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Case Nos: C1/2015/0558
C1/2015/0584

IN THE COURT OF APPEAL (CIVIL DIVISION)
ON APPEAL FROM THE HIGH COURT OF JUSTICE
QUEENS BENCH DIVISIONAL COURT
THE RT. HON. LORD JUSTICE LAWS AND
THE HON. MR JUSTICE CRANSTON
[2015] EWHC 295 (Admin)

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 25/03/2015

Before :

THE MASTER OF THE ROLLS
LORD JUSTICE ELIAS
and
LORD JUSTICE SALES

Between:

(1) The Queen on the Application of the Law Society
(2) Criminal Courts Solicitors' Association and Others
- and -
The Lord Chancellor

Appellants/
Claimants

Respondent
/Defendant

Ms Dinah Rose QC and Mr Ben Jaffey (instructed by Bindmans LLP)
for the First Appellant/Claimant
Mr Jonathan Swift QC, Ms Joanne Clement and Mr Rupert Paines
(instructed by Kingsley Napley LLP) for the Second Appellant/Claimant
Mr Martin Chamberlain QC, Mr Nicholas Moss and Simon Murray
(instructed by The Treasury Solicitor) for the Respondent/Defendant

Hearing dates: 10 -11 March 2015

Approved Judgment

Lord Justice Sales:

Introduction

1. This is the judgment of the Court, to which all its members have contributed, on an appeal from the judgment of the Divisional Court (Laws LJ and Cranston J) at [2015] EWHC 295 (Admin). In that judgment, the Divisional Court dismissed claims for judicial review of the decision of 27 November 2014 by the Lord Chancellor (“the November 2014 decision”) to introduce a tendering process for 527 contracts for solicitors to provide Duty Provider Work (DPW) across England and Wales, to advise criminal suspects at local police stations and, in certain circumstances, at magistrates’ courts. For ease of reference, we will refer to the appellants as the claimants, as in the Divisional Court (the London Criminal Courts Solicitors’ Association and others being the first claimants and the Law Society the second claimant).
2. The Lord Chancellor’s decision to introduce 527 DPW contracts is one part of wider reforms of the legal aid system in the area of criminal law, according to which fee reductions of 17.5% are to be introduced alongside a restructuring of the market for provision of legal services. In very summary terms, the limited number of new DPW contracts proposed will provide a flow of work under each contract which it is hoped will encourage consolidation of providers in the market, so that they are able to absorb the reductions in fees by taking advantage of economies of scale and by being able to deal with a wider spread of cases which will allow providers the better to average out profit-making and loss-making cases so as to realise overall profits on a ‘swings and roundabouts’ approach.
3. Whether this will in fact be the effect of the reforms is very controversial. It is strenuously contested by the claimants. They say that the Lord Chancellor has not made a proper and lawful assessment of the likely impact of his proposed reforms on the legal services market: his assessment is based on a number of unsustainable and irrational assumptions.
4. At the centre of the claimants’ case is the contention that, in his assessment, the Lord Chancellor has simply left out of account an important element of costs which will have to be incurred by providers in restructuring their affairs to put themselves into a position to bid for and implement the proposed DPW contracts while sustaining their own commercial viability. We will refer to these costs as “investment costs”: they include the costs of funding any increased working capital needed to provide a service under larger DPW contracts, costs involved in achieving staff efficiency levels implied by the proposed contracts and costs involved in achieving consolidation to bid for and implement those contracts. The Lord Chancellor has set as one objective of his reforms that the DPW contracts should be large enough in volume and value to be “sustainable in their own right” and in his assessment that objective will be fulfilled in relation to the proposed 527 contracts. However, the appellants contend that by leaving investment costs out of account in the way they say he has done, the Lord Chancellor has acted unlawfully and could not rationally conclude that his objective that the DPW contracts be sustainable in their own right will be met.

5. In the Divisional Court, Laws LJ made the following introductory remarks to set the present dispute in context, which we gratefully adopt:

“1. These applications concern proposals by the Lord Chancellor to make profound changes in the market for the provision of criminal legal aid services by solicitors. The essence of the policy is the introduction of two types of contract to be entered into between his department, through the Legal Aid Agency (LAA), and the profession: contracts for Own Client Work (OCW) and contracts for Duty Provider Work (DPW). OCW consists in cases where the client comes to the solicitor because he chooses to engage that firm. DPW consists in casework carried out by solicitors on duty at local police stations (and in some circumstances magistrates courts), where they advise and represent persons detained or brought there. Under the existing regime some 1600 Standard Crime Contracts are in place, under which firms carry out both kinds of work.

2. The Lord Chancellor does not intend to impose any limit on the number of OCW contracts, and some 1808 such contracts were awarded in June 2014 and are due to be operated from summer 2015. But by his decision of 27 November 2014, sought to be challenged in these proceedings, he proposes to restrict the number of DPW contracts to 527. Alongside this dual contract system the Lord Chancellor introduced a cut in legal aid fees of 8.75% on 20 March 2014, and a further cut of 8.75% is now planned for July 2015.

3. There are two sets of proceedings, though their target is the same and the proposed grounds of challenge tend to converge. Both are applications for permission to seek judicial review of the November 2014 decision. In the first there are four claimants, the London Criminal Courts Solicitors Association, the Criminal Law Solicitors Association, Nelson Guest & Partners and Payton's Solicitors. I shall refer to them compendiously as the first claimants. The Law Society is the claimant in the second application. The Lord Chancellor is the defendant in both. Directions have been given in both claims (by Holroyde J in the first on 19 December 2014 and by Jay J in the second on 22 December 2014) for an expedited rolled-up hearing of the permission applications with the substantive judicial review to follow if permission granted. On 23 December 2014 Jay J ordered that the tender process for the DPW contracts should be suspended until after judgment in the proceedings.

4. The principal focus of both claims is the Lord Chancellor's use, in arriving at his decision, of a Report

published in February 2014 which he had commissioned from KPMG and which I will describe in greater detail. The figure of 527 DPW contracts was derived from a model developed in the KPMG Report. The model proceeded on various assumptions. KPMG gave warnings about unknowns and uncertainties inherent in the model's application, in particular as regards the need for investment finance that would be required for firms to achieve improved staff efficiency and to restructure or consolidate: these were, and are, evolutions seen as essential to the dual contract scheme.

5. The Law Society's principal complaint, advanced by Miss Dinah Rose QC, is that the Lord Chancellor's adoption of the 527 figure ignores the fact that the KPMG assumptions (especially what may be called the "break-even" assumption: see further below) take no account, as KPMG themselves made clear, of the cost of the investment finance which would be needed for firms to improve efficiency and restructure or consolidate to meet the challenge of the new system; that the Lord Chancellor misunderstood (or failed to take into account) what KPMG were saying about investment finance; and that since receiving the report he has taken no steps to inform himself of the likely realities, for example by obtaining information from financial institutions, against a background in which there was substantial evidence that law firms would find it difficult to obtain funds. Miss Rose also submits that the Lord Chancellor's response to the difficulty – a reliance on support packages – is flawed, principally in relation to his proposals for interim payments.

6. ... [Laws LJ referred here to the arguments below for the first claimants, which have been refined for the purposes of this appeal: see below]

7. Aside from the point on [Article 1 to the First Protocol to the European Convention on Human Rights – “A1P1”], the challenge falls under two heads of claim. (1) There is a breach of the Lord Chancellor's duty articulated in *Tameside* [1977] AC 1014 (*per* Lord Diplock at 1065) to "ask himself the right question and take reasonable steps to acquaint himself with the relevant information to enable him to answer it correctly". (2) The decision has been unfairly arrived at and is unreasonable. ...

8. This is not the first judicial review directed to this policy initiative by the Lord Chancellor. On 27 February 2014 he issued an earlier decision, to the effect that there would be 525 DPW contracts. The first 8.75% cut in criminal legal fees was announced at the same time. The 525 figure, like

the later 527 figure, was based on KPMG's model. The assumptions on which it proceeded and which were set out in the KPMG Report were largely developed by the Ministry of Justice in light of a Report from Otterburn Legal Consulting LLP commissioned by the Law Society. KPMG's Report, together with the Otterburn Report, was as I understand it published at the same time as the February decision (it was re-issued on 11 March 2014). This earlier decision was challenged before Burnett J, as he then was, on the ground that fairness required the Lord Chancellor to disclose the Otterburn and KPMG Reports so that representations might be made as to their contents; that had not been done before the decision. There was also a challenge to the proposed cut in criminal legal fees. Burnett J rejected the latter complaint, but held (with respect, plainly correctly) that the Otterburn and KPMG Reports should have been disclosed for consultation. His judgment was given on 19 September 2014 ([2014] EWHC Admin 3020). He quashed the Lord Chancellor's decision of February 2014 to provide for 525 DPW contracts. His account of the background to the case at paragraphs 8 – 31 is very clear and full, and should be read with this judgment: [this is appended as Annex A to this judgment, as Laws LJ appended it to his].“

6. The Divisional Court handed down its judgment on 18 February 2015. Permission to appeal was granted by Moore-Bick and Sales LJ at an oral hearing on 27 February. The appeal hearing was expedited. In the meantime, the interim relief ordered by Jay J was extended.
7. The arguments for the second claimant on the appeal were again advanced by Miss Rose QC. They revolved around issues relating to the extent, if at all, that the Lord Chancellor took into account the investment costs which would need to be incurred by providers in restructuring in order to bid for and then deliver services under the new DPW contracts. These were the same issues which were identified by Laws LJ at para. [53] of his judgment in the Divisional Court:

“1) Did the Lord Chancellor squarely understand that the break-even assumption [i.e. a particular assumption in the KPMG Report that service providers under the proposed DPW contracts would make profits of at least 0.1%] made no allowance for investment costs? If he did not (as the claimants assert he did not), he would have misapprehended a significant dimension of the KPMG material. (2) Should the Lord Chancellor have taken steps to investigate the likely impact of investment costs on firms which might bid for DPW contracts? More accurately: was it perverse not to do so? (3) In the circumstances, are the Lord Chancellor's proposed measures of support (notably interim payments) legally sufficient (in *Wednesbury* terms)?”

8. The Divisional Court held (1) the Lord Chancellor did understand that the break-even assumption in the KPMG Report made no allowance for investment costs (paras. [54]-[55]); (2) the Lord Chancellor acted reasonably in declining to investigate the likely impact of investment costs further than he did (paras. [56]-[62]); and (3) the Lord Chancellor's proposed measures of support, in particular in the form of interim payments of legal aid fees, were legally sufficient in *Wednesbury* terms to address the issue of investment costs (paras. [63]-[74]). On this appeal, Miss Rose submits that the Divisional Court erred in its conclusion on each of these points, though we think it is fair to say that the main emphasis of her submissions was on her challenge to the conclusions in relation to questions (2) and (3).
9. On the appeal, the arguments for the first claimants were presented by Mr Swift QC. Mr Swift adopted Miss Rose's submissions and made some additional submissions to challenge certain other assumptions made by KPMG in their Report and adopted by the Lord Chancellor in his November 2014 decision. Mr Swift maintained that the Lord Chancellor had attached insufficient weight to representations made by solicitor firms regarding what they maintained was the unreality of the assumptions made and had acted irrationally by accepting and proceeding on the basis of the assumptions. On this part of the case, Mr Swift took issue in particular with paras. [79]-[82] and [88]-[89] of the judgment of the Divisional Court, in which it rejected similar submissions made below.
10. In the Divisional Court, the first claimants also advanced submissions based on A1P1. The claim based on A1P1 was rejected by the Divisional Court at paras. [90]-[94] of its judgment. In this court, Mr Swift accepted that on proper analysis, even if well-founded, the claim based on A1P1 added nothing to the other submissions which he and Miss Rose advanced. Accordingly, whilst not formally abandoning this part of the appeal, he did not seek to develop it and Mr Chamberlain QC for the Lord Chancellor was not required to answer it. It is unnecessary, therefore, to say anything more about it.

The legal context

11. Section 1 of the Legal Aid, Sentencing and Punishment of Offenders Act 2012 ("LASPO") provides in relevant part as follows:

"(1) The Lord Chancellor must secure that legal aid is made available in accordance with this Part.

(2) In this Part 'legal aid' means—

...

(b) services consisting of advice, assistance and representation required to be made available under section 13... (criminal legal aid).

...

(4) The Lord Chancellor may do anything which is calculated to facilitate, or is incidental or conducive to, the carrying out of the Lord Chancellor's functions under this Part."

Section 2:

"(1) The Lord Chancellor may make such arrangements as the Lord Chancellor considers appropriate for the purposes of carrying out the Lord Chancellor's functions under this Part.

...

(3) The Lord Chancellor may by regulations make provision about the payment of remuneration by the Lord Chancellor to persons who provide services under arrangements made for the purposes of this Part."

Section 13(1):

"Initial advice and initial assistance are to be available under this Part to an individual who is arrested and held in custody at a police station or other premises..."

12. It was common ground that, under LASPO, the Lord Chancellor has a binding duty to ensure that legal aid in the form of the kind of legal services to be provided under the DPW contracts is in fact provided at local police stations (and, so far as relevant, in magistrates' courts), but that he has a discretion as to how to achieve that end result.
13. Mr Chamberlain realistically accepted that, under these provisions, even if a decision-maker starting with a blank canvas might have a wide discretion how to proceed in order to achieve the result required, he might proceed in stages and gradually structure his consideration of how to move forward. A decision-maker who structured his approach in this way might adopt criteria as a guide for himself. If he does so, the rationality of his decision-making might in principle be tested by reference to the rationality of his assessment whether his own chosen criteria have been satisfied. The rationality of steps in his reasoning could in this manner be assessed in a more precise and determinate way. In the present case, the Lord Chancellor decided that each DPW contract should be "sustainable in its own right". Mr Chamberlain therefore accepted, in this context, that the issue of investment costs was identified as a matter of concern which the Lord Chancellor was obliged to consider and take into account. Mr Chamberlain's submission was that the Lord Chancellor did just that; he made a rational assessment of their impact on the financial modelling he adopted as the basis for determining that there should be the 527 DPW contracts which he proposed to introduce; and he made a rational assessment that those contracts would each be "sustainable in their own right" for the legal services provider who won the tender for it.

14. Mr Chamberlain also submitted that the other assumptions made by the Lord Chancellor which were challenged by the first claimants were rationally defensible and were a proper and lawful basis for his decision to introduce the 527 DPW contracts.
15. An aspect of the arguments in the Divisional Court received greater emphasis in the submissions below as compared with the way in which the appeals were presented in this court. This was the part of the case regarding intensity of review, which the Divisional Court addressed at paras. [25]-[37] of its judgment. In this court, there was little difference between the parties about this. All sides accepted that where a matter is identified by a decision-maker as relevant to his decision, “it is for the decision-maker and not the court, subject ... to *Wednesbury* review, to decide upon the manner and intensity of inquiry to be undertaken into any relevant factor accepted or demonstrated as such”: *R (Khatun) v Newham LBC* [2004] EWCA Civ 55; [2005] QB 37, at [35] per Laws LJ; see also *R (Khatib) v Secretary of State for Justice* [2015] EWHC 606 (Admin), [51]-[52] per Elias LJ.
16. Before this court, the first and second claimants contend that the Lord Chancellor acted irrationally, contrary to the *Wednesbury* standard, either by leaving investment costs out of account in his assessment whether the DPW contracts would be “sustainable in their own right” or by failing to investigate the extent and financial implications of the investment costs. The first claimants also argued that the Lord Chancellor had made an irrational appreciation in respect of each of the other assumptions which they seek to challenge.
17. The claimants contended that the risk posed to fulfilment of the Lord Chancellor’s duty to provide full coverage for legal assistance under the relevant provisions of LASPO was high if the Lord Chancellor had made a mis-prediction about the effect of limiting the number of DPW contracts as he proposed, and that this could be taken to indicate that some higher obligation of investigation arose. However, Mr Chamberlain pointed out that the Lord Chancellor would have a period of months of notice if insufficient providers came forward to bid for the new contracts, before the contracts were supposed to take effect. This would enable the Lord Chancellor to take a range of measures to adapt to such a situation, if (contrary to his considered expectation) it arose, and still ensure that he would fulfil his statutory duty. The Ministry of Justice internal documents made it clear that contingency options had been considered and would be kept under review as the situation developed.
18. In our view, this aspect of the case does not affect the application of the usual *Wednesbury* standard of review in relation to decisions regarding investigative steps, as set out in *Khatun*. The obligation of investigation on the Lord Chancellor regarding the individual commercial viability of the proposed DPW contracts was not a special or unusually heightened form of that normal obligation.

The factual background

19. A good deal of the factual background is explained in the judgment of Burnett J on the previous judicial review, in the section appended as Annex A to this judgment, and is not repeated here. The salient points for present purposes are as follows.

20. On 9 April 2013 the Lord Chancellor launched a consultation in which he made it clear that he sought immediate savings of 17.5% in criminal legal aid, and presented proposals as to how that objective could be achieved. The proposals were highly controversial, and a range of objections was presented in the responses to the consultation.
21. The proposals were modified, and the new proposals were presented in a second consultation paper dated 5 September 2013. As Burnett J explains (paras. [16]-[19] of his judgment: see Annex A), there were two significant changes: (i) the 17.5% reduction in criminal legal aid fees would be introduced in stages, with a first 8.75% cut in the spring of 2014 and a further 8.75% cut in the spring of 2015; and (ii) criminal legal aid work was to be divided between an unlimited number of OCW contracts and a limited number of DPW contracts, with the DPW contracts to be large enough in volume and value to be “sustainable in their own right” after taking into account the full 17.5% reduction in fees.
22. Solicitors who would be affected by these changes urged the Lord Chancellor to undertake research before carrying these proposals into effect. Two reports were prepared to examine the commercial viability of the proposals and what form the DPW contracts should take and at what fee rates to be “sustainable in their own right”: the Otterburn Report (by Andrew Otterburn and Vicky Ling), commissioned by the Law Society in consultation with the Lord Chancellor, and the KPMG Report, commissioned by the Lord Chancellor.
23. The Otterburn Report emphasised that the financial position of many solicitor firms providing services under the criminal legal aid scheme is “fragile”, and that the supplier base is “not financially robust”. In that context, the Otterburn Report took “achieving a 5% [profit] margin as a minimum definition of a viable practice”. The Report also recommended that the fee cut be introduced after consolidation of the market (i.e. not before any new DPW contracts commenced).
24. The KPMG Report set out an analysis regarding the number of DPW contracts which would, in KPMG’s view, be “sustainable in their own right”, meaning that the providers of services under those contracts would be able to be financially viable in providing those services without cross-subsidy from other work. As a result of their analysis, KPMG gave a range between 432 and 525 DPW contracts. As set out in their Report, KPMG made a number of assumptions for the purposes of their analysis, of which the following are relevant on this appeal:
 - i) a firm making any level of profit, however small, would be considered viable (this was variously described as the 0.1% profit assumption or “the break-even assumption”);
 - ii) successful bidders for DPW contracts could achieve a 15% improvement in capacity due to latent capacity within firms and/or reallocation of staff (“the latent capacity assumption”);
 - iii) successful bidders could achieve organic growth of 20% through recruitment (“the organic growth assumption”); and

- iv) successful bidders would create capacity to do DPW work by reducing their OCW work by 50% (“the 50% OCW assumption”).
25. KPMG specifically referred to the investment costs (i.e. costs which providers would be likely to need to incur in order to re-structure their affairs and put themselves in a position to realise the increased efficiency assumed by KPMG in their modelling), but explained that they had not taken those costs into account in their modelling. KPMG said this:

“Investment funding may be required in three areas

- * To fund increased working capital that would arise as a result of larger contracts
- * To fund the investment required to achieve the staff efficiency levels implied by the proposed contracts
 - For example, IT spend on digital technologies and virtual working could increase productivity and enable greater geographic coverage
- * To fund the costs of consolidation as outlined above

We have not sought to quantify the likely size of this funding although we highlight risks to its availability

- * Otterburn’s survey data indicates that firms have limited cash on their balance sheets available for investment
- * Other studies indicate that the market believes that it will struggle to obtain funding from lenders (see page 57)”

(p. 11 of the Report)

...

“Ability to source funds for investment in consolidation

Any structural change within an organisation will likely incur investment costs (professional fees, relocation and redundancy costs, opportunity cost of management time) – The scale of this cost has not been estimated – However, Otterburn analysis demonstrates that providers have limited reserves to fund these costs ...”

(p. 56 of the Report)

...

“Firms are likely to require a level of investment funding to successfully transition to new duty provider contracts

Investment funding may be required in three areas

- * To fund increased working capital that arise as a result of larger contracts
- * To fund the investment required to achieve the staff efficiency levels implied by the proposed contracts
 - For example, IT spend on digital technologies and virtual working could increase productivity and enable greater geographic coverage
- * To fund the costs of consolidation as outlined on the previous slide

We have not sought to quantify the likely size of this funding.

In this context, it is important to note that Otterburn’s survey data indicates that firms have limited cash available for investment

- * The median cash balance across the full sample was £16,490, with a significant range between the upper and lower quartiles and also by size of firm
- * Both the median 13-40 and 40+ solicitor firms were in an overdraft position of -£30,000 and -£371,860 respectively

In addition, the market believes that it will struggle to obtain funding from lenders

- * ‘The investment opportunities which may occur in 2015, such as our applying for contracts in neighbouring areas could not be taken up with our balance sheet taking a further hit...We will simply not be able to secure investment funding’ [Transforming Legal Aid: Next Steps, A Report for the Law Society of England and Wales and the Ministry of Justice’, Otterburn Legal Consulting, November 2013]
- * This aligns with Deloitte’s interview findings with financial service providers: ‘We see the legal aid sector as being challenging in terms of cash flow and profitability, compared to several other areas of legal work’ [Deloitte, ‘The Government’s proposed legal aid reforms: A report for the Law Society’, May 2013]”

(p. 57 of the Report)

26. Investment costs would need to be incurred to assist many providers to achieve scale and efficiencies so as to be able to absorb the full 17.5% fee cut whilst providing the services set out in the DPW contracts. Although KPMG modelled their viability analysis by reference to single firm providers of services bidding for DPW contracts, the Lord Chancellor assessed that many bidders would take the form of delivery partnerships under joint venture arrangements between different firms (“the delivery partnerships assumption”). The costs involved in setting up delivery partnerships would be a sub-set of the investment costs referred to by KPMG, and hence were put to one side by them for the purposes of their analysis.
27. Investment costs could be of different types, as described in general terms by KPMG. Some might be one-off costs (such as the outright purchase of a new computer to increase the productivity of staff), but that would not necessarily be the case (e.g. a computer might be bought on hire-purchase or acquired using money borrowed from a bank, with an ongoing cost of borrowing). The unifying general theme in relation to investment costs is that they represent advance expenditure or financial commitments in order to enable service providers to operate more efficiently and effectively, and hence with a better chance of realising greater profits from their income in future than would otherwise be the case.
28. There is an important issue in this appeal regarding the relationship between investment costs and cash-flow of providers. The claimants contend that these are two very different things, with little or no bearing on each other. The Lord Chancellor, on the other hand, submits that they are inter-connected: an improved cash flow in an early period means that a provider is able to finance investment costs in that period with a view to making greater profits at later stages during the life of a DPW contract. We address this aspect of the dispute in the discussion below. At this stage, however, it is relevant to note that the section at page 57 of the KPMG Report quoted above links availability of cash with the ability to bear investment costs in order to realise later gains, indicating that there is a relationship between improved cash-flow and an ability to incur investment costs.
29. The KPMG Report was eventually put into final form in a version dated 11 March 2014, but it was available to the Lord Chancellor in substantially the same form in February 2014, as was the Otterburn Report. An earlier report by PA Consulting was also available. The KPMG financial modelling was “stress tested” within Government by statisticians before the Lord Chancellor took his decision regarding the number of DPW contracts to introduce.
30. On 12 February 2014, the Lord Chancellor and the Minister for Legal Aid met with representatives of the Law Society to discuss the proposed legal aid changes. As a note of the meeting records, “Much of the discussion focused on what transitional support could be offered to firms to help them to adapt”, and the Law Society’s concerns about the availability of finance for this were raised. It was agreed that Ministry of Justice officials should continue to work with the Law Society to try to agree a package of transitional support measures.

31. On 14 February 2014 a Submission to Ministers was sent to the Lord Chancellor and the Minister for Legal Aid. It had appended to it, among other materials, the Otterburn Report and the KPMG Report (both in draft at that stage, effectively in the forms in which they were later finalised). The Submission made recommendations in relation to the number of new DPW contracts to be introduced and recommended that the first fee cut of 8.75% for new cases should be announced and then brought into force on 20 March 2014. The Submission noted that it was an absolute priority to ensure that the Lord Chancellor complied with his statutory duty under LASPO, and reviewed contingency options. It included this section, headed “Interim Fee Reduction”:

“20. The criminal legal aid market (both litigators and advocates) has sustained a series of fee reductions and fee structure changes over the past ten years and yet still remains relatively the same size and structure of provider base that existed ten years ago. This market has been extremely resilient to previous fee cuts. That said, we have heard from the profession that further cuts without creating opportunities to exploit economies of scale could lead to serious risk to viability for firms and destabilise the market.

21. We acknowledge that some providers would find it challenging to cope with a 8.75% fee reduction ahead of the opportunity to exploit economies of scale from a more consolidated market structure. However, we believe that there are others that could sustain the fee reduction without any significant structural changes to their business and most providers could look at more efficient ways of working, such as better use of duty solicitors and if necessary reducing salaries. Some providers will choose to take early steps to join with others and explore opportunities to share back office functions and cost of support staff. In fact, some have already done so.

22. It is important to reiterate our earlier advice to you that any fee reduction would only apply to new cases starting after the commencement of the change and would therefore take a period of time to take effect and have any significant impact on claiming levels for providers. Current initial analysis shows that after five months, half of the legal aid fee revenue will still be on the existing higher remunerated scheme, as applying the proposed new fee scheme only to new cases means moving from one fee scheme to another is a gradual process. This means that providers would be increasingly required to explore opportunities to consolidate and make efficiency savings over a period of months. It is important to note that we are proposing the cut to come into effect three weeks after it is announced and this will be the first time confirmation has been given to providers. We highlight the risks associated with this approach in the Key Risks section below.

23. A number of respondents have argued that the interim fee cut would present challenges for providers in terms of

securing upfront investment which they suggest may be very difficult to obtain. We therefore intend to work alongside the Law Society to establish a working group to explore the types of support, both financial and non-financial, we could offer to practitioners both prior to and during the procurement process to help with the changes they face. The interim payment measures described below would also help to mitigate the financial challenge faced by providers.”

32. The Submission gave further consideration to this under the heading of “Sustainability”, at paras. 108 to 128. In this section, the Submission reviewed advice from PA Consulting, KPMG and in the Otterburn Report regarding the ability of the market to absorb fee cuts and to make efficiencies to adjust to them (paras. 110-112, in particular). Issues regarding the procurement of criminal legal aid were also reviewed, and the ability of providers to draw on latent capacity, as indicated by the KPMG Report and the Otterburn Report, was identified (para. 114), Contingency measures, if the prediction of viable adaptation to the new legal aid system proved not to be correct, were also reviewed (para. 115 and Annex E).
33. On 25 February 2014, there was a further meeting between the Lord Chancellor and Minister for Legal Aid and representatives of the Law Society, at which progress in the consideration of transitional support measures was discussed.
34. On 27 February 2014, the Lord Chancellor announced the Government’s decision as to how to proceed (“the February 2014 decision”). There was to be a tendering process for 525 DPW contracts. There was to be a phased fee reduction: a cut of 8.75% in fees for new cases from 20 March 2014, with a further 8.75% reduction “upon commencement of the new contracts in spring 2015” (para. 74). In other words, the second fee reduction would coincide with the consolidation of the market around the new DPW contracts. Paragraph 76 of the decision stated as follows:

“It is important to note that the fee reduction will only apply to new cases starting on or after 20 March 2014 and will take a period of time to take effect and to have any significant impact on claiming levels for providers. This is because the proposed new fee scheme will only apply to new cases, which means moving from one fee scheme to another will be a gradual process. We believe this gives those providers who have not already taken steps sufficient opportunity to make necessary efficiency improvements to be able to cope with the fee reduction. Our analysis suggests that after five months of the introduction of the interim fee cut, on average, around half of the legal aid revenue paid will still be on the existing higher remunerated scheme.”
35. The February 2014 decision included the announcement of a “transitional support package” to support service providers “in terms of information and guidance and specialist support to help firms invest in their infrastructure” (paras. 60-72). The main measures discussed were an information pack to assist those interested in bidding for the new contracts, a “business partnering support network” to provide advice regarding seeking financial support for restructuring and contact with the British

Business Bank (“BBB”) regarding loan guarantees which it might offer (at a cost of an additional 2% of interest) to assist firms to obtain commercial loans. The claimants are dismissive about the effectiveness of this package.

36. The February 2014 decision also announced an enhanced system of interim payments at the start of trial in long-running cases (trials of 10 days or more) and in relation to an effective plea and case management hearing (“PCMH”) ahead of a trial of any length, “to help with the cashflow of legal firms ... and to cushion the impact of the fee reductions” (para. 89). The first of these types of interim payment was to be introduced later in 2014, the second “in summer 2015” (para. 94).
37. On 26 March 2014, the Lord Chancellor again met with representatives of the Law Society, this time to discuss a proposal by him for “further transitional support” for law firms. The Lord Chancellor emphasised the need, in the current economic climate, for the Ministry of Justice to make substantial savings across the entire range of its work. Nonetheless, as recorded in the note of the meeting, the Lord Chancellor said that, in addition to the package of transitional support measures already proposed “to help providers manage the implementation of the fee reductions and market restructuring”, he could go further: he offered either a grant of £9 million, to be spread between providers who won DPW contracts “to support providers investing in their restructuring or IT, relocation, recruitment etc” (option A), or to bring forward the interim payments for the PCMH stage “by twelve months, easing cashflow for all providers during 2014/15” (option B). By an email dated 27 March 2014, the Law Society stated that its Chief Executive and President had consulted and chose option B. The Ministry of Justice proposed to implement this extension of the interim payments scheme in the summer of 2014; in the event, there was some slippage in this timetable.
38. Although option A would have involved outright payment of additional money to providers and option B, by contrast, involved earlier payment of money which would eventually have to be paid to providers in any event, the evidence for the Lord Chancellor explains that the Ministry of Justice valued option B at about £9 million as well. This assessment reflected government accounting principles, according to which the year in which expenditure occurs is important. The Law Society preferred option B, at least in part, because it would benefit all its members, not just those who might successfully bid for DPW contracts.
39. In our view, this meeting is an important feature of the factual background to the present proceedings. We consider that it is clear that by this stage that Lord Chancellor had received and digested the KPMG Report which he had been sent with the February Submission, and that he had focused on the concerns being raised with him personally in the meetings he attended on 12 and 25 February and 26 March 2014 regarding the difficulties providers would have in dealing with investment costs. It is also clear that option B was being offered as an alternative way of providing additional finance to help providers with their restructuring (i.e. to help them fund investment costs), and that this was to be done by improving cash-flow.
40. The discussion at the meeting and the proposals made indicate that there is no hard and fast division between cash-flow issues and the funding of investment costs. If providers had better cash-flow at an earlier point in time (as contemplated under option B) they could use the increased money in their hands at that time to make

investments to restructure and improve their productivity to help them remain profitable at the later period when the second round of fee reductions was implemented and the new DPW contract system was in place. To the extent the Ministry of Justice paid them fees earlier than it would otherwise have done, providers would have less need to borrow money to fund investment costs at the critical time. This is so even though the overall capital saving for providers, on a simple comparison of option A and option B, would be a good deal less (i.e. the amount of interest payments they would receive, or would not have to pay on borrowed money, as a result of having fees paid into their bank accounts at an earlier time) than the £9 million which would be gained in capital terms by providers under option A. Such a simple comparison leaves out of account the further benefits which might be achieved at a later stage by having money in hand to invest at the earlier stage.

41. In our judgment, the Lord Chancellor was entitled to attribute weight to the cash-flow benefits of option B as a means of assisting providers to bear the investment costs associated with the restructuring likely to be needed under his reform proposals. It is important to note that this extension of the interim payment scheme to the PCMH stage (like the original extension to long trials announced in the February decision) was something which had not been factored into the analysis for the KPMG Report.
42. The first claimants then commenced the first of their judicial review proceedings, challenging the making of the February 2014 decision regarding the number of DPW contracts without allowing an opportunity for consultation on the Otterburn Report and the KPMG Report and challenging the introduction of the first fee reduction. Those proceedings culminated in the hearing before Burnett J, in which, by his judgment of 19 September 2014, he dismissed the challenge to the introduction of the first fee reduction but upheld the claim to quash the decision to introduce 525 new DPW contracts.
43. Meanwhile, after those proceedings were commenced, on 2 May 2014 the Law Society wrote a letter to the Director of Legal Aid Commissioning and Strategy at the Legal Aid Agency, pointing out (among other things) that KPMG had not estimated the scale of investment costs and asking what further analysis the Ministry of Justice had done “to satisfy itself that firms will be able to source the capital needed to undertake the growth and consolidation its proposals require”. There was no reply to this letter. Mr Chamberlain gave as the reason for this that legal proceedings were then on foot against the Lord Chancellor. We do not regard this as a good excuse; but in the event we do not think it is something material to the outcome of the present proceedings. As a result of the judgment of Burnett J, there was a further round of consultation in which both the first claimants and the second claimant (the Law Society) had the opportunity to make all the points they wished. We refer to this below.
44. As set out in Burnett J’s judgment of 19 September 2014, the first claimants succeeded in their claim that the Lord Chancellor had acted in breach of the obligation of fairness by failing to consult on the Otterburn Report and the KPMG Report. This meant that the Lord Chancellor had to consult further on the proposed changes to the arrangements for criminal legal aid, and in particular on the number of new DPW contracts which should be put in place. However, the first claimants failed in their challenge to the introduction of the first fee reduction, which “was driven by an

immediate financial imperative” (see para. [55] of the judgment of Burnett J). There was no appeal against any part of the judgment.

45. On 24 September 2014, as a result of Burnett J’s judgment, the Lord Chancellor commenced a further round of consultation on the number of new DPW contracts which would allow for a future legal aid scheme which would be “sustainable with viable providers”. The consultation period was to end on 15 October 2014.
46. Pending the handing down of Burnett J’s judgment, the Ministry of Justice came to appreciate that its proposals to extend the interim payment scheme to the PCMH stage were going to cost more than it had previously thought, at £16 million (£1 million in 2014/15, £14 million in 2015/16, £1 million in 2016/17) rather than the £9 million it had previously thought (again, this is from a government accounting perspective, and is all in terms of advancing into earlier years payments which would otherwise be due in later years). A Submission to Ministers dated 1 September 2014 (“the 1 September Submission”) reviewed the options for the Lord Chancellor. It recommended that, despite the additional cost, the Lord Chancellor should stick to the commitment to implement the interim payments (unless Burnett J quashed the first fee reduction, which in the event did not happen).
47. At this stage, the Ministry of Justice was contemplating that it would still introduce the second 8.75% fee reduction in July 2015 (essentially, this was a financial imperative), even though there was now likely to be some delay in the introduction of the new DPW contracts until about October 2015, as a result of the further consultation which Burnett J might require, which would push back the timetable for deciding on the number of new contracts and the tendering arrangements in relation to them. This was a variation from what the Lord Chancellor had originally decided, in the February decision, namely that the second fee cut and the new DPW contracts would come into effect at the same time. The Lord Chancellor accepted the recommendation in the 1 September Submission that the introduction of the PCMH interim payments system should not be delayed.
48. Amongst other points, the 1 September Submission included the following reasoning:

“If our overall objective is to secure the fee cut next July, and achieve consolidation in the duty contract market next year, then the introduction of interim payments with no significant delay will help with that. Given the new procurement timetable, our current plan is to implement the second fee cut slightly earlier than the date on which new duty contracts start next year. It will greatly strengthen our argument that the market will be able to withstand this gap between the fee cut and consolidation if interim payments are in place, effectively giving a cash flow boost to providers through that critical time. It will also play into our analysis and assessment that we have said we will undertake in December/January before confirming that the second fee cut should proceed; ...”
49. Miss Rose argued that this reasoning contemplates that the PCMH interim payments would assist the Government in its argument that the legal services provider market would be able to withstand the (new) gap between introduction of the second 8.75%

fee cut from July 2015 and the introduction of the new DPW contracts (with a consolidated provider market) in October 2015. She submitted that this was of considerable importance, because it showed that even if in March 2014 the Lord Chancellor had proposed the interim payments for the PCMH stage as a way of providing some financing to assist with investment costs, by the time of the November decision now under challenge the benefit of those interim payments had been assigned in the Lord Chancellor's reasoning to helping the market absorb the new three month delay between the introduction of the second fee cut and the coming into effect of the new DPW contracts (reflecting consolidation in the market). Accordingly, says Miss Rose, even if it might have been open to the Lord Chancellor to say as at March 2014 that the advanced implementation of the PCMH interim payments scheme provided assistance to cover investment costs, by the time he took the November decision he could no longer rationally maintain that he had properly considered the issue of investment costs and made a reasonable provision in respect of them by means of bringing forward that interim payment scheme.

50. In further support of this contention, in her oral submissions in reply Miss Rose referred to a table of figures (Table 3 at para. 10 of the 1 September Submission) and argued that they showed that the whole value of bringing forward the PCMH interim payments would be used up by offsetting the effect of the second fee reduction in the three months before consolidation in the market with the coming into effect of the new DPW contracts. Since Mr Chamberlain had not had an opportunity to deal with the point on Table 3 in his submissions, we invited him to put in short written submissions about it after the hearing. Miss Rose put in some further submissions in writing as well.
51. Mr Chamberlain disputes the claimants' general submission in relation to the 1 September Submission and the detailed submission in relation to Table 3. He maintains that nothing in the 1 September Submission indicates that the Lord Chancellor had now notionally assigned the whole benefit of the advance in the PCMH interim payments scheme to offsetting the cash-flow effect of the introduction of a gap in time between the introduction of the second fee cut (for new cases commencing from about July 2015) and the commencement of the new DPW contracts, so that he could not rationally maintain the position arrived at in March 2014.
52. In our judgment, Mr Chamberlain is correct in these submissions. First, Table 3 does not have the significance for which Miss Rose contends. The part of Table 3 on which she sought to rely simply (i) shows, among other things, how much it would cost to delay the second fee cut by three months, at £13.2 million in total, concentrated in 2015/16 and 2016/17, and (ii) compares the benefit for the Government of a delay in the introduction of interim payments from 2014 to May 2015 (benefit of £1.4 million in 2014/15 and £7.9 million in 2015/16), but with an increase in costs in later years, adding up overall to zero by the end of 2017/18. The distribution in (i) reflects the fact that the fee cut would only affect new work from the date of its inception. The distribution in (ii) reflects the cash-flow savings for the Government by delaying the introduction of the PCMH interim payments, meaning that less had to be paid in the earlier period but more had to be paid later on.
53. Contrary to Miss Rose's submission, these figures do not show that the cash-flow effect of the advance in the PCMH interim payments scheme would be swallowed up

by the introduction of a three month gap between the second fee cut (in the event, it was decided that it would be introduced in July 2015) and the commencement of the new DPW contracts (in the event, it was decided this would occur in October 2015). If anything, the figures show that, on the parameters for the November decision - i.e. bringing forward the PCHM interim payment scheme into 2014; commencement of the second fee cut for new work in July 2015; and commencement of new DPW contracts in October 2015 – there would continue to be a significant cash-flow benefit for providers associated with bringing forward the PCMH interim payment scheme into 2014. The new interim payments commenced in 2014, while the second fee reduction would only take effect for new cases commenced in or after July 2015 and so would not have a major impact upon the improved cash-flow for law firms associated with the introduction of the interim payments.

54. More generally, the 1 September Submission does not indicate that the “cash flow boost” from interim payments to which it referred would notionally be allocated by the Lord Chancellor purely and in full to absorbing the impact of the commencement of the second fee cut three months before the inception of the new DPW contracts. The point made in the reasoning quoted above was a general one, which is consistent with the Lord Chancellor’s previous decision in March 2014 to assist with investment costs by provision of a cash-flow benefit for the provider market. Improvements in cash-flow can reasonably be assessed as providing both assistance for firms to cope with the (new) three month gap before the introduction of the new DPW contracts and assistance with investment costs. In fact, by the time of the November decision, certain aspects of the picture regarding cash-flow for the market had improved from what the Lord Chancellor expected in March 2014: (i) the value of bringing forward the interim payments now appeared to be about £16 million, rather than £9 million, and (ii) there had been a delay in the introduction of the second fee cut beyond that contemplated in the February decision, from “spring 2015” to July 2015. The Lord Chancellor assesses that the cost to his department (with a corresponding benefit to law service providers) is of the order of £5 million per month of delay in the introduction of the second fee cut (and this is broadly reflected in the figures in Table 3 in the 1 September Submission).
55. In our view, therefore, the 1 September Submission does not represent a radical transformation in the financial outlook for law firms in terms of cash-flow from that which the Lord Chancellor had in mind in March 2014.
56. A range of representations were received by the Lord Chancellor in response to the further consultation on the number of DPW contracts. In the representations from the first claimants and the second claimant at this stage it was not contended that the Lord Chancellor could not assess the number of DPW contracts unless he did further work to calculate the likely investment costs and factor those costs into the KPMG analysis. Rather, emphasis was placed on the broad-brush assessment in the Otterburn Report that a 5% profit margin should be taken as the marker of future viability of providers under the new DPW contracts (the Otterburn Report, like the KPMG Report, was produced without knowledge of and took no account of the interim payment arrangements included in the February decision and the extension of those arrangements in March 2014).
57. Mr Otterburn and Ms Ling put in a consultation response which similarly did not contend that the Lord Chancellor should conduct further work to assess the

investment costs; rather, they repeated the recommendation of a 5% profit margin as a safeguard. Their response included the following, which is of significance in the context of Miss Rose's argument on this appeal:

“KPMG also assumed that a positive profit was sufficient to ensure viability for providers. We disagree. Our financial analysis allowed for a notional salary for the equity partners of just £51,750, based on the median salary of the highest paid employed fee earners in the participant firms. Having allowed for this notional salary the firms were currently achieving a net margin of 5% in crime and even at this level the financial viability of many of the firms was fragile. 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 highly difficulty obtaining bank finance as their business case would be so weak. It is also debatable whether many people would take the personal financial risk of setting up and running a firm when they could earn virtually the same as an employee elsewhere.”

58. In that passage, Mr Otterburn and Ms Ling ran together the issues of cash-flow and coverage of investment costs, in much the same way that KPMG had done in the KPMG Report. The Otterburn/Ling consultation response is a further indication that the Lord Chancellor has not behaved irrationally in linking those two issues in his decision-making.
59. The Lord Chancellor instructed KPMG to review the consultation responses. KPMG produced a report dated 13 November 2014 on the responses (“the KPMG Review”). In the KPMG Review, KPMG noted that “market participants may have found themselves commenting upon market changes which they would not wish to be imposed” and commented: “It is important to distinguish between the current preferences of firms, pre-change, and the potential future strategies they may adopt, post-change.”
60. In their Review, KPMG also called attention to, and again adopted, the same qualifications which had applied in relation to the KPMG Report, including that investment costs had not been brought into account in their financial model. KPMG discussed the consultation responses received which were critical of their break-even assumption, but affirmed their view that (since they had already highlighted in the KPMG Report the same risks to which consultees called attention) they did not consider it necessary to change the analysis in the KPMG Report.

61. On 21 November 2014, a further Submission to Ministers was sent to the Lord Chancellor and the Minister for Legal Aid (“the 21 November Submission”). The 21 November Submission reviewed the position which had been arrived at after the consultation. It reviewed the differences between the Otterburn Report and the KPMG Report. The Submission recommended a modest adjustment to the number of proposed DPW contracts, from 525 to 527.
62. The 21 November Submission included a discussion of profit margins and the finances of providers at paras. 27-36. It referred to measures to provide information and guidance to service providers by way of transitional support, including through discussion with the BBB (paras. 31-32); and at para. 33 referred to the new interim payment arrangements as additional measures “to combat cash flow issues”. It was noted at para. 33 that “Those provisions will substantially help to soften the impact of the first fee cut, before the consolidated DPW contracts are offered.”
63. Miss Rose focused on this in order to suggest that by this stage the Lord Chancellor regarded the interim payment arrangements as referable to helping firms cope with the fee cuts, and not as a means of providing assistance in relation to investment costs. We do not accept this. The two issues are not distinct in the way she suggests: see paras. [39]-[41] and [48]-[55] above.
64. The 21 November Submission included discussion regarding the key assumptions which had been made for the purposes of the analysis in the KPMG Report, including the 50% OCW assumption, the organic growth assumption and the latent capacity assumption. In relation to the break-even assumption, the 21 November Submission included the following discussion:

“55. The other assumption that generated a lot of debate was the minimum level of profitability for sustainable trading. Following discussions with KPMG, we agreed to set the level at 0.1%. Some respondents misinterpreted this assumption, believing that KPMG and MoJ were suggesting that organisations would bid for a contract accepting that they would only receive a 0.1% profit margin.

56. A 0.1% profit assumption assumes that all staff including equity partners will be properly paid and all existing costs met. A firm will not know in advance of being awarded a contract what level of profit they might make, and will clearly not be aiming to make a profit as low as 0.1%. However, on the assumption that (contrary to its own expectations) the firm only achieves a profit as low as 0.1%, then bearing in mind all staff had been paid and costs met the firm would not become unviable simply by virtue of only having broken even and could continue to trade. A firm which did get as low as 0.1% profit would then have to find ways to make further efficiencies so as to improve its profitability going forward. Conversely, organisations may offset the need to find greater staff efficiency savings by exploring mechanisms to use latent capacity.

57. The model showed that in order to achieve a higher profit margin, organisations would need to explore greater staff efficiency savings.
58. No new evidence has been presented by respondents. All of the points raised were either raised by the Law Society, by practitioners or by other representative bodies through the extensive engagement throughout that process.”
65. Miss Rose focused on paragraph 56. She submitted that this demonstrated the fundamental error that the Lord Chancellor made. Miss Rose says that the reasoning in this paragraph shows that the Lord Chancellor and those advising him believed that the financial modelling in the KPMG Report assumes that *all* costs are met before the break-even assumption is arrived at, whereas in fact an important element of costs (the investment costs) are not assumed to be covered in that modelling, but are left to one side.
66. We do not agree with this submission. Paragraph 56 of the 21 November Submission falls to be read against the background of the KPMG Report and the KPMG Review, and the qualifications which appeared on their face. In our view, the reference to “existing costs” in paragraph 56 is a reference to the cost elements which KPMG had expressly allowed for in their Report and Review, leaving out of account the investment costs element (which was not a matter of “existing” costs); and the later reference in the paragraph to “all ... costs” is to all the existing costs referred to in the preceding sentence. In the light of all the other material in the case, this paragraph does not indicate that any error of understanding has occurred on the part of the Lord Chancellor or his officials. No-one familiar with the KPMG Report and Review or closely involved in the decision to be made and the way in which matters had developed since February 2014, as the Lord Chancellor and his officials were, could have made the error which is alleged. Paragraph 56 of the Submission can be read and should be interpreted accordingly.
67. The Lord Chancellor accepted the recommendation in the 21 November Submission. By an email dated 22 November 2014 from Hannah Payne in the Lord Chancellor’s private office, the Lord Chancellor and the Minister for Legal Aid indicated that they considered that there should be 527 DPW contracts and that the second fee cut should take place in July 2015 (subject to further consideration). In the same email, the Lord Chancellor sought further advice regarding what would be said in the decision with respect to the concern raised by respondents to the consultation “that firms do not have the financial capability to fund the transitional costs associated with scaling up.” A further short Submission to Ministers dated 25 November 2014 was sent in reply (“the 25 November Submission”). This referred to transitional support (including by way of discussions with the BBB) and, in addition, the new interim payment provisions which had been “designed to combat cash flow issues” and would “substantially help to soften the impact of the fee cuts” and “help providers to manage any cash flow challenges posed by the transition”.
68. Miss Rose submitted that the email indicated that the Lord Chancellor had taken his decision regarding the number of DPW contracts *before* he appreciated that the financial modelling KPMG Report left investment costs out of account. We do not agree. In our opinion, the email shows clearly that by the time of the November

decision the Lord Chancellor understood very well that KPMG had left investment costs to one side. By the email, he was asking for advice regarding how that sensitive aspect of the November decision would be communicated to law firms. This was a presentational issue which indicates that he well appreciated the significance the point had in the context of the decision to be made. It is a further item of evidence which corroborates other evidence indicating that the Lord Chancellor had received and had digested and understood the KPMG Report.

69. Miss Rose also referred to the email of 22 November as further evidence in support of her thesis that the Lord Chancellor had notionally allocated the benefits from the introduction of the PCMH interim payments to absorbing the effects of the gap between introduction of the second fee cut and the commencement of the new DPW contracts, and therefore could not rely upon them as a means of addressing investment costs issues. In our view, however, the email does not support this inference. The answer to Miss Rose's thesis, as explained above, is that the Lord Chancellor did not make the distinction between cash-flow and investment costs that she alleges; and in any event, the email is explicable as explained in the previous paragraph – the Lord Chancellor was understandably concerned about how such a sensitive matter would be presented.
70. By the Ministry of Justice Paper, *Transforming Legal Aid: Crime Duty Contracts*, dated 27 November 2014, the Lord Chancellor announced the November decision and set out his reasoning in relation to it. The discussion in the November decision reflected that in the 21 November Submission. There was a section on the finances of legal service providers, at paras. 2.16 to 2.22. Paragraphs 2.19 and 2.20 addressed concerns which had been raised by respondents regarding their “financial capability to scale up” (i.e, their ability to fund investment costs), by reference to the support and guidance measures mentioned in the April decision and the approaches made to the BBB. In relation to those costs, paragraph 2.21 added that the new interim payment arrangements had not been announced at the time of the Otterburn Report; stated (in line with the 21 November Submission) that the PCMH interim payment provisions, which had been introduced in October 2014, were “designed to combat cash flow issues”; and stated that the provisions would “substantially help to soften the impact of the fee reductions, before the DPW contracts are offered.”
71. Miss Rose submitted that the 21 November Submission and paragraph 2.21 of the November decision again showed that by this stage the PCMH interim payment measures were being allocated to soften the impact of the fee reductions, and so were not available to be relied upon to meet concerns regarding transitional costs. We do not agree. In our view, the answer to this point already given in para. [63] above applies.
72. The November decision included a discussion of the Lord Chancellor's reasoning in relation to the key assumptions which had been made:
 - i) Paragraph 2.22 included a discussion of the delivery partnerships assumption in the context of financing arrangements, which reflected its significance in relation to, amongst other things, investment costs.
 - ii) There was an extended discussion of the 50% OCW assumption: paras. 2.27 to 2.42. The Lord Chancellor decided to accept this assumption as made by

KPMG, observing that there was a considerable amount of uncertainty about how firms would seek to ensure they had capacity for DPW contracts by diversion of some resources from OCW matters, so that one had to make a reasonable assumption for the purposes of modelling what might happen (para. 2.39); and noting that allowance should be made, in assessing the responses on this point, for an element of focusing on what providers would like to happen rather than on what they might actually do when push came to shove (para. 2.42: this reflected KPMG's comment to similar effect in the KPMG Review).

- iii) The organic growth assumption was discussed in paras. 2.43 to 2.46. It was noted that this assumption fell to be considered alongside the latent capacity assumption and the OCW assumption. The Lord Chancellor recognised that providers would face hard choices how to develop capacity to meet the service requirements under the DPW contracts, but considered that they could adapt in different ways to achieve this (para. 2.46).
- iv) The latent capacity assumption was discussed in paras. 2.47 to 2.67. It was noted that providers would have greater flexibility under the new DPW contract system (para. 2.48); and that while work volumes had fallen in recent years, the number of duty solicitors doing legal aid work remained broadly the same, which "suggests there is capacity in the market to undertake more work ... " (para. 2.50).

73. The profitability, or break-even, assumption was addressed at paras. 2.52 to 2.56, as follows:

"2.52 Respondents said that break-even was not the minimum level of profitability for sustainable trading. Some respondents misinterpreted his assumption, believing that KPMG and MoJ were suggesting that organisations would bid for a contract accepting that they would only achieve a 0.1% profit margin.

2.53 0.1% is the floor in the KPMG model – not a suggested aspiration. The model certainly permits providers to make a profit (including a profit over the 5% outlined by Otterburn) and the Government is not preventing providers making such a profit. However, the Government does not consider that it would be appropriate to build into the model for determining how many DPW contracts an assumption that providers should make a significant profit from work which is publicly funded or to specify what that specific level of profit should be.

2.54 The model showed that in order to achieve a higher profit margin, organisations would need to explore greater staff efficiency savings. Conversely, organisations may offset the need to find greater staff efficiency savings by exploring mechanisms to use latent capacity. The model focuses on the smallest bidding provider within an area and assesses the staff efficiency challenge for that particular provider to break-even.

The larger bidding providers within that area are likely to be more profitable than the smallest [See page 34 of the KPMG report]

2.55 A 0.1% profit assumption assumes that all staff including equity partners will be properly paid and all existing costs met. An organisation will not know in advance of being awarded a contract what level of profit they might make, and will clearly not be aiming to make a profit as low as 0.1%. However, on the assumption that (contrary to its own expectations) the organisation only achieves a profit as low as 0.1%, then bearing in mind all staff had been paid and costs met the organisation would not become unviable simply by virtue of only having broken even and could continue to trade. A organisation which did get as low as 0.1% profit would be likely to strive to find ways to make further efficiencies so as to improve its profitability going forward. Conversely, organisations may offset the need to find greater staff efficiency savings by exploring mechanisms to use latent capacity.

2.56 No new evidence has been presented by respondents. All of the points raised were either raised by the Law Society, by practitioners or by other representative bodies in previous consultation exercises or through the extensive engagement throughout that process.”

74. Miss Rose focused on paragraph 2.55 of the November decision, to suggest (as she had done in relation to paragraph 56 of the 21 November Submission, set out above, which was in similar terms) that it showed that the Lord Chancellor did not appreciate that investment costs had been left out of account in the financial modelling for the KPMG Report. We do not accept this submission. The answer to it is the same as the answer to the submission on the 21 November Submission: see para. [66] above.
75. Section 3 of the November decision was entitled “Next Steps”. Paragraphs 3.4 to 3.11 appeared under the heading “Fee Reduction”. Paragraph 3.5 stated that the new DPW contracts (and new OCW contracts) would not now commence until October 2015, while paragraph 3.6 stated that the second fee reduction would occur in July 2015. Paragraphs 3.7 to 3.10 stated as follows:

“3.7 This approach will create a three month gap between the implementation of the fee reduction and the start of the new 2015 Crime Contracts and so depart from the approach announced in February. Assessing the likely impact of such an approach on providers, suggests that this gap would not be expected to pose a threat to service provision. This is because a number of factors help to reduce the impact of this headline reduction in fees.”

3.8 The second fee reduction will only apply to new cases. Much of the value of work that providers bill for during this

three month gap will have started before July 2015 and will therefore be under previous, higher fee schemes. Consequently, as it takes time for new cases to complete and be billed for, it follows that providers will not be immediately operating with all of their fees at 17.5% lower levels for this period.

3.9 Interim payments also reduce the impact of fee reductions on providers in the short term by improving cash-flow. Following our agreement with the Law Society in March to bring forward the implementation of interim payments for litigators in Crown Court cases (which was originally planned for next summer but was implemented on 2 October) providers are already able to benefit from improved cash-flow. This will have a substantial positive effect on provider revenues in the period from July to October 2015.

3.10 Using 2013-14 billing data, we have made an assessment of how the mix of cases on different fee schemes, combined with the interim payments, impacts on the level of fee reduction that providers face during the 2014-15 financial year until the October 2015 service commencement date. We acknowledge that providers will all be affected differently by interim payments and this will be largely dependent on the amount of Crown Court work a provider does. Indicative analysis suggests that the average firm will be subject to an overall reduction in the legal aid fee income they receive of, on average, approximately 5% during the period April 2015 to October 2015 when compared with fee income prior to the first and second fee reductions (ie. Fee income prior to 20 March 2014).”

76. As part of her submission that the Lord Chancellor did not, by this stage, regard the cash-flow benefits for providers associated with the interim payments scheme as an answer to the investment costs issue, Miss Rose emphasised that this section of the November decision was distinct from the discussion of legal service provider finances in section 2 of the decision. However, in our judgment, the inference cannot be drawn from this that the Lord Chancellor considered that the cash-flow benefits which he emphasised in these paragraphs were irrelevant to the question of investment costs. The reasoning in this section of the November decision is consistent with, and supports, the basic position which the Lord Chancellor had adopted in his meeting with the Law Society in March 2014, namely that the cash-flow benefits associated with interim payments would assist providers in dealing with investment costs they would face.
77. It is by no means the case that the new three month gap which now existed between the implementation of the second 8.75% fee cut and the commencement of the DPW contracts swallowed up the cash-flow benefits on which the Lord Chancellor was relying to provide assistance for providers in meeting investment costs: see the discussion of the 21 September Submission at paras. [46]-[55] above. As Mr Chamberlain pointed out in his submissions, the work done by officials underlying paragraph 3.10 of the November decision showed that in the period April to October

2015 (when law firms would be looking to scale up their activities in order to be able to bid for DPW contracts on a viable and profitable basis), revenue was estimated to be on average only 5% below the level at which it had been prior to the first fee cut (i.e. prior to implementation of any part of the 17.5% fee cuts which the Government was seeking to implement). This bears comparison with what the Lord Chancellor had expected in the February decision, in which it was estimated that after 5 months from the inception of the first fee cut only about half of revenue would still be paid at the original, higher rates (para. 76). Paragraph 3.10 of the November decision indicates that in the period under consideration, more than 12 months after the first fee reduction in March 2014, average revenue was estimated to be down by only 5% on pre-March 2014 levels. This, combined with the fact (see para. 3.9 of the November decision) that the second fee cut would only have a gradual, delayed impact, meant that the Lord Chancellor was entitled to maintain his earlier assessment regarding the significance of interim payments for helping to meet investment costs.

78. We have dealt with the facts at some length above, because ultimately this appeal turns predominantly upon factual matters. In what follows we will first discuss the ground of appeal based upon the Lord Chancellor's approach to investment costs, then turn to deal with the grounds of appeal in relation to other assumptions.

Investment costs

79. The Divisional Court posed three questions at para. [53] of its judgment: see above. We are now in a position to deal with the appeal in relation to them.

Question (1): Did the Lord Chancellor squarely understand that the break-even assumption made no allowance for investment costs?

80. The Divisional Court answered this question in the affirmative: paras. [54]-[55].
81. In our view, it is clear on the facts that the Lord Chancellor did understand this. He was provided with the KPMG Report, which is very clear on its face. He personally discussed the Law Society's concerns regarding investment costs at meetings on 12 and 25 February 2014, and again at the important meeting on 26 March 2014. Investment costs was a topic with which he was personally and extensively engaged. The email sent on his behalf on 22 November 2014, just before the November decision, again shows that he knew about the issue, understood it and appreciated its sensitivity.
82. Accordingly, we unhesitatingly reject the appeal against this part of the Divisional Court's judgment.

Question (2): Was it perverse of the Lord Chancellor not to take steps to investigate the likely impact of investment costs on firms which might bid for DPW contracts?

Question (3): Are the Lord Chancellor's proposed measures of support (notably interim payments) legally sufficient, in Wednesbury terms?

83. It is convenient to deal with these questions together. The Divisional Court rejected the claimants' challenge under question (2) at paras. [56]-[62] of its judgment. It rejected the claimants' challenge under question (3) at paras. [63]-[74].

84. In our judgment, the appeal in relation to the answers given to these questions should be dismissed. We have dealt with the factual nuances in relation to this at greater length than did the Divisional Court, to reflect the development of the argument before us. However, as appears from the analysis of the factual background above, the basic point made by the Divisional Court at para. [73] of its judgment – that the Lord Chancellor could reasonably think that the provision of interim fees would be a real advantage for bidders for DPW contracts and that the advantage was not limited to softening the blow of the second fee cut in advance of consolidation with the commencement of the DPW contracts – is correct and is unassailable on appeal.
85. On this appeal, a major point for the claimants is that the break-even assumption used by KPMG in their Report and adopted by the Lord Chancellor as the basis for his decision depends upon investment costs being left out of account. KPMG accepted that it was likely that many providers would need to incur such costs. Therefore, if nothing were done to address those costs, either by adjusting KPMG’s financial model or by arrangements made by the Lord Chancellor outside that model, the impact of investment costs would falsify the break-even assumption that KPMG had made. This would potentially affect the assessment made of the number of self-sustainable DPW contracts which could be introduced.
86. The Lord Chancellor agrees that the KPMG financial modelling did not bring the investment costs into account. That much is clear from the face of the KPMG Report. His case, however, is that he took measures – which were also outside the model and not part of the set of assumptions on which it was based - to improve funding for solicitor firms, designed to assist them to bear investment costs. The Lord Chancellor maintains that the most important of these measures was to introduce interim (i.e. advanced) payment of legal aid fees earned by solicitor firms, to improve their cash-flow and assist them to invest so as to be able to bid for and implement the proposed DPW contracts on a viable basis. Interim payment of fees was not an assumption underlying the KPMG modelling, but a benefit for solicitor firms over and above the benefits analysed by KPMG. Therefore, as Mr Chamberlain says, it can be seen that the KPMG modelling was on what he described as a “steady state” basis, which left both the investment costs element (a minus for solicitor firms) and the interim payments element (a plus for solicitor firms) to one side. In his submission, the Lord Chancellor could rationally make the assessment that the measures (in particular, the introduction of interim payments) to assist solicitor firms with investment costs were sufficient general measures to allow for that element of cost and address the risk posed by it in relation to whether bidders could take on the proposed DPW contracts on a viable basis.
87. We accept these submissions. They are relevant to both of questions (2) and (3). The analysis of the factual background set out above supports the Lord Chancellor’s case.
88. The Lord Chancellor knew that the financial modelling in the KPMG Report did not bring investment costs into account. As at the end of March 2014, however, he considered that he had addressed them adequately, by making the offer he did at the meeting on 26 March and then agreeing to bring forward the introduction of the PCMH interim payment scheme under option B, when that was chosen by the Law Society as the preferred way to address investment costs.

89. Had the position remained stable as at that point, we think that the Lord Chancellor's position would clearly have been a lawful one. Whether the additional funding being provided under option B was sufficient to address an important additional costs element not catered for by the KPMG model was an evaluative judgment which the Lord Chancellor was rationally and lawfully entitled to make. He was entitled to have regard to the fact that the Law Society had chosen this in preference to a straight grant of monies, under option A, and that it was not at that stage contending that this was an improper or inadequate way to address the issue of investment costs.
90. In the KPMG Report, KPMG did not advise that it was necessary for the Lord Chancellor to carry out further modelling in relation to investment costs. It merely advised that consideration should be given by the Lord Chancellor to how the issue of investment costs should be addressed. The Lord Chancellor did this, in consultation with the Law Society, in particular at the meeting on 26 March 2014.
91. The Lord Chancellor could rationally assess, at that stage, that it would not be appropriate to try to model investment costs in a more specific way. It was known that there was wide variation between law firms as to how they might go about preparing themselves to bid for the DPW contracts, with different investment costs profiles associated with different approaches. The Otterburn Report was based on returns of information from a comparatively small number of the approximately 1,600 solicitor firms currently in the market, and even then it noted that a key theme raised by firms who did respond was "Lack of reliable data." Further attempts to model investment costs would have been highly speculative and fraught with difficulty, and offered little benefit in terms of arriving at a decision.
92. The Lord Chancellor was therefore rationally entitled to assess that the admittedly broad brush approach he adopted at the end of March 2014 was a reasonable one in the circumstances. The fact that he made allowance for investment costs in the way he did at that stage took away any pressure there might otherwise have been, according to a standard of rational conduct, to investigate further the extent of investment costs across the market.
93. Further, the dimension of negotiation between government and private service providers in relation to the overall cost to the public purse of provision of legal aid services which was inherent in the situation cannot be ignored. The question whether sufficient allowance had been made to take account of investment costs was not a matter of fine calculation, but was one aspect of a wider commercial negotiation. The Lord Chancellor was entitled to give weight to the fact that at the end of March 2014 the Law Society accepted the validity of his approach in relation to investment costs, no doubt recognising that the financial constraints for the Lord Chancellor and his department would need to be accommodated in some way, and could not be simply left out of account.
94. On the basis that the position adopted by the Lord Chancellor with respect to investment costs at the end of March 2014 was lawful, the question arises whether circumstances changed to such an extent in the period up to the November decision so that either it can be said (i) that in fact he no longer relied on the PCMH interim payments to address those costs (with the result that a fatal gap opened up in his reasoning in reliance on the modelling in the KPMG Report) or (ii) that his reliance

on those interim payments to address investment costs in his November decision had been undermined to such a degree as to be irrational.

95. Having regard to the discussion of the factual background, above, we do not consider that either of these contentions is sustainable. As we have explained, the issues of cash-flow, adaptation to the fee cuts and investment costs were not in separate categories, but ran together; and the Lord Chancellor was entitled to take them into account together in his reasoning.
96. The Lord Chancellor was rationally entitled to assess that the PCMH interim payments would bring cash-flow benefits which would assist law firms to meet investment costs. The KPMG Report indicated that there was a link between cash-flow and meeting investment costs. The Law Society had accepted as much in their choice of option B at the end of March 2014. The consultation response of Mr Otterburn and Ms Ling, like the KPMG Report, indicated that it was rational to view them as issues which were connected.
97. Further, as explained above, although there had been some changes of circumstances between March 2014 and the November decision as regards cash-flow, they were not all adverse to the position of the legal service providers and were not such as to swallow up the cash-flow benefits which the Lord Chancellor assessed there would be. By the time of the November decision, the Lord Chancellor was rationally entitled to assess that sufficient was being done by way of provision of cash-flow benefits under the interim payment provisions to cover investment costs to a reasonable degree.
98. Nothing had happened between March 2014 and the November decision to indicate that the Lord Chancellor was now under a new obligation to make further inquiries to try to build estimates of the investment costs into the KPMG financial modelling. The problems associated with trying to do that remained as before. Moreover, in the responses to the further consultation in September and October 2014, no-one had suggested that this was a feasible or necessary exercise to undertake. In fact, in no response did anybody suggest adoption of anything other than a broad brush approach. Other broad brush approaches were urged on the Lord Chancellor, including that he should build the model around a 5% profit margin, as suggested in the Otterburn Report. Against this, the Lord Chancellor was rationally entitled to prefer his own approach to the issue of investment costs.
99. For these reasons, which in substance reflect the judgment of the Divisional Court, we would dismiss the appeal in relation to the treatment of investment costs.

Other assumptions underlying the November decision

The delivery partnerships assumption and the break-even assumption

100. As Mr Swift acknowledged, the complaint regarding the adoption of the delivery partnerships assumption is a sub-set of the complaint regarding the Lord Chancellor's approach to investment costs. In our judgment, the appeal on this point should be dismissed for the reasons given in relation to investment costs above.

101. Similarly, the first claimants' submissions in relation to the break-even assumption overlap with, and essentially repeat, the second claimant's submissions in relation to the investment costs issue, and should be dismissed for the same reasons.

The latent capacity, organic growth and 50% OCW assumptions

102. Mr Swift's submission in relation to each of these assumptions was that the Lord Chancellor made an irrational and unlawful assessment of them for the purposes of the November decision. Mr Swift contended that the Lord Chancellor received a wealth of responses from service providers in the consultation which followed Burnett J's judgment, giving factual information to indicate that one or other or all of these assumptions were incorrect. In Mr Swift's submission, the Lord Chancellor erred in treating these assumptions as matters for his evaluative judgment, rather than proceeding on the basis of the facts set out for him by respondents.
103. We agree with the Divisional Court that these submissions should be rejected: see paras. [79]-[82] of its judgment. As Laws LJ put it at para. [81], the Lord Chancellor "was entitled to conclude that respondents were inclined to think in terms of the current market and how it operated; and in contrast to proceed on the perception ... that professionals whose world has changed may look the new world in the eye and find the means to live in it." The KPMG Review had called attention to this aspect of the consultation responses, and the Lord Chancellor could not be said to be irrational in making the assessment of them which he did.
104. In other words, the Lord Chancellor could rationally make the assessment that he was not dealing with a pure matter of current fact, but rather was required to make an evaluative judgment how legal service providers might be expected to react if confronted with the new world of his legal aid reforms. Mr Swift correctly pointed out that what law firms said in their consultation responses about their current position was relevant material to be considered by the Lord Chancellor. However, the Lord Chancellor was not bound to treat what they said as conclusive evidence regarding their likely future behaviour when the reforms took effect. He could rationally approach what law firms said in their consultation responses with a degree of healthy scepticism, when making his own assessment about that. It was not so much that they might be insincere in their responses, as that he could think that they would prove to be more entrepreneurial and inventive than they thought they would be, if they really had to operate in the new, restructured legal aid environment. In making his assessment, he was entitled to have regard, as he did, to broad features of the market, such as that work volumes have fallen in recent years, but the number of duty solicitors doing legal aid work is broadly the same (as an indication that there is latent capacity in the market: para. 2.50 of the November decision).
105. In view of the rational and lawful evaluation of the consultation responses made by the Lord Chancellor, it was not incumbent on him to investigate the current underlying facts in any greater detail than he did.
106. In our judgment, the first claimants' appeal in relation to these further assumptions should be dismissed.

Conclusion

107. For the reasons given above, we dismiss this appeal.

ANNEX

Paras. [8]-[31] of the judgment of Burnett J at [2014] EWHC 3020 (Admin):

8. Following the financial difficulties that engulfed the world towards the end of the last decade the legal aid budget was not protected from scrutiny and the need to find savings. The cost and efficiency of the delivery of criminal legal aid services had been under consideration even before, in particular in the review conducted by Lord Carter of legal aid procurement in 2006. On 9 April 2013 the Lord Chancellor issued the first consultation paper entitled “Transforming legal aid: delivering a more credible and efficient system”. Its scope was wider than criminal legal aid. It encompassed proposed reforms to civil and family legal aid in addition, although its focus was criminal legal aid.
9. In his ministerial foreword, the Lord Chancellor summarised the proposals. The Government proposed that the provision of criminal legal aid should be subject to price competitive tendering [“PCT”] between firms of solicitors. There was a need for more efficiency in the system. The result would be that successful firms would grow and that mergers would be required to achieve economies of scale. The consultation paper later explained that there would be a consolidation of the market

“with fewer and more efficient providers accessing greater volumes of work, whether delivered directly by providers accessing greater volumes of work, whether delivered directly by providers or through some other business structure, for example a joint venture.”

Contracts would be available in a series of procurement areas. In deciding on the number of contracts that would be available, the consultation paper identified four broad factors which would be taken into account:

- i) Sufficient supply within each procurement area to deal with potential conflicts of interest in multi-handed cases;
 - ii) Sufficient volume of work to enable the fixed fee scheme to work. This was a feature of the proposals which assumed that some cases would be profitable and some not. A sufficient number of cases should be available to each successful bidder so that the risk of loss on some cases could be managed;
 - iii) Market agility, a shorthand term to reflect the ability of providers in each procurement area to deal with the additional volumes of work, including by growing or developing new business structures;
 - iv) Sustainable procurement, a shorthand term for ensuring that there would be competition in future tendering rounds. The proposal was for three year contracts with the possibility of extension for a further two years. The expectation underlying the proposal was that “most successful applicants will be joint ventures or a legal entity using agents”.
10. This consultation paper envisaged a total number of about 400 contracts. The consequence recognised in the consultation paper would be that to secure a contract

existing providers would on average need to grow by 250% or join other providers to bid.

11. One of the consequences of the Lord Chancellor's proposals was that "clients would generally have no choice in the representation allocated to them at the outset": consultation question 17.
12. Immediate savings of 17.5% in criminal legal aid spending through fee cuts formed part of the proposals. Changes in the remuneration of "Very High Cost Cases" were also proposed as were changes to the way in which the Bar was to be remunerated. All of the proposals were highly controversial and led to a sustained and public discussion involving the professions about whether each aspect was appropriate. The consultation period closed on 4 June 2013. There were responses from over 16,000 consultees. Amongst the responses were representations relating to the adverse consequences of PCT upon access to justice and the viability of many firms of solicitors. There was objection to the loss of client choice which the proposals entailed.
13. The Government considered the responses, which it should be emphasised covered every aspect of the new arrangements being proposed, and decided that it would not press ahead with the proposals for PCT for solicitors or with the immediate cut of 17.5% in the criminal legal aid budget. The Ministry of Justice then worked up new proposals.
14. In this they worked closely with the Law Society. I should record that the two professional bodies who are claimants in these proceedings, and many individual solicitors working in publicly funded criminal law, became dissatisfied with the way in which the Law Society dealt with the Government on this issue. It is well known that divisions developed as the months went by and culminated in a vote of no confidence by Law Society members in the President and Chief Executive on 17 December 2013. The ins and outs of the disagreements within the profession are not material to the arguments which have been developed in these proceedings. Putting it as neutrally as I can the two positions might be expressed in this way. The Law Society felt it in the best interests of its criminal practitioner members to work with the Ministry of Justice to achieve the least bad result, accepting that fundamental change would be imposed come what may. Many of its members believed that the Law Society should have resisted the changes more vigorously and not become party to their development.
15. As a result of the work undertaken over the summer of 2013 a second consultation paper was issued on 5 September 2013 entitled "Transforming Legal Aid: Next Steps".
16. In the context of this claim, two significant changes to the original proposals were set out in this paper. The first was that the Government would not seek to impose a cut of 17.5% in criminal legal aid fees in one go. Instead, it was proposed to reduce fees by an average of 8.75% in the spring of 2014 and then again by 8.75% a year later (paragraph 2.37). The second related to the contractual arrangements with solicitors for the provision of criminal legal aid. 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 consultation paper mooted 570 as a possible number. The rates of remuneration under the contract would be fixed, and not part of the award criteria; in that way PCT went. 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.

17. The Government restated its conviction that the re-structuring and consolidation of the market in criminal legal services was necessary and that it should be encouraged by introducing an element of competition into the procurement process (paragraph 2.29). It then described the dual model and that there would be unlimited numbers of Own Client Work contracts available (subject to quality assurance) but that the position for Duty Provider Work contracts would be different. The four factors previously identified as informing contract numbers in the earlier consultation process were readopted. However, the Government added a further factor, namely an aim to make the Duty Provider Work contracts large enough in volume and value to be “sustainable in their own right” (paragraph 2.31). That meant that the aim was to let contracts which were large enough to enable bidders to abandon own client work if they chose. It was not a prediction of what would in fact happen. The consultation paper continued:

“In order to help inform our final decision on the number of contracts for Duty Provider Work, we intend to jointly commission with the Law Society a further piece of research exploring the size of contract necessary for it to be sustainable.”

18. The details of the approach to determining the number of contracts was spelt out in Chapter 3 of the consultation paper. Procurement areas were proposed which mirrored the Criminal Justice Areas in England and Wales with separate consideration for London. A section was devoted to expanding upon the way in which the number of Duty Provider Work contracts would be determined. Relying upon recent data relating to the numbers of defendants in multi-handed trials, the indication was that conflict of interest concerns would be met if there was a minimum of four contracts in each area. The approach to whether a sufficient number of cases would be on offer for each contract would take account of the proposed new fixed fee scheme (i.e. a 17.5% reduction on average, albeit over two years) and the need to enable those doing Duty Provider Work to abandon Own Client Work if they chose. The approach to

market agility referred again to the need for existing organisations to expand to take on Duty Provider Work but added that the views of firms who may have to scale down their businesses would be taken into account, with consideration being given to the extent to which Own Client Work would mitigate that impact. Sustainable procurement for future rounds remained an objective.

19. Paragraph 3.32 made clear that the objective of making Duty Provider Work sustainable in its own right was to be judged on the assumption that the full 17.5% reduction in fees overall was achieved. The consultation paper continued:

“3.33 In order to help inform our analysis of sustainability and the final decision on the number of contracts for Duty Provider Work, we intend to jointly commission with the Law Society a further piece of work to get more detailed information for this purpose. It would be necessary for this work to take into account the proposed size of procurement area.

3.34 Therefore, we propose to determine the appropriate number of contracts for Duty Provider Work on the basis of the four factors ... and outcomes of the further research. We would welcome consultees’ views on these factors and whether there are any others that we should consider.

3.35 We note that an indicative analysis set out in a report by Otterburn and Ling, supplied by the Law Society in response to the previous consultation, suggested that three hypothetical organisations operating across the proposed CJS procurement areas would have a better chance of sustaining their business after a 17.5% reduction in fees, if they have an annual turnover of around £1m (including VAT). Taking the estimated spend on criminal legal aid services in scope of the proposed new contract after the proposed 17.5% reduction in fees ... this would suggest that we should offer, no more than, 570 contracts for Duty Provider Work. Whilst this is a useful starting point, this number does not take account of the other factors set out above, and also presupposes that the providers with Duty Provider Work contract would need to absorb all Own Client Work available in the market during the contract term in order for the contracts to be sustainable. As indicated above, our aim is that Duty Provider Work contracts should be large enough to be sustainable in their own right after the cumulative reduction in fees by 17.5%. We would have regard to all the factors set out above, including further research described at paragraph 3.33 above, in determining the final contract numbers for this work.”

The consultation questions asked whether consultees agreed with the model, the proposed procurement areas and the methodology for determining the number of contracts.

20. The consultation period was due to end on 1 November 2013. On 23 September 2013 William Waddington, chair of the Criminal Law Solicitors Association (the second claimant) wrote to the Lord Chancellor inviting him to delay the close of the consultation period until after the independent research had become available. That would be “for a few weeks”. In summary his point was that the exercise in determining numbers of contracts was complex on questions of capability and capacity. Any firm responding to the consultation without the fruits of the jointly commissioned research would be “working very much in the dark”. The Lord Chancellor refused the request in his reply of 8 October in these terms:

“Your letter questions whether the response to the current consultation ... should be delayed until the outcome of the research previously mentioned. We do not believe that it is necessary to do so. The consultation paper clearly sets out the factors that we propose to use to determine the number of contracts for Duty Provider Work and invites views on those factors. One of those factors is the sustainability of the Duty Provider Work contracts. We will of course carefully consider all the responses we receive (including any views or evidence on sustainability) as well as the independent research being conducted by Otterburn to help inform our assessment of the number and size of the Duty Provider Work contracts that would be awarded.”

21. It was the intention of the Law Society and the Ministry of Justice to commission Otterburn to conduct further research into the finances of criminal legal aid firms and questions relating to the viability of the proposals. What was envisaged was a data collection exercise. However, the Otterburn research was commissioned by the Law Society and not jointly with the Ministry of Justice because for the Ministry unilaterally to have entered into a contract with Otterburn would apparently have breached procurement rules. Otterburn would not be able to do the number crunching required to deliver an indicative range of Duty Provider Work contracts. To undertake that work the Ministry of Justice entered into a contract with KPMG on 30 October 2013 (after an appropriate procurement exercise). It was in that way that the single piece of research referred to in the consultation paper became two, with the Ministry of Justice and Law Society each paying for one part.
22. The terms of reference for Otterburn were agreed between the Law Society and the Ministry of Justice as were the questionnaires to be sent to all criminal legal aid solicitors. It was also envisaged that interviews would be conducted with about 25 firms to explore the issues in more detail. Notes for the interviewers were agreed. The surveys were sent out in late September with a request that they be returned by 25 October 2013. The user notes explained that the Ministry of Justice would be appointing independent financial consultants to undertake modelling using the aggregate information provided through the survey. The survey asked for an estimate of the current split between Own Client and Duty Provider work. It sought a breakdown of current fees from crime and details of income from other areas of activity. It invited respondents to provide detailed information about staffing at every level within the firm together with financial information relating to salaries and overheads. A section dealt with questions of funding. It sought further information

on the assumption that the firm concerned would undertake Own Client Work and Duty Provider Work, and then moved to what would happen if the firm failed to secure a Duty Provider Work contract and was left only with Own Client Work. It concluded with a number of general inquires and asked whether the respondent would be willing to take part in an interview.

23. The response rate was low. 167 firms provided information. For one reason or another, the input from ten fell to be discarded. The size of firms was broken down into four categories: (a) 1 – 5 solicitors; (b) 6 – 12 solicitors; (c) 13 – 40 solicitors; and (d) 40+ solicitors. It was originally expected that the work of both Otterburn and KPMG would be completed by mid-November 2013. Finalising their respective reports took much longer than expected and each went through various drafts as their content was the subject of discussion with officials at the Ministry of Justice and officials from the Law Society. The Law Society remained engaged throughout this process with detailed input from a small number of its officials. However, they were subject to duties of confidence which precluded them from discussing the research or evolving views with any outside their number. That included the elected officers of the Law Society and its various specialist committees. There was an exception, namely on the question whether a firm of solicitors which secured a Duty Provider Work contract would be likely to give up Own Client Work. The strong view of a very small number in the Law Society asked (and a view shared by the officials) was that they would not.
24. The Otterburn report was published at the same time as the Lord Chancellor announced his decisions in February 2014. Otterburn identified the scope of the task undertaken by the firm:

“We were asked to research:

- The current financial position of criminal defence firms;
- Firms’ views on the size of the contract they would need to deliver a viable duty and own client contract;
- The impact of the proposals on firms that just have an own client contract.

In order to consider these particular issues:

- The volume and value of contract needed to ensure viability and thus the number of contracts that can be awarded;
- The size of the procurement areas and the impact that has on the costs firms incur;
- The ability of firms to expand and to do so quickly enough to the scale that would be required to deliver the contracts.”

25. Otterburn summarised their findings in an Executive Summary and then set out their conclusions. The material findings recorded that the key issue facing criminal legal aid firms was a reduction in work levels. In recent years there had been a fall off in work passing through the criminal courts. Average profit margins were 5% with the biggest firms achieving lower margins, which was described as counter-intuitive, and London firms being the least profitable. Profit was calculated as income less overheads, together with a notional salary for equity partners and notional interest on partners' capital. Finances of many firms were fragile. Problems were identified by respondents relating to fee reductions and to procurement areas with particular concerns reported about the impact in rural areas. Most firms were dependent on duty work for generating new work. Few would be sustainable in the medium term without it. The bigger firms would be able to expand reasonably rapidly, others not. It would be difficult for firms to reduce costs quickly and few had an appetite for merger or an interest in bidding for contracts outside their own procurement area.
26. These findings fed into Otterburn's conclusions (which were based also on their deep experience of the market). They may be summarised as follows:
- (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%;
 - (v) A number of the proposed procurement areas were too large;
 - (vi) There should not be a single national contract size across the country;
 - (vii) The mid-size players in the market were likely to be key to the new system;
 - (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.
27. The Otterburn report went through many iterations before its final version. In the course of that process, Otterburn had recommended a number for Duty Provider Work contracts, although it had not been part of the brief to do so. No such recommendation appeared in its final report.
28. The evolution of the KPMG report is traced in the witness statement on behalf of the Lord Chancellor of Dr Elizabeth Gibby, which also sets out the complete history of the reforms process. KPMG had payment data from the Legal Aid Agency relating to

all criminal legal aid firms. Otterburn provided financial information in aggregate form which came from the survey. The aim was to run models for each firm based upon these data. To produce a range of numbers for Duty Provider Work contracts a series of assumptions about the behaviour of the market was needed. Initially, KPMG indicated that one of the assumptions they believed should underlie any calculation was that a firm which secured a Duty Provider Work contract would give up Own Client Work altogether. That was because the Duty Provider Work contract would provide greater volume and more certainty. That was known by the Ministry of Justice to be highly controversial. Intense discussion continued involving the two sets of consultants, the Ministry of Justice and the Law Society officials concerning all the assumptions that should underlie the modelling. The question of what percentage of Own Client Work a successful bidder for Duty Provider Work would give up was compromised, for the sake of the modelling, at 50%. This remains one of the most contentious aspects of the modelling. In the course of the process, the Lord Chancellor was involved personally in discussions with KPMG concerning the approach they proposed to take and the assumptions on which they would base their calculations.

29. KPMG identify the assumptions they worked on, and their source, in the final report dated 25 February 2014, also published with the decision. Those which have formed the subject matter of debate in these proceedings are:

- (i) volumes of work would remain constant at 2012/13 levels. Source - MoJ;
- (ii) Successful bidders could achieve a 15% improvement in capacity due to latent capacity within firms and/or reallocation of staff to crime from other areas of work. Source – MoJ;
- (iii) Successful bidders could achieve organic growth of 20% through recruitment. Source - MoJ;
- (iv) It was assumed that only 75% of incumbent bidders (i.e. existing firms) were to be ‘of scale’ to bid for Duty Provider Work contracts and that two new entrants to the market would bid for each contract. Source -MoJ;
- (v) Successful bidders could reduce staff costs by 20% of revenue. Source – analysis of differences in staff cost ratios across the sector;
- (vi) A firm making any level of profit, however small, was considered viable. Source – (by inference) KPMG judgement.

30. In so far as figures used by KPMG derived from the Otterburn report, as they did for example on overheads and percentage of criminal turnover spent on salary costs, KPMG identified a caveat relating to the small sample size. They questioned the statistical significance of much of the sampling. By way of example, only three firms with 40 or more solicitors working in criminal legal aid provided data. KPMG noted the lack of data informing the question of the extent to which firms would consolidate, although Otterburn produced qualitative evidence suggesting that there were significant barriers. Information about the level and availability of funding necessary to expand so as to be able to service the new Duty Provider Work contracts was absent. KPMG did not quantify the investment needed but warned that the

market believed that it would struggle to obtain funding. They cautioned about the possibility of unsuccessful bidders surviving until the next round (after four years) and stated that the impact of failing to secure a contract on unsuccessful bidders was not within the scope of their work. In their recommendations, KPMG advised the MoJ to take these factors into account when deciding upon numbers for each procurement area.

31. On the basis of the assumptions applied (including a number not the subject of real criticism in these proceedings) and with the qualifications they had identified, KPMG's analysis produced a range of between 432 and 525 Duty Provider Work contracts. The modelling undertaken by KPMG was "stress tested" within Government by statisticians before the Lord Chancellor decided on the figure. Some progress has been made since February in implementing the new arrangements. The contracts for Own Contact Work have been let with a view to commencement in summer 2015. The tender process for Duty Provider Work contracts has not begun.