Lord Chancellor himself in the November Submission related to a small number of mergers and acquisitions (that is, inorganic growth) (see §49).

85. Third, the model assumed that firms would give up 50% of their OCW in order to take on DPW, and so would carry on doing only 50% of that work alongside DPW work

[CB/tab14/p34]. This was a compromise figure which did not purport to reflect what any firm would actually do. It is flawed:

(1) The Claimants' evidence, and the re-consultation responses, explain that OCW is the lifeblood of a firm's business. Giving it up would be "commercial suicide": Payton, §21; Waddington 1st, §§10, 106; Nelson 1st, §26. The evidence of those who work in the market is unequivocal. It would also be incompatible with the principles of those who do criminal legal aid work to turn away a client who had returned to the firm, seeking their help in a further matter: Gray, §10.

(2) The nonsense of the assumption was made clear by Otterburn in his re-consultation response: "Any business relies on its regular loyal customer or client base to generate the majority of its income and profits. We believe solicitors' practices are no different from any other business in this respect" [CB/21/2].

(3) It is intended that there be future contract rounds in four or five years' time. Giving up OCW (i.e. turning away clients, who will then go to rival firms) will mean that if the firm fails to win the next tender, it will have no clientele left at all. No business could survive on this model: Waddington 1st, §106.

86. The fact that the model assumes 50% OCW will be given up does not, of course, require any particular firm to do so. But the viability of the model rests on an assumption that 50% of OCW will be given up, even though it would be "commercial suicide". If that assumption is flawed, there is a consequent impact on the capacity of firms to deliver DPW contracts, and therefore the appropriate number of DPW contracts which should be supplied. Even if the Lord Chancellor is right that firms which obtain a DPW contract will be more likely to give up more OCW than they allow for (which is not accepted), he has made no effort to justify the particular figure he has adopted, or rationalise it in the light of workloads or existing market behaviour.

87. Heavy reliance is placed by the Lord Chancellor on the approach of some consultation responses to the effect that they would not give up 50% OCW, but did not have latent capacity or capacity for organic growth either (Detailed Grounds, e.g. §§29 & 105). This is said to be inconsistent. It is not. It is an attempt to make the Lord Chancellor

understand that the capacity assumptions he is relying on so that the DPW contracts can be serviced are flawed; the answer to the objection should not be that the objections are wrong, but that the model is wrong.

E. The Tender Process

88. It is not in dispute that the Decision setting a two month tendering window is subject to the Public Contracts Regulations 2006 ("**PCR**") and that the Lord Chancellor is subject to the requirement in reg. 4(3) that he treat economic operators equally and in a non-discriminatory way and act in a transparent way. Nor is it in dispute that the EU law derivation of the PCR means that the Decision must be compatible with the principle of proportionality, and that the Decision must be a reasonable and rational one.

89. Tenderers must be placed in a position of equality both when they formulate their tenders and when those tenders are being assessed: Case C-19/00 *SIAC Construction Ltd v Mayo County Council* [2001] ECR I-7725 at §34. It is acknowledged that an evaluation criterion which can only be satisfied by a small number of tenderers, or which some tenderers find it easier to satisfy than others, may not thereby be discriminatory (cf Detailed Grounds, §60), but here it is not the tender criteria themselves which are challenged, but the two month tender timetable which has been adopted by the Lord Chancellor, which runs contrary to his own stated rationale of encouraging market consolidation and permitting smaller firms to compete for DPW contracts.

90. The Claimants do not suggest that a two month tender window will always be unlawful, but that it is too short a window in these particular, unique, circumstances where very substantial market changes are being required in order for the new contracts to be performed. Although interim relief was granted to suspend the tender process, if the Lord Chancellor is successful in these proceedings, the window will remain at two months.

91. The Claimants highlight the following elements of the tender and its context which disadvantage smaller firms:

(1) Just 4% of the criminal legal aid market is made up of firms with 15 or more duty solicitors (and, as already noted, 76% of the market is comprised of firms with between one and five duty solicitors [Vol1/tab7/p16]). Accordingly, only a very small percentage of firms as currently constituted can tender individually for the large DPW contracts available under the Decision.

(2) The final number of DPW contracts available to tender for in each area, their values, and the requirements and criteria of the tender, only became available on 27 November 2014. Until then, it was uncertain for any particular firm how much additional capacity it would have to access in order to bid for a contract and which other firms were suitable bidding partners. The Decision included changes in relation to split procurement areas, altering the ability of firms to bid: Cox, §§8, 13 (and see the Statement of Facts and Grounds at §§46-49). The contract values also differed from those announced in February.

(3) Even if it were possible within the two month timeframe provided, firms cannot now merge, form joint ventures, or otherwise create new legal entities because a DPW contract bidder must be the "same entity" which already holds an OCW contract (IFA, §2.6). The OCW contract tender process closed on 23 May 2014.

(4) If a firm wished to form a delivery partnership, as the Lord Chancellor expects the majority of applicants to do, it must have in place "a formal written agreement" with each of its delivery partners by 29 January 2015 (IFA, §2.19). It must have completed due diligence on its delivery partners (IFA, §2.22). A delivery partner cannot be changed during the tender process (IFA, §2.26) and there is no obligation on the LAA to accept a change in delivery partner after the award of a DPW contract (IFA, §7.24). The Law Society's estimate is that the agreement of a delivery partnership will take 5-6 months [Vol1/tab7/p85].

(5) Although an agent (which must also hold an OCW contract) may be used for up to 25% of the contract work, no consideration is given in the award of marks for capability provided through an agent (IFA Technical Envelope, Annex C).

(6) The demonstration of capacity to perform the DPW contracts requires details of "all staff members it will Employ" on DPW, including vacancies (IFA, §3.36). A full staffing plan is therefore required by the close of the tender.

(7) The process poses particular challenges for new entrants (see Gascoyne, §§6-14), notwithstanding that KPMG assumed two new entrants bidding in each procurement area and two or four in London areas.

(8) The tender process itself is a lengthy and time-consuming exercise for small firms to complete, when they also have fee-earning responsibilities: Gray, §7. In evidence opposing the grant of interim relief, Mr MacMillan, head of the Criminal Legal Aid Policy Team, noted that "It is the first time that Crime practitioners have been involved in a process such as this. The assessment is complex": §11.

92. Firms cannot reasonably be expected to have taken substantial preparatory steps prior to the commencement of the tender process, not least because the rules of the process have changed since it was first announced in February 2014. For example:

(1) The full rigour of the restriction on DPW contracts to the "same specific legal entities that are awarded an Own Client Contract" [Vol2/tab32/p2] only became clear in the OCW IFA published on 25 April 2014. The February response had not been so explicit, stating only that "Organisations must be awarded an Own Client Work contract to be invited to apply for a Duty Provider Work contract" (buried in Annex C to the response document [Vol2/tab16/p68]).

(2) The draft Initial DPW Contract Specification published in July 2014 stated at clause 1.8 that "You must...have capacity to deal with increases in the level of Contract Work up to 50%...on an ongoing basis" [Vol2/tab47]. No such term appears in the current DPW contract, because the 50% additional capacity is no longer an absolute requirement but something which will give rise to higher marks for a tender.

(3) Similarly, a DPW Additional Information document published during the OCW tender states that "The tender requirements will include a basic capacity

test...that bidding organisations (or their Delivery Partners) employ at least one full time fee earner with relevant experience of crime work for every £83k of the indicative contract value" [Vol2/tab48/p6]. Under the DPW IFA, this is not a requirement; again, it is a matter which accumulates a higher score.

It would be unfair to expect firms to make the considerable investment in merger, delivery partnerships and other measures to acquire capacity before they understand precisely what will be *required* of them in capacity terms (as opposed to what will generate higher marks, and so could potentially be sacrificed on a cost-benefit basis).

93. In effect, the Lord Chancellor has repeated the error of the Legal Services Commission in *R (Law Society) v Legal Services Commission* [2010] EWHC 2550 (Admin), in which a family law tender procedure was challenged (*inter alia*) for the announcement of tender criteria at the outset of an eight week tender window which included accreditation on particular panels. If a bidder did not already have that accreditation, it could not be obtained within the tender window. The Commission had stated that it expected the majority of existing providers to continue to provide services under the new contracts. The Divisional Court found, at §96 (and §§104-107), the Commission's approach to be irrational:

> If the purpose of the selection criteria was to rank bids in order of merit, as she says, there is no reason that we can understand why a provider should not be given a fair opportunity to acquire the necessary accreditation. Merit is to be assessed by accreditation. The more existing providers able to demonstrate the excellence of their qualities, the greater the chance that the LSC could achieve its objective. Depriving providers of the opportunity not of claiming but achieving accreditation impedes those objectives. It is irrational because it unfairly and arbitrarily reduces the number of those who would otherwise have been awarded maximum points. If those who gain maximum points are, as we are prepared to accept for the purposes of this argument, those who are best able to provide the services needed, there is no reason to reduce their number by failing to explain the importance of accreditation on both the specified panels, and give an opportunity for such accreditation. Such a reduction merely diminishes the pool of those with accredited knowledge, commitment and experience.

Here, giving firms an arbitrary two months in which to make the required consolidation arrangements deprives them of a fair opportunity to adapt and grow, as the Lord Chancellor wishes them to do, and undermines the very rationale for the Decision by precluding firms from consolidating.

94. The Lord Chancellor has not articulated any coherent justification as to why the two month window is required given that he proposes that the LAA will take some four and a half months to evaluate the tenders.

(1) Even on the Lord Chancellor's own advertised timetable, contracts will not be awarded until June 2015 and work under them will not begin until October 2015. There is ample time within the overall timetable for a longer tender period; at worst, the LAA would have to assign more manpower to the evaluation of tenders.

(2) There is in any event no particular advantage to be gained by awarding DPW contracts at the earliest possible opportunity. The second tranche of the fee cut has now been promised for July 2015 (subject to two outstanding reviews of the criminal justice system: Decision, §§3.6-3.7), and so is not dependent upon the start of the new contracts (Waddington 1st, §189). So a shorter tender period does not "save" money and the Lord Chancellor was advised by officials that introducing the second fee cut in advance of the new contracts would not cause significant difficulties (November Submission, §103).

(3) Although the current standard crime contracts expire in July 2015, the Lord Chancellor has already taken steps to extend them so there is no danger of any gap in service provision being caused by a longer tender period. Contrary to §147 of the Detailed Grounds, the First and Second Claimants have not advised their members not to sign the proposed extensions; they have simply suggested waiting whilst advice is taken. No final decision has been made: Waddington2, §99. Given that there are 1600 existing holders of a DPW contract, and there will be only 527 under the new model, the number of potential providers not currently holding a contract (whom the Lord Chancellor says may be disadvantaged by a contract extension: Detailed Grounds, §147) is likely to be minimal, especially given the difficulties for new entrants.

(4) The short tender period runs directly contrary to the Lord Chancellor's avowed intention, that the market can and should consolidate, by merger, delivery partnerships etc. It has not been his express aim to exclude smaller firms, far from

it, and it may be that he has simply not appreciated the impact of his actions. If it is truly his intention to advantage the largest firms, that would be grossly unfair to the great majority of dedicated practitioners, who work in smaller firms (in order to make criminal legal aid work pay), and deserve at least a genuine opportunity to compete to carry on businesses they have worked hard over the years to build up: Waddington 1st, §§132-135. Smaller firms provide a wealth of expertise which is greatly valued by their clients, and should be valued by the legal aid system as a whole; it ought not to be lost effectively by default.

95. Nor does it assist the Lord Chancellor to say (Detailed Grounds, §144) that if there are no bidders of scale, firms only able to deliver a lower volume will be selected to fill the void. It can be no answer to a claim of unequal treatment that the unequally treated bidder might nevertheless be successful; and it is unrealistic, since firms who cannot acquire sufficient capacity in time will not bid at all rather than incur the expenses of bidding in the hope that no firms with sufficient capacity will participate. A lengthier period of time would give smaller firms a better chance to consolidate and meet the tender criteria: Nelson 1st, §24; Payton, §§13-15; Cox, §§18-19.

96. Accordingly, it is submitted that the Decision to set a tender window of two months critically disadvantages the ability of firms which have to consolidate to submit a realistic bid for a DPW contract, in favour of the limited number of firms which already possess existing capacity. That Decision is contrary to the requirement of equality of treatment, disproportionate and unlawful.

F. <u>Article 1 of the First Protocol</u>

97. Criminal legal aid firms have goodwill, in their OCW. OCW is the essence of a firm's goodwill because it is the source of continuing instructions: Waddington 1st, §10. Firms rely on DPW not for its own worth, but to assist in replenishing OCW: Payton, §§10-11, 16-20; Waddington 1st, §10. Contrary to the Lord Chancellor's analysis in the Detailed Grounds (§§153-154), DPW contracts are not relied upon as possessions under A1P; it is the goodwill, located in the OCW, which is the possession.

98. The Decision, by limiting the number of DPW contracts to 527, threatens to destroy the goodwill of many firms:

(1) A large number of firms will not obtain DPW contracts. That would not be offensive to A1P in and of itself, but the removal of the opportunity to act as a duty solicitor will have the effect that those firms will fall into financial difficulties. Many will close: see, e.g., Nelson 1st, §§28-30; Payton, §§16-20. The practical effects of the Lord Chancellor's decision will inevitably be that a large number of existing, currently profitable, criminal legal aid firms (or practices within firms) across England and Wales will go out of business: Burnett J at §§16, 47 and 50.

(2) Even for those firms which do obtain a DPW contract, on the Lord Chancellor's own reasoning, and financial modelling, those firms will be expected to give up, on average, 50% of their OCW in order to service that contract. They will not of course be legally obliged to do so, but KPMG and the Lord Chancellor confidently expect that this is in practice what will have to happen. That is a further interference with the possessions of the firms such as the Third and Fourth Claimants, as well as those represented by the First and Second Claimants.

99. Contrary to the Lord Chancellor's submissions (Detailed Grounds, §150), this claim is not out of time. There was a "fresh decision" (Detailed Grounds, §100) in November 2014, which the Third and Fourth Claimants are entitled to challenge. If the Claimant associations had relied upon Article 1P in their first claim, they would have been met the response that they were not entitled to complain under the Human Rights Act 1998 as they are not "victims", as required by s. 7(1)(a) HRA.

Interference with Possessions

100. It is settled that commercial goodwill is a "possession" for the purposes of Article 1P. As it was put in *R (Malik) v Waltham Forest NHS Primary Care Trust* [2007] 1 WLR 2092, §29: "there is clear Strasbourg authority ... and domestic authority ... that the assets of a business may include possessions for the purposes of article 1 in the form of "clientele" or goodwill of the business. Where such clientele/goodwill exists, measures that

diminish its value, as, for example in *Van Marle v The Netherlands* (1986) 8 EHRR 483, interference with professional practice, may engage article 1".

101. This approach was reaffirmed in *Malik v UK* (Application No 23780/08), where the European Court held that "law practices and their clientele were entities of a certain worth that had in many respects the nature of a private right and thus constituted assets and therefore possessions". This applied whether the possession was acquired solely through the practice's own work, or by "taking advantage of a favourable position" (§89). The revocation or withdrawal of a licence or permit to carry on an activity will constitute an interference with a right of peaceful enjoyment of the economic interests of the underlying business (§§91-92). Significantly, goodwill is a legitimate element of the valuation of a professional practice, but must be distinguished from future income, which is only a possession once earned or contracted for (§93).

102. The Divisional Court in *R (Lumsdon) v Legal Services Board* [2014] EWHC 28 (Admin) recently considered whether or not the Quality Assurance Scheme for Advocates interfered with the possessions of criminal barristers. It concluded that barristers did not have clientele or goodwill analogous to "a GP's patient list": they might have repeat clients, but they did not possess "something which is marketable" (§127). This is clearly correct: no barrister can sell on his practice to a successor. The Court considered that the "advocate employee" (i.e. the criminal barrister employed by a law firm) was the "strongest case", but that in that situation "it is the firm, not the advocate, which has any marketable goodwill" (emphasis added).

103. Applying these principles, the Decision interferes with the commercial goodwill and business practice of the firms represented by the Claimant associations and of the Third and Fourth Claimant firms. Solicitors' firms are ongoing businesses which can be, and are, taken over, merged or sold. Part of their value is their clientele and goodwill. That marketable value will be adversely affected by the Decision: firms which fail to obtain a DPW contract face the closure of their businesses, and the Decision is premised upon an assumption that at least some successful firms will turn away their clientele and so give up substantial parts of their goodwill. The claim is not one based upon possible future earnings from a DPW contract of any particular size but concerns interference with the existing possessions of firms, which are protected by A1P.

Justification for the Interference

104. Where goodwill is interfered with, the test for justification for such an interference is set out in *Bank Mellat v HM Treasury (No.2)* [2014] AC 700 at §20 *per* Lord Sumption:

> ...the question depends on an exacting analysis of the factual case advanced in defence of the measure, in order to determine (i) whether its objective is sufficiently important to justify the limitation of a fundamental right; (ii) whether it is rationally connected to the objective; (iii) whether a less intrusive measure could have been used; and (iv) whether, having regard to these matters and to the severity of the consequences, a fair balance has been struck between the rights of the individual and the interests of the community. These four requirements are logically separate, but in practice they inevitably overlap because the same facts are likely to be relevant to more than one of them. Before us, the only issue about them concerned (iii), since it was suggested that a measure would be disproportionate if any more limited measure was capable of achieving the objective. For my part, I agree with the view expressed in this case by Maurice Kay LJ that this debate is sterile in the normal case where the effectiveness of the measure and the degree of interference are not absolute values but questions of degree, inversely related to each other. The question is whether a less intrusive measure could have been used without unacceptably compromising the objective.

105. Those principles must be applied taking into account the serious impact of the Decision on the Third and Fourth Claimants, and on the clients of those firms. Hundreds of small practices, built up over many years of hard work for modest reward, and which are currently (just) profitable, will be forced out of business. Clients of those firms, often vulnerable individuals, will no longer be represented by those they trust. Access to justice will be seriously endangered. These impacts demand the closest judicial scrutiny of the Lord Chancellor's actions.

106. The Lord Chancellor relies upon the aim of effecting savings from the legal aid budget in the context of a difficult financial climate. The Claimants accept that this is, in the abstract, a legitimate aim, and that the reduction of DPW contracts in order to force market consolidation so that fewer larger providers can better withstand further fee reductions is a measure which can be said to be rationally connected to that aim.

107. However, less intrusive means could have been used to achieve that aim and the means actually chosen do not strike a fair balance between the interests of those affected and the general interest in reducing public expenditure. The Lord Chancellor has chosen to

implement an immediate and very substantial cut of two-thirds in the number of contracts for DPW, which requires very substantial market consolidation. His reasons for assuming that the necessary degree of consolidation is achievable do not stand up to the intense scrutiny required by the *Bank Mellat* test, given in particular (a) the failure to investigate the practical realities of whether consolidation is achievable, (b) the very serious difficulties which firms face in seeking to acquire additional capacity, and (c) the tendering decisions taken by the Lord Chancellor which have prevented firms from doing what he says he wishes them to do. Restructuring could have taken place over a longer period of time, with a more gradual reduction in contract numbers, thereby allowing the market to adjust in an orderly way. Cost savings may be necessary, but to force hundreds of firms out of business, giving no time for considered consolidation, to achieve those savings is to use a hammer to crack a nut.

108. As a discrete point, the requirement that tenderers bid in the current tender timescale (27 November 2014 – 29 January 2015) is an unnecessarily intrusive interference with their possessions, particularly for those which cannot tender successfully in that time period. This prejudices those firms which cannot make arrangements to scale up properly in the very short period (Nelson 1st, §§20-24; Payton, §§12-14; Cox, §§18-19), and those new entrants which find the burdens imposed too great to discharge in that period: Gascoyne, §§4-14. It is difficult to see how this could be justified, given the far longer period which the MoJ has allocated to itself to award the tenders and the pressing public and constitutional interest in maintaining a functioning criminal legal aid system.

109. Even if the Lord Chancellor's approach did represent the least restrictive means available, it would remain disproportionate. There is no sufficient imperative to save costs that could justify this level of destruction of the criminal justice system.

G. <u>Relief</u>

110. For the reasons set out above, it is submitted that the Decision should be quashed.

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