2026 Report on the State of the US Legal Market

Peak prosperity and the fault lines below

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Thomson Reuters Institute

Firms in an unstable environment

Fifty million years ago, the Indian subcontinent began its inexorable collision with the Eurasian plate; and in that grinding of tectonic forces, the earth did something extraordinary — it began to build upward. Limestone that once rested on an ancient seabed was thrust skyward, folding and fracturing along fault lines that would reshape the face of the planet. This wasn't a gentle rising; rather, it was a violent reorganization of matter, in which some sections of crust were pushed to unprecedented heights while others remained relatively unchanged, creating the greatest peaks and deepest valleys on Earth.

The Himalayas emerged from this chaos, and at their apex stood what the world would come to call Mount Everest, standing at 29,032 feet not *despite* the fault lines, but because of them.

Today, the US legal market is experiencing its own tectonic moment, one in which fundamental forces — such as shifting client power, economic instability, and technological disruption — are creating fault lines that are pushing some to extraordinary heights while others find themselves on more unstable ground. The difference between the peaks and valleys this time is no longer determined by traditional metrics of size and prestige alone, but by a complex interplay of factors: technological sophistication, practice mix, cost structure discipline, and perhaps most critically, the ability to deliver value to an increasingly pressured customer.

What makes this moment particularly treacherous is that the very forces creating today's peaks are simultaneously undermining the ground beneath them.

The numbers underscore the tectonic nature of the moment. While the *average* law firm celebrated 13.0% profit growth in 2025, firms of different shapes and sizes found ways to capitalize on the opportunities of the moment. The profits per lawyer of the Am Law 100 firms have soared as they've increasingly concentrated on delivering on the highest-priced work. The Second Hundred is also growing profits rapidly while expanding headcount and capturing increasingly substantial client work. Midsize firms, after years trapped in a vicious cycle of aggressive hiring and constrained pricing power, have finally broken free to capture historic demand growth. However, the threat of once again falling back is growing rather than receding.

What makes this moment particularly treacherous is that the very forces creating today's peaks are simultaneously undermining the ground beneath them. The surge in demand that's lifting profits to record heights stems not from economic health but from chaos — trade wars, regulatory upheaval, and geopolitical tensions – all of which require constant legal navigation. At the same time, many GCs are finding themselves squeezed, with stagnant budgets having to somehow withstand the increased weight of the moment. This results in an accelerating migration of demand as clients move in search of greater value and lower prices.

While the cause of this uplift is out of the average firm's control, its reaction to it is not. Firms are racing to capitalize on the instability by loading up on talent and tech, with technology spending up nearly 10% and talent costs rising 8.2% compared to 2024 levels. Using the gains of a prosperous year to reinforce one's competitive edge is by no means a poor play; however, firms are spending like the current revenue conditions represent a permanent shift rather than a temporary spike.

History suggests otherwise. The legal industry has surged like this before — in 2007 before the Global Financial Crisis (GFC), and in 2021 before an inflation crunch — and each time, firms that mistook altitude for stability found themselves falling furthest when conditions shifted.

Leaders of today's high growth firms, standing atop their own Mount Everests of profitability, would do well to remember that the same forces which build mountains are capable of breaking down with sudden ferocity. How firms prepare for that moment, the decisions they make, and the foundations they reinforce or abandon will determine where they stand once the ground inevitably shifts again.

Key findings:

1. **Unprecedented demand surge amid market redistribution** — The US legal market experienced some of the strongest demand growth in more than a decade, driven in part by regulatory shifts and geoeconomic instability. Critically, smaller firms took the lion's share of the growth as clients moved demand from the most expensive firms to lower-cost firms.

2. **Intense expense growth** — Technology spending and talent costs are rising rapidly, with firms aggressively investing in AI capabilities while simultaneously expanding their headcount. This dual arms race is sustainable, but only so long as demand and rate growth can be maintained.

3. **Structural business model conflict** — The industry remains trapped between transformative technology and outdated billing structures. Despite heavy AI investments that fundamentally will alter how work is performed, firms and clients remain locked in hourly billing arrangements that may no longer reflect value delivered.

4. **Deteriorating buyer sentiment** — Many corporate general counsels (GCs) are signaling significant spending pullbacks ahead, with key practice areas turning negative and spending anticipation approaching pandemic-era lows. Financial forecasts point to contraction by mid-2026, suggesting that current demand levels may not continue.

5. **Historical warning patterns** — Today's legal market dynamics — characterized by booming demand amid instability, runaway expenses, and universal optimism — closely mirror the conditions that preceded previous industry downturns. The legal market appears to be repeating its pattern of surging just before a significant correction.

Law firm performance in 2025

Any honest assessment of law firm performance in 2025 must begin with the extraordinary pressures that have reshaped the entire landscape. The second Trump administration's arrival created a regulatory and geoeconomic shock that fundamentally altered global markets, with the United States as the epicenter. As tariffs escalated, trade wars intensified, and the federal government underwent radical restructuring. These mounting pressures saw clients swarm their law firms[1] for legal advice, and as a result, legal demand surged over the course of the year, averaging 2.5% but hitting as high as 4.4% growth in July.[2]

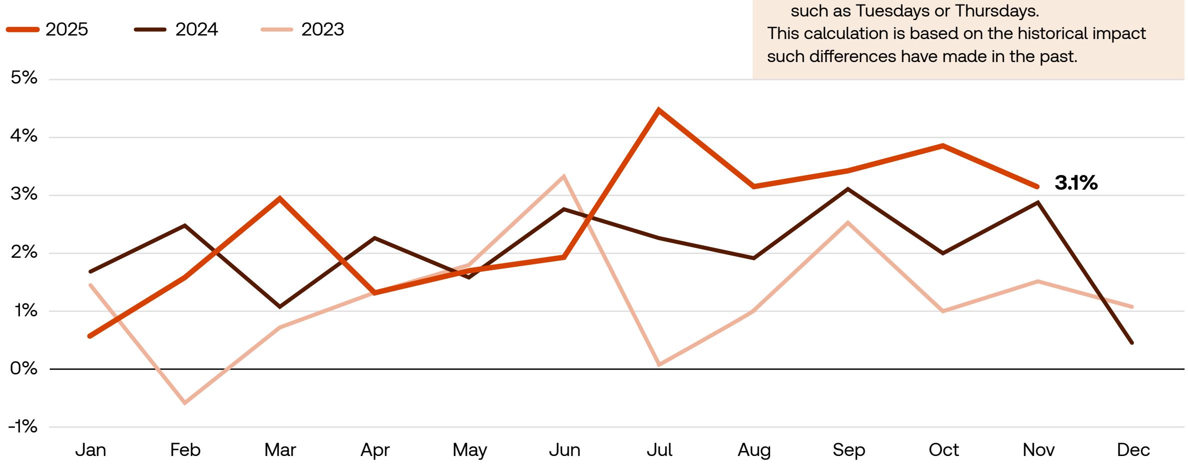
FIGURE 1:

Weekday-adjusted demand growth

Year-over-year change

Weekday-adjusted (WDA) demand is a new metric that accounts for:
- The working day difference between months.
- The differences in the number of specific days — such as Tuesdays or Thursdays.

This calculation is based on the historical impact such differences have made in the past.



Source: Thomson Reuters 2026

What began as a cooling market in early 2025 — one that was still descending from 2024's stratospheric heights — rapidly reversed course. The demand surge built steadily throughout the year, culminating in a third quarter that marked one of the most rapid expansions in total hours worked by law firms: a 3.9% year-over-year demand increase for the average firm. This powerful second half of the year lifted 2025 up to be the third best year for demand growth since the GFC, with the average firm achieving 1.9% demand growth for the year.

To understand the magnitude of this reversal, consider that the industry has averaged just 0.6% quarterly year-over-year growth since the beginning of the 2010s. Moreover, previous quarters that approached this level of growth typically represented rebounds from dramatic falls, such as the pandemic-induced collapse or other economically driven contractions.

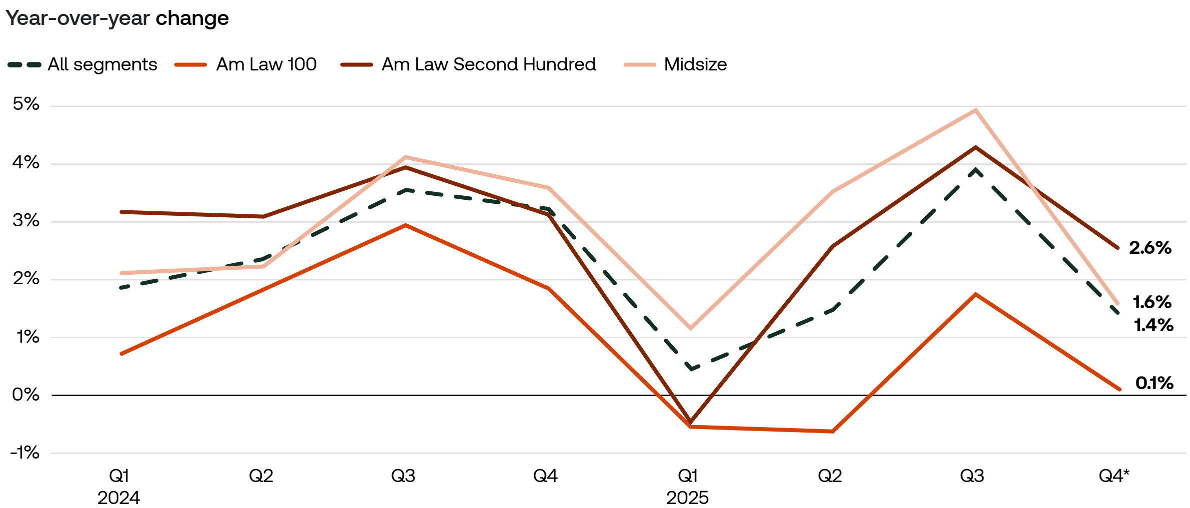
1 Financial data for this report is provided by Thomson Reuters Financial Insights. Data is based on reported results from 184 US-based law firms, including 50 Am Law 100 firms, 58 Am Law Second Hundred firms, and 76 Midsize firms (US-based firms ranked outside of the Am Law Second Hundred). Legal buyer sentiment data is from Thomson Reuters Market Insights, which provides legal buyer information from around the globe based on annual interviews with around 2,500 legal buyers with revenues of more than $50 million (US).

2 For the purposes of this report, *demand* is defined as total billable hours worked. Demand growth metrics illustrate the year-over-year change in total billable hours for the average law firm during the period examined.

The 2025 surge defied this pattern entirely. These results came *despite* being measured against 2024's record-breaking performance, a comparison that created significant headwinds throughout the year and particularly dragged second quarter results. The fact that firms achieved such growth while climbing an already elevated mountain, makes this performance even more remarkable.

FIGURE 2:

Segment demand growth separation



*Includes data through November; December data unavailable at the time of publication.

Source: Thomson Reuters 2026

This is not to say that all segments performed equally well. As we've mentioned before in past reports, mobile demand[3] has been reshaping the market for the last couple of years, and 2025 saw the divergence between segments reach its clearest example on record. Midsize firms surged ahead with nearly 5% demand growth in the latter half of the year while the Am Law 100 couldn't crack 2%, resulting in the largest percentage point-spread gap in demand between the top and bottom segments since the GFC. For much of the year, the Am Law 100 actually *contracted* while smaller firms captured all the growth. Indeed, top firms needed the third quarter's explosive surge just to crawl into positive territory for the year.

This dramatic shift reflects how GCs were caught in an impossible squeeze, managing the legal chaos of the Trump administration and a slowing economy while keeping budgets under control. With the average Am Law 100 lawyer's standard rates cracking the $1,000 barrier in 2025 — while everyone else averaged around $600 — the math became irrefutable. GCs needed to do far more legal work with the same amount of money, and they saw mobile demand as a solution. Shifting routine matters, and increasingly even moderately complex work, to those law firms charging in many cases 40% less gave GCs the breathing room their legal departments desperately needed.

The result is that firms outside the Am Law 100 grew their fees worked[4] at a pace equal to or faster than their larger counterparts despite a significant advantage towards the largest firms in terms of rate increases, suggesting the traditional hierarchy (in which the biggest firms traditionally captured the best revenue growth) may be fundamentally shifting. It's certainly working for clients, who spent less per

3 Mobile demand refers to the phenomena, prominent in 2022 and 2023, in which considerable volumes of work flowed from top-level Am Law firms to smaller, less expensive Midsize firms, greatly boosting those firms demand level and fees-worked performance.

4 Fees worked growth is a firm's total billable hours for a given period multiplied by the average worked rate.

hour on the average legal service in 2025 than they did in 2024[5]. And this was despite the average law firm's worked rates increasing 7.3% over the year.

In fact, it may have been this fundamental shift to less costly firms downstream in the market that made the overall surge in legal demand possible for most clients to afford.

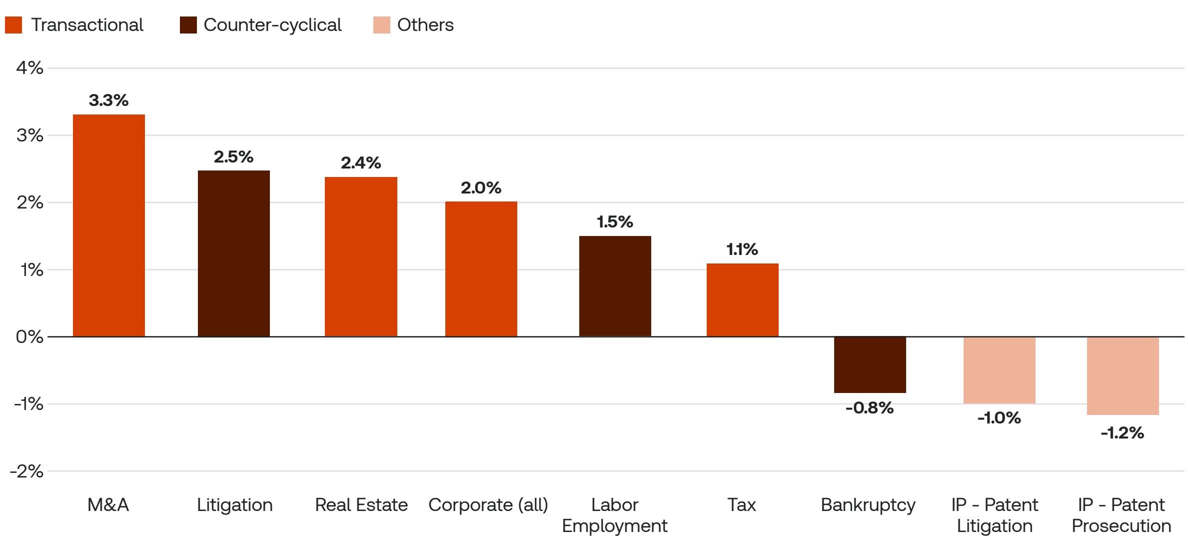
Parallel peaks in transactional and counter-cyclical work

Another feature that made 2025's surge in legal demand particularly interesting was the breadth of practices in which it was seen. Transactional practices[6] such as mergers & acquisitions (M&A), real estate, and corporate general work, were among those that drove demand the strongest; but counter-cyclical practices[7] like litigation and labor & employment, also saw greatly elevated levels of growth.

FIGURE 3:

Practice demand growth

Year-over-year change



2024 Proportion:

M&A	Litigation	Real Estate	Corporate (all)	Labor Employment	Tax	Bankruptcy	IP - Patent Litigation	IP - Patent Prosecution
4%	27%	8%	24%	11%	3%	2%	4%	5%

All timekeepers. Billable time type; non-contingent matters.

Source: Thomson Reuters 2026

This simultaneous surge across these two practice areas is highly atypical, again except for in periods of severe market disruption. Large law firms typically operate as amplifiers of the broader economic cycle. When businesses expand and capital flows freely, transactional work flourishes while counter-cyclical practices like litigation and bankruptcy recede. This inverse relationship exists because clients' legal needs fundamentally shift with changing economic conditions.

5 Thomson Reuters Institute. *Law Firm Rates in 2026*. Thomson Reuters, October 2025; available at https://www.thomsonreuters.com/en-us/posts/legal/law-firm-rates-report-2026/.

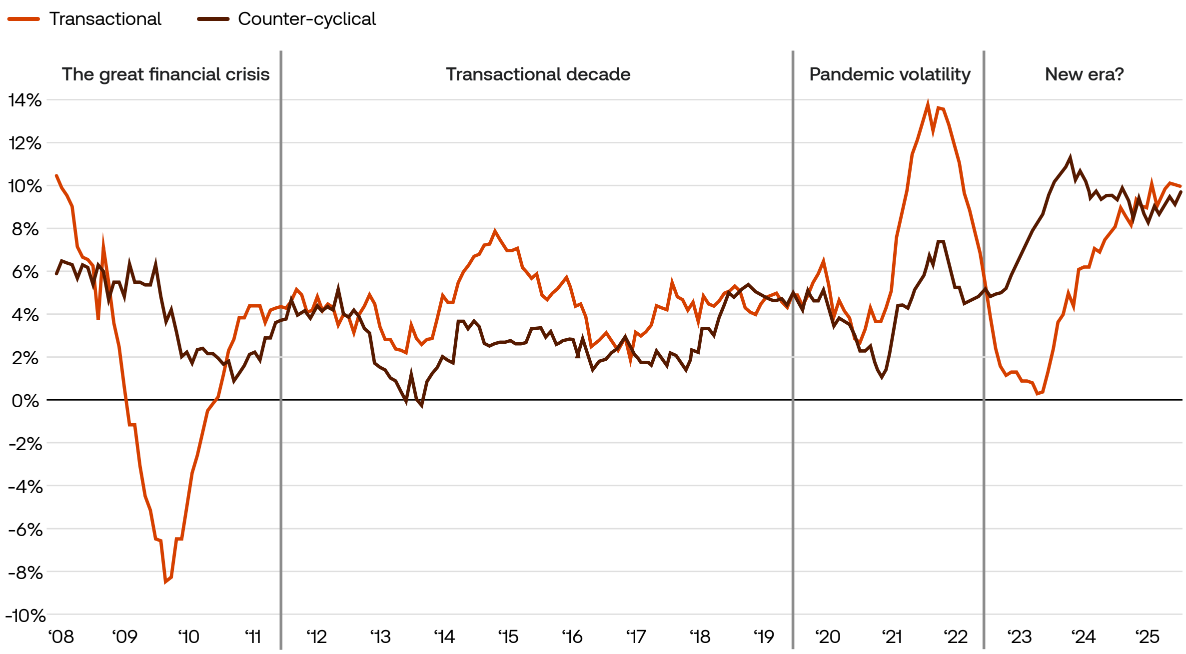
6 Transactional practices are those that tend to thrive during periods of economic expansion. For the purposes of this report, the transactional practice group is composed of corporate general, M&A, banking & finance, real estate, and tax.

7 Counter-cyclical practices are those that typically rise as other portions of the economy slow and include litigation, bankruptcy, and labor & employment.

FIGURE 4:

Transactional vs. Counter-cyclical fees worked growth

Year-over-year rolling 12-month change



All timekeepers. Billable time type; non-contingent matters. *Source: Thomson Reuters 2026*

Both practice areas have grown simultaneously during only two previous periods: in the recovery following the GFC (from 2011 to 2013), and in the early pandemic era (late-2019 to 2020). In both instances, extraordinary government intervention and regulatory upheaval created parallel demand streams. Companies needed transactional counsel to navigate new stimulus programs and restructure operations while simultaneously requiring litigation support for the ongoing economic struggle.

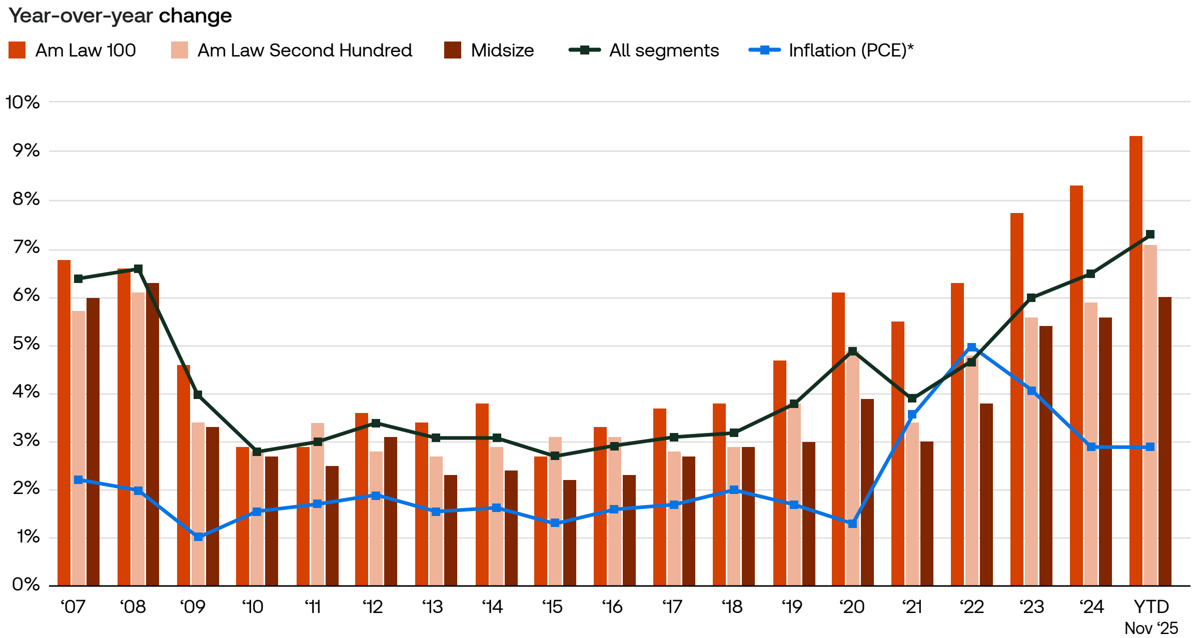
Today, the 2025 surge follows this rare pattern. Regulatory whiplash and policy uncertainty has generated both offensive and defensive legal work in equal measures.

Value and arbitrage help push rates to new heights

Where 2025 diverges from even this historical paradigm is in billing rates. While law firms in the past have experienced relatively normal worked-rate growth even during such moments of economic positivity, 2025 was anything but normal in this regard. Indeed, it shattered records. The average large law firm grew its worked rates beyond the 7% mark, the fastest growth pace since at least the GFC and likely well before that.

FIGURE 5:

Worked rates growth vs. inflation



*PCE Inflation measure = Personal Consumption Expenditures Excluding Food and Energy.

Source: Thomson Reuters 2026

For years, law firms maintained a comfortable cushion above inflation — nothing dramatic, but a steady, sustained pricing advantage of about one percentage point that reflected the specialized nature of legal work. Then in 2022, inflation briefly outpaced rate growth and firms found themselves in the unusual position of falling behind. The response was swift and decisive. Firms didn't just catch up, rather they accelerated their rate growth past inflation and kept going. By 2025, with inflation settling around the more normal (yet still elevated) 3% range, many law firms were still pushing rates of more than double that. The gap between what firms charged, and basic economic pressures had become a chasm.

While firms celebrated rate growth, it came against a backdrop of extreme client budget pressure, meaning every rate increase faced scrutiny that didn't exist in previous boom periods. The continuation of this trend thus put further tension on client spending and expectations of legal service. Much like tectonic plates coming into collision, that kind of pressure can build for years before it reaches its breaking point. There are multiple justifications for sustained premium pricing, although their viability remains largely untested. One theory holds that if firms deliver more value per hour through AI and efficiency tools, they could justifiably charge more per hour. It seems logical that when a brief that once required 10 hours to create but now might take five hours or less with AI assistance, the math might need to change. Law firms might view those saved five hours as being worth more as they contain additional strategic analysis and less document drafting. However, clients may not agree, and firms aren't yet making this case confidently.

Rather than citing AI efficiency as justification for rate increases, firm leaders express concern about needing to prove they're still worth their current rates in an AI world. Their focus is defensive, not offensive, making them appear paralyzed by fears of value erosion rather than confident explanations of value enhancement. Our research shows that what clients value extends far beyond faster turnarounds or more work per hour. Legal departments need outside firms that alleviate their current constraints, whether that's providing practical tools they can reuse, embedding seamlessly with their teams, or demonstrating clear links between legal advice and business objectives. For AI efficiency to justify premium pricing, firms must first understand what *value* means to each specific client and then demonstrate how the firm's AI deployment serves those particular needs.

Until then, it remains a compelling theory awaiting market validation, more marketing hype than a legitimate strategy.

The second dynamic – beyond AI-driven pricing pressure – that's impacting rates is more strategic and reflects a fundamental restructuring of the legal market itself. The largest Am Law firms, supercharged by the explosive growth in private equity (PE) work, are deliberately reconfiguring their practice portfolios. With PE-driven transactions commanding astronomical fees and creating seemingly endless demand for sophisticated deal work, the largest firms are concentrating their businesses on the complex transactional work that those high-paying PE clients require.

This concentration strategy has created an unexpected windfall for Am Law Second Hundred and Midsize firms. As top-tier firms narrow their focus to PE work, highly accomplished partners in other practices are finding themselves attracted to firms outside the upper echelons of the Am Law Top 50. These moves aren't departures of underperformers, rather they are strategic realignments of successful lawyers bringing substantial books of business and established teams to firms eager to expand.

It's not trickle-down economics so much as economic arbitrage.

When a top-tier litigation partner moves to a Second Hundred firm with their entire team and an intact client roster, they bring not just revenue but also the credibility to command higher rates, further fueling rate growth across the industry. Although such a move is somewhat rare (our data suggests less than one-third of laterals bring their entire book and team), it still could be enough to produce significant outcome in an industry in which even a small amount of demand growth can make a difference to a firm's bottom line.

Interestingly, this talent movement has a profound ripple effect throughout the entire legal industry. The largest firms achieve even greater profitability by concentrating on ultra-premium work like PE and pushing rates higher — all the while distributing those profits among a smaller group of equity partners. Meanwhile, smaller firms receive this talent infusion and gain the expertise and client relationships they can use to justify their own aggressive rate increases.

It's not trickle-down economics so much as economic arbitrage — although how sustainable this situation is may be a question for all participants, especially if more difficult times are on the immediate horizon.

Thomson Reuters Institute Insights

Diagnosing where your firm creates or destroys value

Premium pricing requires premium value delivery; however, most firms can't systematically identify in which areas they excel or fall short. Thomson Reuters Institute's Value Chain Health Diagnostic provides a 15-minute self-assessment across five critical stages:

1. **Demand management** — Do we understand the business problem, not just the legal question?
2. **Service design** — Are our offerings built around client outcomes or our internal structure?
3. **Delivery excellence** — Do we have systems that prevent failures before they reach clients?
4. **Value capture** — Can clients clearly understand the delivery value we've articulated?
5. **Relationship management** — Do we build trust systematically or hope it happens organically?

How it works — Rate your firm 1 to 5 (Never to Always) on three questions per stage. Scores below 9 in any stage are a sign of value destruction. These should be your priority areas to fix.

Firms that systematically audit and improve their value delivery will command premium rates even as client scrutiny intensifies. Those that assume past performance guarantees future pricing power find themselves competing on cost alone.

The technological arms race

A historic acceleration in tech spending

The current boom in legal demand has masked an arms race that's consuming cash at breathtaking speeds. The average law firm's spending on technology and knowledge management tools has grown an astonishing 9.7% and 10.5%, respectively, over the already record growth of 2024. With both categories enjoying a 7-percentage point increase above core inflation, 2025 has seen the most rapid *real* growth in these expense categories likely ever experienced. And the tech revolution this time around isn't the gentle cycle that law firms experienced when online research replaced sprawling legal libraries or when email supplanted fax machines. Such changes streamlined workflows but left the fundamental practice of law untouched.

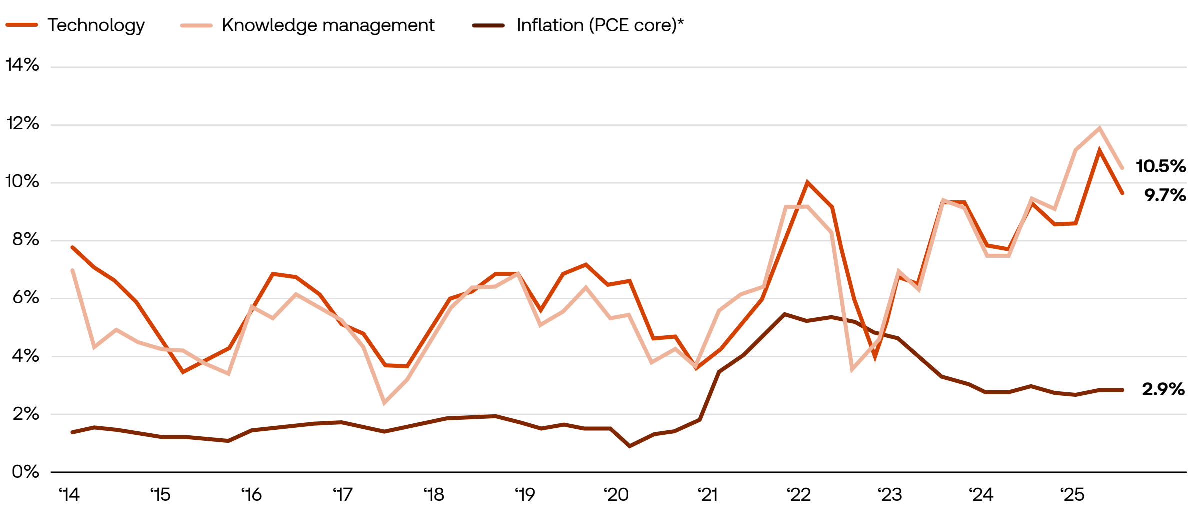
Now, the use of advanced AI-driven technology like generative AI (GenAI) represents something different: A technology that can draft briefs, analyze contracts, and synthesize case law in ways that can actually alter how legal work gets done. For an industry that's operated essentially the same way since Langdell introduced the case method in the 1870s, this is uncharted territory. And law firms have found themselves in an arms race to see which firm can claim it first and best.

The winners will not necessarily be the firms that spend the most, but those whose AI plans are strategic and intentional. Law firms with a visible AI strategy are 3.9 times as likely to see at least one form of ROI compared to firms without any significant plans for AI adoption.[8]

FIGURE 6:

Technology spend vs. inflation

Year-over-year rolling 12-month change



*PCE Inflation measure = Personal Consumption Expenditures Excluding Food and Energy.

Source: Thomson Reuters 2026

8 Thomson Reuters Institute. Future of Professionals Report 2025: Actionable Insights for Law Firm Leaders. Thomson Reuters, June 2025; available at: https://legal.thomsonreuters.com/en/insights/reports/future-of-professionals-report-2025-actionable-insights-for-law-firm-leaders.

The pressure isn't just coming from within. The same forces that are sending clients flooding to law firms — escalating risk, growing regulatory complexity, and the sheer volume of issues requiring legal attention — are simultaneously forcing those clients to find ways to afford it all. The financial crisis of 2008 killed the old model in which law firm invoices arrived, and checks were cut without question. Today's GCs scrutinize every line item, demand detailed matter budgets, and increasingly ask pointed questions about efficiency. When they see their own legal departments using AI to handle routine work at a fraction of the cost, they wonder why their outside law firms — which charge increasingly high hourly fees — aren't delivering similar efficiencies. No surprise then that corporate legal departments have led their outside firms in GenAI use since its public introduction in 2022.[9]

Indeed, GenAI has become the answer everyone's chasing. Clients see it as the key to controlling costs, while firms see it as easy justification for premium pricing based on enhanced value delivery.

AI meets an outdated system

Yet for all this technological transformation, the fundamental law firm business model remains stubbornly unchanged. According to Thomson Reuters Legal Tracker data,[10] a full 90% of all legal dollars still flow through standard hourly rate arrangements — the same billing structure that's dominated since the 1950s. This creates an almost absurd tension that sees firms deploying technology that can accomplish in minutes what once took hours, then trying to bill for it by the hour. The math doesn't work unless firms can negotiate rate increases steep enough to offset the efficiency gains; however, clients aren't eager to see all their productivity benefits flow straight to law firm profits. Nor are they prepared for the sticker shock of a $2,000 hourly bill from an associate, even if what they've accomplished in that time may have taken 10 hours to complete previously.

The result is a standoff that would be comical if the stakes weren't so high. Client interviews reveal that corporate legal departments want their outside law firms to propose innovative billing solutions that incorporate AI's efficiencies, while law firms complain that clients still evaluate everything by converting it back to hourly rates. Why spend months developing a sophisticated value-based pricing model when the procurement team will just divide the total by estimated hours and compare it to last year's rates?

Both sides are waiting for the other to blink first, meanwhile continuing to operate under a billing system that makes less sense with each passing quarter. Making matters worse, most clients don't even know if or how their outside firms are using GenAI —a disconnect that suggests neither side is having the honest conversations necessary to break the impasse.

Behind the scenes, however, firms are quietly assembling more creative solutions. They're increasingly packaging together various pricing structures, automated services, and partnerships with alternative legal service providers (ALSPs) into comprehensive offerings. ALSP usage has risen steadily over the past decade,[11] and forward-thinking law firms are incorporating these providers as force multipliers rather than viewing them as competition. The question in the legal sphere has become *how* to structure arrangements that let both firms and clients capture value without getting trapped in outdated billing models. (This is also an area in which North American firms are farther behind the curve. Just 27% of lawyers from North American firms reported that their firm has a non-traditional legal services division or partners with independent ALSPs. This compares to 76% of lawyers across the UK, Europe, and Australia.[12]

9 Thomson Reuters Institute. *2025 Generative AI in Professional Services Report*. Thomson Reuters, April 2025; available at: https://www.thomsonreuters.com/en/reports/2025-generative-ai-in-professional-services-report.

10 Thomson Reuters Institute (in collaboration with Legal Value Network). *2025 Legal Department Operations (LDO) Index*. Thomson Reuters, September 2025; available at: https://www.thomsonreuters.com/en-us/posts/corporates/ldo-index-report-2025/.

11 Thomson Reuters Institute, Center on Ethics and the Legal Profession at Georgetown Law, and Saïd Business School, University of Oxford. *Alternative Legal Services Providers 2025*. Thomson Reuters, January 2025; available at https://www.thomsonreuters.com/en-us/posts/legal/alsp-report-2025/.

12 Ibid.

And this is a critical quest. The firms that crack this code first and create pricing structures that align incentives rather than pit efficiency against profitability will have a decisive advantage when the current demand surge moderates. Those firms that don't may be in trouble, as according to the Thomson Reuters *Future of Professionals 2024* report,[13] 52% of corporate legal respondents say they believe a larger proportion of work will move in-house over the next five years.

The good news is that law firms still have time. Corporate clients are not yet demanding that their firms use AI to cut costs. Research from both the Thomson Reuters Institute[14] and the Association of Corporate Counsel[15] have found that more than 80% of senior corporate legal counsel are not requiring their outside counsel to use AI.

However, the mix of work flowing from clients to their outside firms is changing. With GCs increasingly under cost pressures, particularly in an uncertain economic market, in-house automation will continue to be an attractive option for cost containment. While law firms continue to be the primary resource for bet-the-company legal work, many firms will need to find how to replace the low-level, repeatable work that bolsters their overall revenue figures.

Thomson Reuters Institute Insights

Pricing models must evolve with client value — not against it

There's an uncomfortable irony at the heart of law firms' AI investments: The more efficiently that firms deliver legal work to clients, the less they can charge under traditional hourly billing models. Firms are pouring millions of dollars into AI-driven tools that compress 10 hours of work into two, then find themselves either ratcheting up their hourly rates by extraordinary levels or watching their revenue shrink. Meanwhile, clients operating under severe resource constraints are increasingly seeking firms that alleviate those constraints — yet hourly billing does just the opposite.

Every efficiency gain becomes a zero-sum negotiation, creating adversarial dynamics between outside law firms and their clients that erode trust and drive clients toward competitors that are willing to share the benefits of working smarter.

Those law firms able to break this cycle are the ones getting specific about what *value* actually means to each client, even though it may vary widely. Designing pricing around set definitions — fixed fees for predictable work, success-based arrangements tied to business outcomes, subscription models for ongoing counsel — requires real conversations with clients about their business objectives, not just their legal needs.

Firms that have already moved in this direction report stronger client relationships and better profitability. Those firms that keep defaulting to hourly rates will find their clients have already moved on to someone who bothered to ask what they needed.

13 Thomson Reuters Institute. *Future of Professionals Report 2024*. Thomson Reuters, July 2024; available at https://www.thomsonreuters.com/content/dam/ewp-m/documents/thomsonreuters/en/pdf/reports/future-of-professionals-report-2024.pdf.

14 Thomson Reuters Institute, *2025 Generative AI in Professional Services Report*.

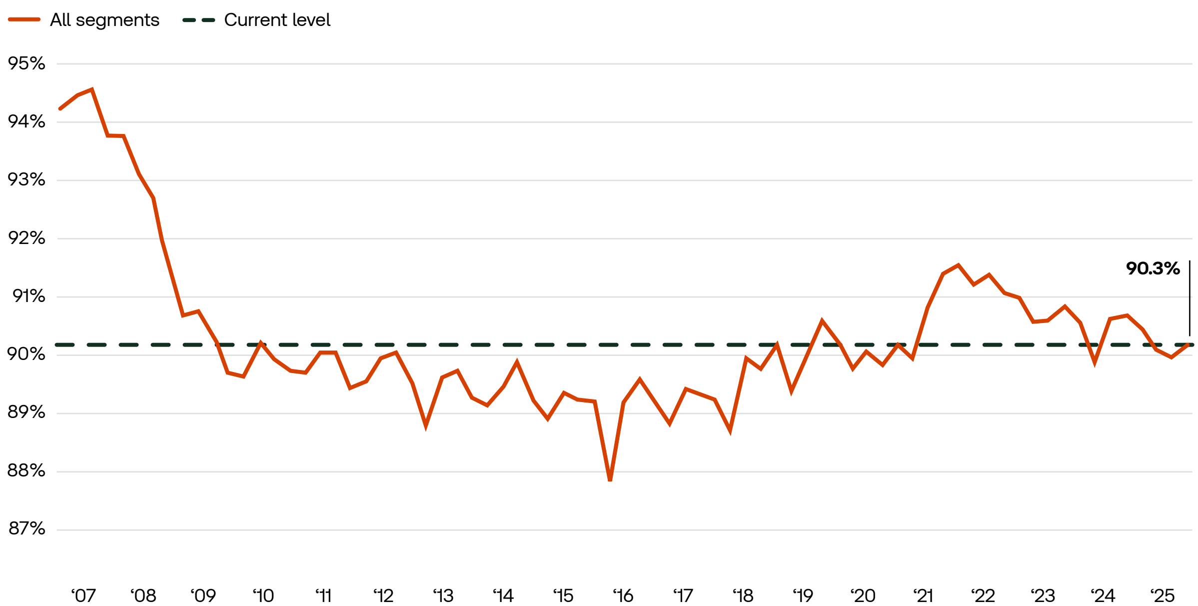
15 Association of Corporate Counsel and Everlaw. *Generative AI's Growing Strategic Value for Corporate Law Departments*. October 2025; available at https://www.acc.com/resource-library/generative-ais-growing-strategic-value-corporate-law-departments-survey-results.

What happens if things go wrong

Law firms have seen this movie before, and they should remember how it ends. The financial crisis that began in 2007 didn't just crater demand; it fundamentally rewired the power dynamic between firms and clients. As firms shed partners and associates by the thousands, corporate legal departments eagerly absorbed this talent, transforming themselves from bill-payers into sophisticated legal operations. Suddenly GCs had former Big Law lawyers on staff who knew exactly how firms made up their bills, which matters required senior attention, and what work could be done for a fraction of the price.

FIGURE 7:

Collection realization against worked (negotiated)



Source: Thomson Reuters 2026

The evolution was swift and brutal: Billing scrutiny went from cursory to forensic, realization rates plummeted, and rate growth flatlined for nearly a decade. Firms that had grown accustomed to annual rate increases of 5% to 6% found themselves grateful for 2%.

Now, GenAI threatens to trigger a similar revolution if the cards fall in the wrong way. If an economic downturn forces clients to again squeeze their legal budgets for every drop of efficiency or sends another wave of top-tier legal talent from firms to in-house departments, the resulting transformation could be even more dramatic. Corporate legal departments armed with both Big Law expertise and AI capabilities wouldn't just negotiate harder on rates, they might stop needing outside firms for entire categories of work.

The firms that survive and thrive will be those that get ahead of this shift now, while demand is strong and resources are available, rather than waiting for the next crisis to force their hand.

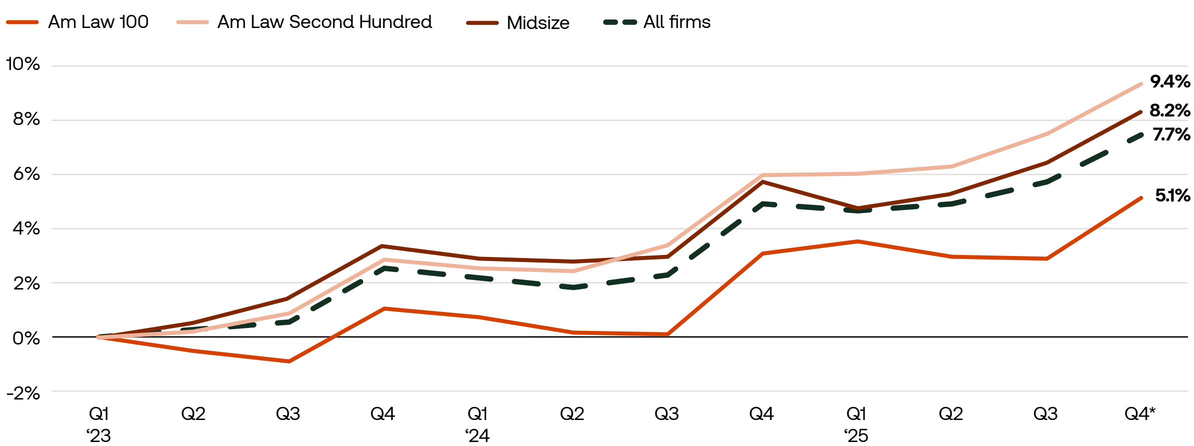
The other arms race – talent

The technology spending surge tells only half the story of law firms' escalating cost structure. Just as much if not more money is flowing into securing top talent, with direct spending[16] on lawyer compensation having jumped 8.2% compared to 2024 — which itself was a year that saw growth at twice the rate of core inflation. This isn't targeted spending on a few rainmakers or strategic lateral hires, rather it's broad-based compensation growth across every level. Per-lawyer spending on associates is up 3.8%, while compensation for everyone else has risen 4.9%. With direct expenses already consuming almost one-third (32%) of the average firm's revenue, this is a substantial portion of a firm's overall budget.

FIGURE 8:

FTE growth since 2023

Percent change since January 2023



*Includes data through November; December data unavailable at the time of publication. *Source: Thomson Reuters 2026*

The spending doesn't stop at lawyer salaries, however. Overhead expenses per lawyer have climbed 4.3%, with support staff costs surging over 6% as firms build out the infrastructure to support their new lawyers. Whereas other industries may be touting AI-induced layoffs to promote efficiency, the legal industry has chosen the opposite course: If AI augmentation makes their lawyers better and more efficient, then that only makes manpower more valuable, not less. Lawyer FTE growth has remained strong, with firms growing headcount by 2.9% in 2025. Indeed, 2025 was the third year of historically strong hiring, with most of that growth coming, perhaps unsurprisingly, from the firms that were experiencing the greatest demand growth. Since January 2023, the average Midsize and Second Hundred firm has grown their total headcount by more than 8%, with the average Am Law 100 firm holding to a more reserved 5%.

The situation makes more sense when you understand what's happening on the ground. Associates, whose realization rates are the lowest on average at 85.6%, are producing work that's already being written off at a significant pace. This creates a buffer in which AI can absorb the inefficient portions without touching collected revenue. In this way, firms can automate the work that wasn't getting paid for while keeping associates busy on higher-value tasks.

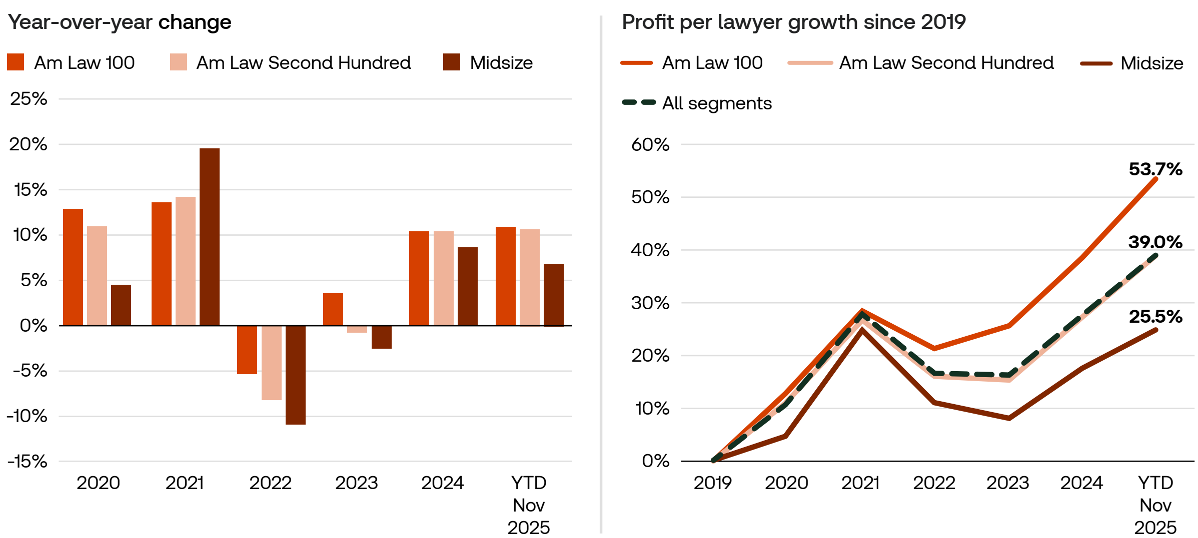
16 For these purposes, direct expenses refer to those expenses related to fee earners, primarily the compensation and benefits costs of lawyers and other timekeepers. Overhead (or indirect) expenses refer to all other expenses of the firm, including occupancy costs, administrative and staff compensation, and benefits, technology costs, business development expenses, and more.

Profits at a precipice

On paper, this formula that law firms have followed works spectacularly. Firms are on track to deliver nearly double-digit profit growth for 2025, with the average firm seeing a 13% rise in profitability compared to the already exceptional heights of 2024. The combination of record demand and historic rate increases has kept firms' immense expense growth from dampening a profit bonanza that rivals the best years in the legal industry's history. Partners looking at their draws might reasonably conclude that the strategy is working — throw money at technology, throw money at talent, raise rates to cover it all, and watch the profits roll in.

FIGURE 9:

Profit per lawyer growth



Source: Thomson Reuters 2026

However, if we drill down on each law firm segment, the story reveals just how differently this boom is playing out across the market. Midsize firms are finally breathing again after years trapped in what we've sometimes referred to as the *Midsize demand trap* — caught chasing demand growth at double the pace of Am Law firms and paying dearly for it. Midsize firms' aggressive hiring during the 2021-'22 talent war sent direct expenses soaring by double-digits just as their more limited pricing power prevented them from pushing rates as hard as their larger competitors. When demand softened in late-2022 and inflation crept in, Midsize firms got crushed between surging costs and constrained pricing. Only now in 2025 have they clawed back to their 2021 profit-per-lawyer peaks — a four-year round trip that should serve as a cautionary tale for the entire market about the dangers of growth at any cost.

The Am Law Second Hundred segment tells a happier story. Having threaded the needle more successfully with strong rate growth and less vicious expense escalation, they're up 39.0% in profits per lawyer since pre-pandemic 2019. Second Hundred firms clearly are benefiting from both the mobile demand flowing their way and their ability to raise rates without the baggage of being the most expensive option.

However, and not surprisingly, it's the Am Law 100 that's truly defying gravity — up an astounding 53.7% in profits per lawyer since 2019, posting the best profit growth of any segment even as the mobile demand movement away from them supposedly threatens their dominance.

The buyers' vote

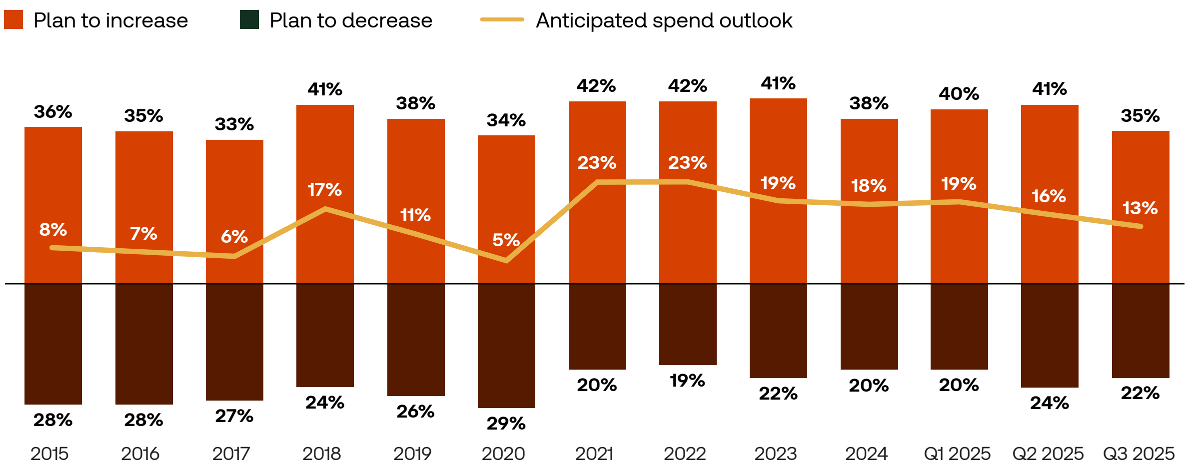
However, the data we're getting from the legal buyers powering this bonanza of growth, may suggest another perspective on this ongoing sunny outlook from firms.

When we surveyed corporate GCs about their 2026 spending plans, optimism is steadily evaporating. Net Spend Anticipation (NSA)[17] has been sliding steadily downward. The higher the NSA number, the more buyers plan to increase their spending; but what we're seeing now is that the NSA number is dropping into territory not seen since the pandemic struck in 2020.

FIGURE 10:

Net Spend Anticipation

Total legal spend optimism: Global cos with $1B+ in annual revenue
(percentage of buyers planning to increase versus planning to decrease)



Source: Thomson Reuters 2026

The crucial insight here isn't that there may be less legal work on the horizon — if anything, the complexity and chaos guarantee continued need for legal services. Instead, it's that clients are being forced to make increasingly brutal choices about which firms get their limited dollars.

Thomson Reuters Market Insights research calls this phenomenon a *client value squeeze,* and it's becoming a major factor behind these constrained spending choices inside corporate legal departments. Even as 86% of GCs say they believe they are making significant contributions to organizational objectives, nearly 90% report that resource limitations are preventing them from delivering the level of strategic impact their organizations expect.

This persistent fire-drill mode has created intense scrutiny over the use of external counsel, with buyers increasingly prioritizing firms that can clearly articulate how their work advances clients' business goals. Compounding this pressure is a widening perception gap within corporations: While GCs believe they deliver high value, the C-Suite[18] often ranks the legal function among the least visible contributors, forcing legal departments to justify every dollar they spend outside the organization.

17 For these answers, we calculated a *Net Spend Anticipation* by subtracting the percentage of respondents who said they anticipate a decrease in their legal spend from those who said they anticipate an increase.

18 Thomson Reuters Institute. *2025 C-Suite Report*. May 2025; available at https://www.thomsonreuters.com/en-us/posts/wp-content/uploads/sites/20/2025/05/2025-C-Suite-Report.pdf.

Against this backdrop, the delivery gap becomes even more consequential. In fact, one-in-four buyers report never having experienced an outside law firm that has successfully delivered excellent value despite a premium price tag, making firms that do differentiate on value communication disproportionately attractive. These dynamics mean that today's tightening client budgets are not merely financial decisions, but strategic reallocations driven by the need to maximize visible impact per dollar spent.

FIGURE 11:

How legal perceives their department's contribution to organizational objectives

Source: Thomson Reuters 2026

The sector-specific breakdown of anticipated corporate spend on legal services reads like an economic weather map with storm systems forming. Real estate development sentiment has turned sharply negative (no surprise given interest rate uncertainties and commercial property distress) while consumer-facing businesses are flatlining. More surprising is the decline for technology and telecom, currently the darling of the stock market as the AI boom has found itself the sole source of stock market growth.

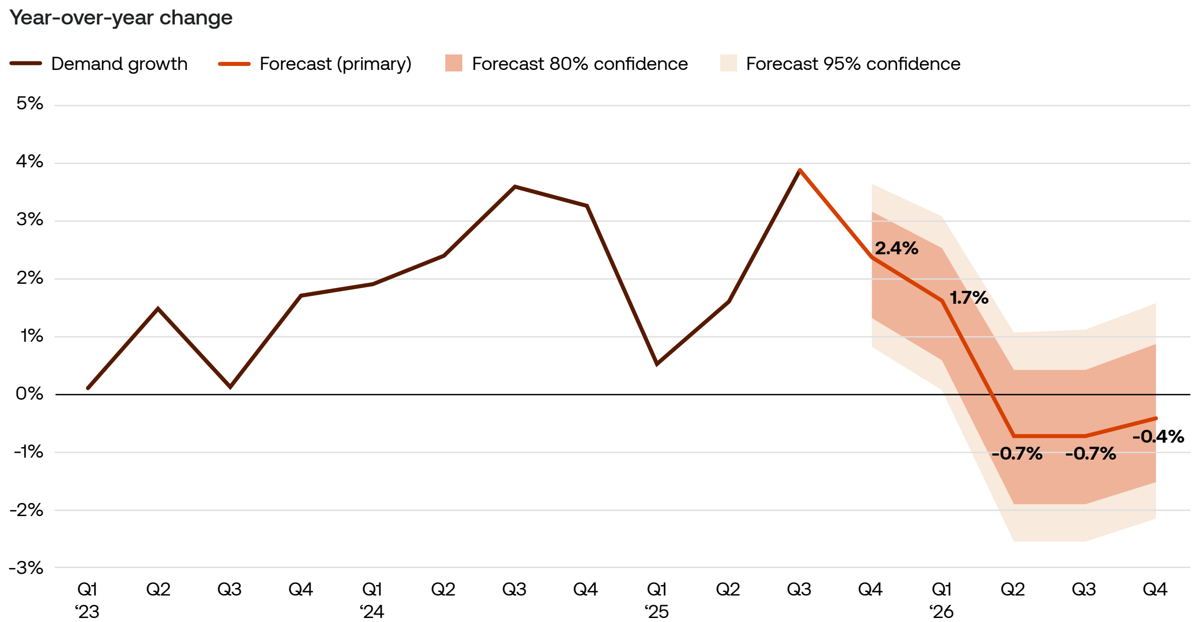
The only bright spots? Healthcare and pharmaceuticals maintain positive momentum, consistent with historical patterns that have seen investors flee to recession-proof sectors during downturns.

Practice area preferences tell the same story of battening down for rough weather. Regulatory work and counter-cyclical practices dominate the few remaining areas with double-digit NSA, while transactional practices — the very ones driving today's law firm profits — face declining anticipation.

These NSA-infused forecasts are not alone. Financial forecasts for the large law firm industry from Thomson Reuters Financial Insights point towards a steep drop off of growth going into 2026, with the middle of the year slipping into contraction. These forecasts, based off current economic fundamentals, only become worse if the US economy were to slip into a full recession.

FIGURE 12:

Q4 and 2026 demand outlook



Source: Thomson Reuters 2026

Thomson Reuters Institute Insights

The playbook nobody wants to use

When the global financial crisis hit almost two decades ago, law firms discovered just how quickly the power dynamic with their clients could flip. Invoices that once sailed through to approval started coming back covered in red ink. Realization rates didn't slowly erode; they cratered and stayed down for nearly a decade. The scrutiny that emerged from that crisis never fully went away, rather it just became the new normal.

This kind of shift can happen faster than most firms' financial planning cycles can manage. And while most firms have contingency plans for something like this, what they truly need is practice — actual simulations in which partners play distressed clients pushing back on bills, finance teams respond to a sudden cash crunch, and someone throws an unexpected wrench into the exercise halfway through.

Law firms already game out cybersecurity incidents and data breaches in this very fashion. Now, they should be doing the same for billing crises and client insolvencies. Beyond revealing vulnerabilities, this kind of game-practice builds institutional muscle, strengthening the reflexes and judgment that let teams improvise when the real crisis inevitably deviates from the script.

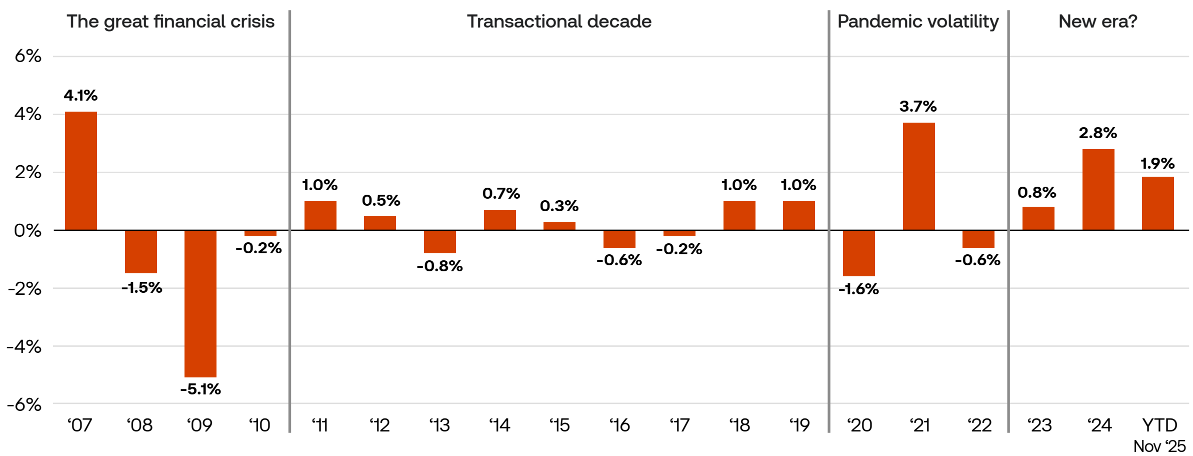
Preparation isn't the most prestigious work, but when realization rates start sliding, it can be the difference between helping pull clients from the ledge or tumbling down with them.

History's warning signs for 2026

Unfortunately, in addition to these dour economic forecasts, history doesn't seem to be on law firms' side either. As our research has shown, the legal industry has a peculiar historical habit of surging just before it stumbles. We saw this in 2007, when firms posted some of their best demand growth in years, right up until Lehman Brothers collapsed. The pattern repeated in 2021-22 as firms rode the pandemic stimulus wave to extraordinary heights, before inflation bit and interest rates spiked. Much of that demand evaporated almost overnight, leaving firms with bloated cost structures and empty pipelines.

FIGURE 13:

Historical demand growth



Source: Thomson Reuters 2026

Today's demand explosion bears uncomfortable similarities to those previous peaks. We're seeing the same breathless deal-making, the same confidence that this time is different, the same assumption that current conditions represent a new normal rather than an aberration. With 3.9% quarterly demand growth in 2025 and the simultaneous surge in both transactional and litigation work, it all feels very familiar.

The warning signs are there: collection realization showing the occasional wobble, clients aggressively moving work downstream even while paying premium rates for what remains, and expense growth threatening to overwhelm even exceptional revenue gains.

Yet there's an argument that this time genuinely is different. Previous surges were tied to economic bubbles — excessive credit in 2007 and excessive stimulus in 2021. Today's demand isn't driven by economic exuberance but by instability itself, such as trade wars, regulatory chaos, and geopolitical tensions. These factors aren't cyclical phenomena that will simply reverse when the economy cools, rather they're structural changes that could sustain legal demand even through a recession. Indeed, when the economy is becoming fundamentally more complex and regulations changing on a tweet, the need for legal services might have genuinely uncoupled from traditional economic cycles.

Viewed through this lens, the groundswell firms are riding suggests that the ground beneath them is becoming fundamentally unstable—less a mountain than a volcano: a risky evolution but still capable of sustaining them through a long winter. Yet living on a volcano carries its own perils, and firms may ultimately miss the relative predictability of the occasional tremor.

What 2026 may bring

The same tectonic pressures that once thrust the Himalayas skyward offer a fitting parallel for today's legal market. Indeed, that very geology reminds us that height is temporary and a single great shock can even bring down mountains. The legal industry's current elevation is no different. Peaks endure only when the forces that built them remain aligned; today, those forces are already shifting.

It's also a key reminder that much of this is simply out of firms' control. The forces that resulted in this surge of demand — political and economic instability — were not the results of firms' actions any more than a city is responsible for the motion of the tectonic plates beneath it. Yet one should not allow these forces being outside of firms' control to become an excuse for firms to act powerless. Other factors, from firms' rate strategies to how they capitalize on or mitigate mobile demand, are very much in firms' power, as are their strategies around technology, talent, and communicating value.

Yet one should not allow these forces being outside of firms' control to become an excuse for firms to act powerless.

Those firms best positioned for what comes next will use the current boom to reinforce their footing rather than admire the view. That means modernizing pricing models that no longer match how legal work is done, strengthening client trust in an environment in which legal buyers are increasingly selective, and deploying technology in ways that deliver measurable value rather than marketing gloss. These steps won't guarantee altitude, but they will anchor firms to something more solid than current momentum.

In this sense, 2025 is less a summit than an inflection point — a moment in which the underlying pressures reshaping the legal landscape became impossible to ignore. The industry is entering a new era in which understanding those forces matters far more than celebrating the height they may temporarily provide. Those firms and their leaders that treat elevation as permanence may find, as countless ranges have over geologic time, that height is not a promise — it's a phase.

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