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The Law Society and Ministry of Justice

Impact of the MOJ Green Paper proposals on legal aid firms – further analysis for the Ministry of Justice

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Introduction

Subsequent to publication of our report commissioned by the Law Society a conference call was arranged between Andrew Otterburn and the Ministry of Justice (MOJ).

We were asked if we could interrogate the data further:

1. to identify the profit margins of firms for whom, respectively, civil, family, crime or private work accounted for 50%+ of their fees;
2. to undertake the same analysis where these areas accounted for 75% of their fees;
3. to examine the responses from criminal firms and establish if the data indicated that the larger criminal firms were impacted disproportionately by the proposals for crime.

It was agreed that as the original survey had been commissioned by the Law Society, their approval would be obtained for this further analysis, and that the results of this work would be shared with both the MOJ and the Law Society.

Profit margins by work type

The overall net profit margin before tax achieved by the firms in the survey was just under 10%. Their fees were £290m and they achieved profits in aggregate of £28m.

Table 1 summarises the margin achieved by firms for whom more than 50% and 75% of fees respectively are in:

- Family
- Civil – this includes debt, housing, welfare benefits, education, mental health and immigration
- Crime
- Private (residential property, probate, commercial work, employment and other litigation)

Table 1

Profit margin for firms for whom 50%/75% fees is in each work type

	Over 50% fees in area		Over 75% fees in area	
	Number of firms	Average margin %	Number of firms	Average margin %
Family	39	5	21	10
Civil	10	0	6	-5
PI and clinical negligence	6	27	4	32
Crime	22	11	15	12
Private	46	6	10	6

Some care has to be taken with this analysis as some of the figures are based on very small sample sizes. Just six firms took part that specialised in civil and very few clinical negligence firms participated. The table is interesting because it illustrates:

- The higher margins achieved by firms that specialise and who undertake the work in greater volume – they are more efficient and able to undertake the work at lower cost;
- The minimal margins achieved by firms that undertake civil work – areas such as housing and welfare benefits are normally a small part of most firms' work, but typically struggle to cover their costs. Many firms have already closed these areas as they lose money;

- The low margins achieved for private work. Often legal aid firms are not in areas where they would attract good quality private clients, and their reputation is often as a legal aid firm. Traditionally therefore their private work has not been as profitable as might be expected. Additionally, many firms are still struggling with the aftermath of the recession with low volumes of conveyancing work. In some firms conveyancers are still working reduced hours and for many firms the housing market is still fragile. The previous ability to cross-subsidise has gone;
- The better margins achieved by firms that undertake personal injury work. In the table, clinical negligence has been grouped with personal injury and most of the fees and profits will relate to PI.

Crime firms

Most of the participants in the survey were firms that undertook family and civil law although a small number were crime firms. Of the 163 participants, crime represented more than 75% fees for 15 of them. The impact of the reductions on these firms is shown in table 2 and table 3 provides a comparison to all 163 participants. The crime firms see a 70% fall in profits, which, whilst not as catastrophic as the impact on the family and civil firms, is still serious.

Table 2

Crime analysis - firms for whom crime is over 75% fees

	Number of firms	Total fees	Total profit	Average margin %
Current position	15	21,868,756	2,411,359	12
After stage one		21,214,791	1,857,394	9
After stage two		20,111,496	754,099	5

Table 3

All firms in the survey

	Number of firms	Total fees	Total profit	Average margin %
Current position	163	290,225,653	28,510,440	7
After stage one		275,772,974	14,837,760	2
After stage two		235,903,954	-25,031,259	-26

Five of the firms for whom crime was 75% fees, generated more than £1m in crime fees. These include some of the leading crime firms and their total fees were £16m. Table 4 indicates the impact on these firms and illustrates that whilst the firms are still in profit their margins become extremely tight.

Table 4

Crime analysis - firms for whom crime is over 75% fees and £1m

	Number of firms	Total fees	Total profit	Average margin %
Current position	5	16,032,371	1,612,795	11
After stage one		15,685,928	1,266,352	9
After stage two		14,852,574	432,998	4

Profits in these firms fall by 75% and these are large firms that will require high levels of funding and capital. These firms have high levels of gearing – the number of other fee earners in addition to each equity partner and their working capital needs to be funded – either by retained profit or from the banks. The average for the five is 33 fee earners in addition to each equity partner, and some firms are significantly higher. These firms require reasonably healthy levels of profit generation in order to provide the working capital to support these levels of fee earner and a 75% fall in profits will make some if not all of them very vulnerable.

Finally, table 5 summarises the position of seven broader based firms that also undertook significant amounts of crime. Crime represented under 75% of the fees in these firms.

Table 5

Crime analysis - other firms with crime fees in excess of £1m

	Number of firms	Total fees	Total profit	Average margin %
Current position	7	33,232,369	3,295,746	9
After stage one		31,494,356	2,107,733	6
After stage two		26,573,868	-2,812,755	-10
Current crime fees		13,246,723		

Overall crime represented approximately 40% of the fees of these firms. They undertook a further £10m of family work and £2.3m of civil work and as a result of the removal of work from scope in these areas see these firms start incurring substantial losses. These firms are likely to be locked into significant lease commitments and will face substantial redundancy liabilities that they may well not be able to fund. Once again these are important, very well known suppliers and due to the impact of the family and civil cuts their criminal work will become extremely vulnerable.

These large crime firms are important suppliers and many feel exposed. They have expressed their concern very strongly that some have already been severely affected by the change in the litigators' graduated fee scheme and that the proposed cuts will further erode their viability. This further analysis does not indicate that they have been disproportionately treated by the current proposals however it does indicate the fragility of this key group of suppliers. There is strong anecdotal evidence that some of the larger crime firms, in particular in London, were disproportionately effected by the previous changes regarding graduated fees, and that the twin proposals regarding the London magistrates courts and crown work will further impact especially on these firms. One of the participants, a large and well-respected London crime firm is already incurring losses, even before these proposals come into effect.

The sample sizes in this further analysis are clearly small, and the MOJ may well decide to undertake a further, larger, study of crime firms, however there is every indication that the conclusions from this initial group of firms will be representative of crime firms generally. Once again, we are aware of anecdotal feedback from our clients of further falls in prosecution rates in some parts of the country and a fall in the number of larger VHCC cases already placing financial pressure on many crime firms.

The main conclusion of this further analysis is that an important group of suppliers who are key to fulfilling the LSC's statutory obligations in providing a criminal defence service is at risk.