



2025 Report on the State of the US Legal Market

by

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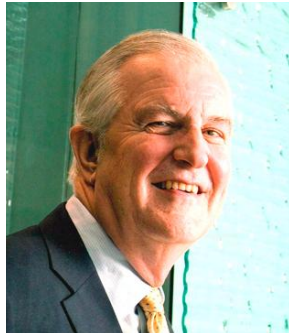
Embracing Change in the Era of Innovation



Thomson Reuters
Institute

In Memoriam

Dedicated to the memory of James “Jim” Jones IV (1945-2024)



It is with great sadness and profound gratitude that we dedicate the 2025 Report on the State of the US Legal Market to the memory of our good friend and colleague, Jim Jones.

Jim's obituary captures well his contributions to the legal field:

With a career spanning over five decades, Jim's legacy is defined by his remarkable contributions to the legal field, his commitment to public service, and his tireless efforts to uplift his community.

Jim's career spanned both private and public service, including as assistant to the general counsel of the United States Air Force, managing partner of Arnold & Porter, general counsel at APCO

Worldwide, chairman of the Pro Bono Institute and Hildebrandt International (later Hildebrandt Baker Robbins), and founder of Legal Management Resources LLC.

Jim was known for his important contributions to the legal academy as a Senior Fellow at the Center for the Study of the Legal Profession at Georgetown Law Center and through the founding of the Master's program in Law Firm Management at The George Washington University College of Professional Studies.

Jim was widely recognized for his expertise and thought leadership, earning multiple awards and countless accolades for his writing and speaking.

It was in this capacity that we at the Thomson Reuters Institute were privileged to collaborate with Jim for more than 15 years through many evolutions of this report, the development of the Alternative Legal Service Providers report, the annual Law Firm COO/CFO Forum event, and countless other occasions for which we are forever thankful.

Jim embodied the phrase "love what you do, and you'll never work a day in your life," as his joy and passion for his work and the legal profession was always evident.

Everyone who was fortunate enough to learn from Jim's well-earned wisdom and insights was better for it. He will be greatly missed.

A handwritten signature in black ink, which appears to read "Michael Abbott". The signature is fluid and cursive.

Michael Abbott
Head of Thomson Reuters Institute

Executive summary

The rapidly evolving landscape of the legal industry throughout the past year may have finally pushed law firms toward an answer to the question “is law a profession or a business?”

While the year-end results for many law firms are encouragingly strong, the underlying factors of the marketplace clearly point to the need for law firms to operate increasingly like the sophisticated businesses they are. That will include working with their clients to consider how the shifting fundamentals of the market will impact the delivery of legal services and the overall business model of the practice of law.

This year’s report highlights significant shifts in law firm business models, driven by changing client expectations, competitive market dynamics, and advancements in technology.

Key Findings:

1. **Rethinking the law firm pricing model** – The traditional billable hour model, long a cornerstone of law firm economics, is under increasing pressures. Discussions around alternative pricing models that focus on the value of the outcome, rather than the amount of time spent, reflect a broader shift towards client-centric practices.
2. **The strength of 2024 law firm economic performance** – Despite uncertainty in the broader economy, law firms have shown resilience, with strong profits per equity partner and overall profitability. This success is attributed to strategic adjustments in compensation structures, performance expectations, and partnership models.
3. **Continued strong growth in demand for law firm services and billing rates** – The legal market in 2024 experienced historic, broad-based growth in demand for law firm services across various practice areas. Billing rates also saw significant increases, continuing their strong upward trajectory and defying historical patterns.
4. **Controlled expense management and the need for strategic investment** – Law firms have managed to control expenses effectively, with a notable focus on technology and knowledge management investments. This strategic spending, and the need to continue to update existing data infrastructure, are essential for adapting to the rapidly changing technological environment.
5. **The shifting law firm talent model** – The composition of law firms is evolving, with a shift towards more experienced lateral hires, growth in two-tier partner structures, and a reduction in junior associate hiring. This trend reflects the changing demands of the market and the impact of generative AI on legal work.
6. **Future challenges facing law firms** – The report underscores the need for law firms to continue adapting to technological advancements, particularly generative AI, which is expected to transform legal services, influence client expectations, and necessitate new pricing models.

The coming year is likely to highlight the importance of agility and innovation in the legal industry – traits which are not historical strong points for the majority of law firms. However, the evidence shows that even in an environment in which law firm business models are changing at an unprecedented rate, law firms themselves have rarely been more successful.

Rethinking the law firm business model

American lawyers have fiercely debated whether the practice of law could be described as a *business* as well as a profession. Opponents of the idea passionately argue that applying commercial concepts to legal practice undercuts the core principles of the profession by focusing on the self-interests of lawyers rather than their obligations to act only in the best interests of their clients. Proponents, on the other hand, point out that successful legal practices have always blended lawyers' business interests with their professional obligations. The growth and expansion of law firms, as well as dramatic changes in the legal market, have pushed the profession toward greater recognition of the need to apply sound business principles to the growing business of law.

Yet, despite this recognition, most law firms still adhere to familiar management patterns drawn from earlier and simpler times when firms were much smaller, more closely knit communities of familiar colleagues, most of whom had grown up in their firms together.

Reflecting this fact, most law firms retained their traditional partnership models — highly leveraged, single-tier partnerships that aspired to lock-step compensation systems. Leaders of these firms believed in growing and promoting talent from within the firm, and regarded their partners as permanent colleagues, all of whom were expected to work collaboratively together.

A further common tenant of that template, of course, has been an historic adherence to the concept of the *billable hour model*. Despite the well-documented faults in this method of billing, from its overreliance on inputs rather than outputs, its inflexibility and its increasingly obsolete nature in regard to the rise of technology-driven automation, the billable hour has remained a fixture of firms for over half a century.

Evolution is well underway, however, and 2024 appears to be the year in which the pressures of change in law firm economics and structure have become inescapable.

At least since the global financial crisis (GFC) that began in 2008, the market for law firm services has become far more competitive, shifting from a sellers' to a buyers' market, driven primarily by a dramatic change in client expectations to be in control of all major decisions related to the planning, scheduling, staffing, and pricing of their matters.

The market for legal talent has also become more competitive, with lateral partner moves and mergers reaching record levels, even during a period of significant economic uncertainty. This has forced many firms to pursue both offensive and defensive talent strategies to both expand and protect their key clients and practices. The most significant of these changes came in the form of reductions in the ranks of equity partners, along with changes to their compensation structures, performance expectations, and more. Other firms altered their partnership tiering as they ramped up their numbers of non-equity partners. Firms have also reduced the pace of associate hiring and the size of their summer associate programs.¹

Most law firms finished 2024 with strong profits per equity partner, continuing their performance from 2023. In many cases, however, that achievement was possible only because of fundamental changes in the economic and compensation models of the firms themselves — changes that would have been hard to imagine a few short years ago.

Clearly, law firms have embraced commercial realities and are moving decisively to protect themselves as viable businesses, even at the price of giving up traditional models. As the vision for tomorrow

¹ Engelland, B., *Law Firm COO & CFO Forum: Preparing for the law firm of 2034*; Thomson Reuters Institute (Nov. 20, 2024) (<https://www.thomsonreuters.com/en-us/posts/legal/coo-cfo-forum-law-firm-2034>).

evolves and generative artificial intelligence and other advancing technologies play ever larger roles in the delivery of legal services, it is likely that even more significant changes will be required. For now, however, it appears the proverbial genie is out of the bottle, with the changes to the world of large law firms set to only accelerate if anything. The financial successes of 2024 may well provide the solid footing needing for law firms to confidently launch into the future rather than waiting for the impetus for change to become unavoidable.

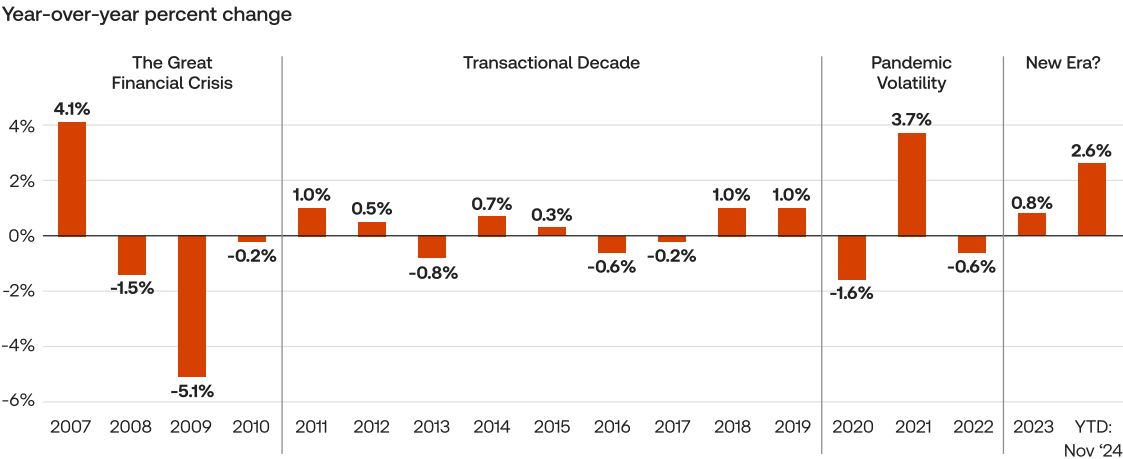
Law firm performance in 2024: A year of anomalies

The performance of law firms in 2024 is perhaps best reflected in the performance of three key metrics where results this year have been surprisingly strong but historically atypical in the post-GFC era: demand, rates, and expenses.

Demand: Growth in all sectors

To be sure, law firm demand² has seen³ a historic growth surge, with the average law firm experiencing growth in demand of 2.6% in 2024. For the large law firm industry, this is incredibly atypical, as firms in that category averaged 0.1% annual demand growth from 2007 to 2023. The level of demand growth seen in 2024 is comparable only to the pandemic-era bounce back from historic lows, when law firm demand grew 3.7% on average in 2021. This growth was, however, measuring from the *collapse* of demand that defined 2020, in contrast to 2024 which is measuring on top of 2023’s already strong growth. In other words, the 2024 demand performance is far stronger and more *real* than 2021’s bounce back.

FIGURE 1:
Historic demand growth



Source: Thomson Reuters 2025

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

3 Financial data for this report is provided by Thomson Reuters Financial Insights. Data is based on reported results from 183 US-based law firms, including 51 Am Law 100 firms, 52 Am Law Second Hundred firms, and 80 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 above \$50 million (US).

Moreover, this demand growth did not come from just one practice area or even a small group of practices, but rather from a general swell of demand across both transactional⁴ and counter-cyclical⁵ practice groups. This is not to say that growth in all practices was equally robust, but many practices that had previously been holding the market back rebounded into positive territory this year, while stronger practices from 2023 maintained or even accelerated their growth pace.

Major transactional practices — corporate (all), real estate, and tax — that were all drags on firm performance in 2023, improved significantly in 2024. The result was a transactional category that, as a whole, rebounded from a 2.3% contraction in 2023 to 1.6% growth as of November of 2024 on a year-to-date basis. Although transactional demand has not yet fully recovered to the heights of 2021, the fact that it is now returning to growth mode means that counter-cyclical practices that have performed exceptionally over the past few years will no longer experience as much drag from transactional work.

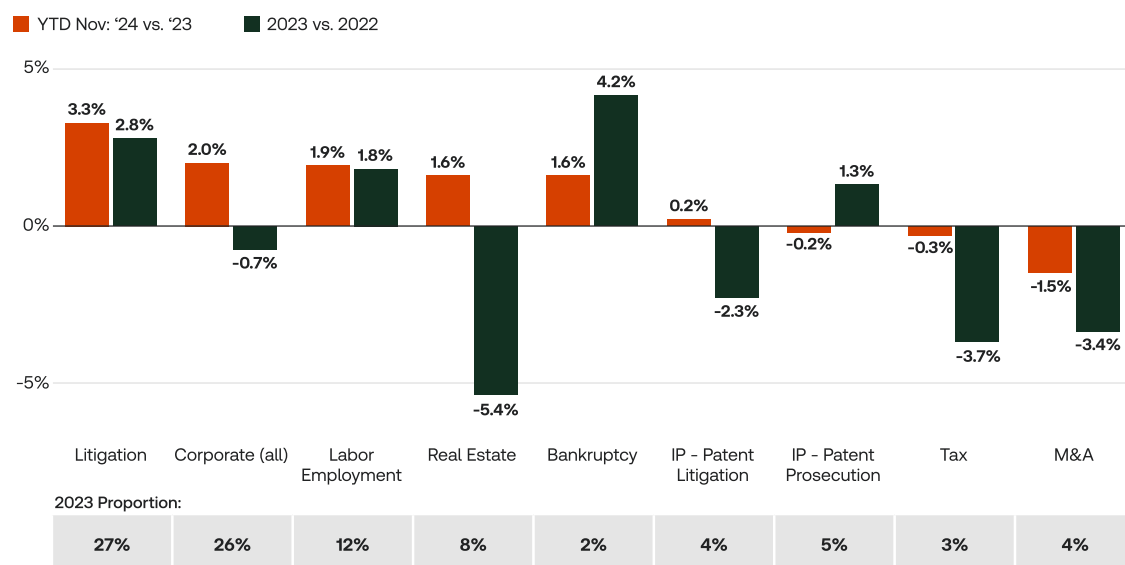
Indeed, if counter-cyclical practices (such as litigation) had simply *maintained* their growth paces in 2024, law firms would already have performed better than the previous couple of years. Instead, what happened was an *acceleration*.

Litigation demand grew 3.3% in 2024 on top of its 2.8% growth in 2023. This, coupled with steady performance from labor & employment, accounted for almost 40% of all lawyer work hours in 2024, meaning the performance of these two practices was far more impactful than the moderate deceleration of smaller practices such as bankruptcy and patent prosecution. The end result was a massive, if highly unusual, surge in overall demand across a number of diverse practices.

FIGURE 2:

Practice demand growth

Year-over-year percent change



Source: Thomson Reuters 2025

4 For our purposes in this report, transactional practices include general corporate, M&A, real estate, and tax practices.

5 For our purposes in this report, counter-cyclical practices include litigation, bankruptcy, and labor & employment.

Moreover, the demand surge across practices occurred in every segment of the market. Midsize firms saw their demand growth increase from 2023, when mobile demand⁶ from price-conscious clients flowed from Am Law 100 firm down to Midsize firms, providing a major growth opportunity for the latter. Am Law 100 firms also had a better year themselves, notching a two-percentage point increase in demand growth compared to 2023. That upswing in demand, combined with leading worked rate growth, significantly boosted Am Law 100 firms' top and bottom lines. Indeed, Am Law 100 firms were the only market segment to grow fees worked⁷ by double digits compared to 2023. Am Law Second Hundred firms also had a good year, driven by a surge in both transactional and counter-cyclical demand, nearly matching Am Law 100 firms in fees worked despite lagging nearly three percentage points in worked rate growth.

The TR Institute's View:

Ultimately, every law firm segment walked away from 2024 with something to brag about in terms of demand growth, although some had weightier hauls than others. Of course, the billable rate factor had a significant influence on firms' results as well. The good news is that, again, every segment experienced strong rate growth. The bad news is that the future capacity for such continued growth may be more in question.

Rates: Defying the law of gravity

In a continued departure from historic patterns, law firm billing rates in 2024 accelerated at their fastest pace since the GFC, averaging 6.5% growth despite weakening inflation. That resulted in *real* growth, or the amount of worked rate growth beyond inflation, at a pace double the yearly average of the past decade. This, of course, comes on top of multiple years of high rate growth for the industry. At the same time, pushback from clients appears minimal, with realization rates holding relatively steady and demand increasing for almost all segments and practice areas.

Obviously, there are questions as to how long such growth can continue in the absence of inflation as a justification, but if the signals from other regions such as Australia (which is about halfway through its fiscal year) are any indication, firms so far are managing to continue defying the gravitational forces that should be slowing the pace of rate growth.

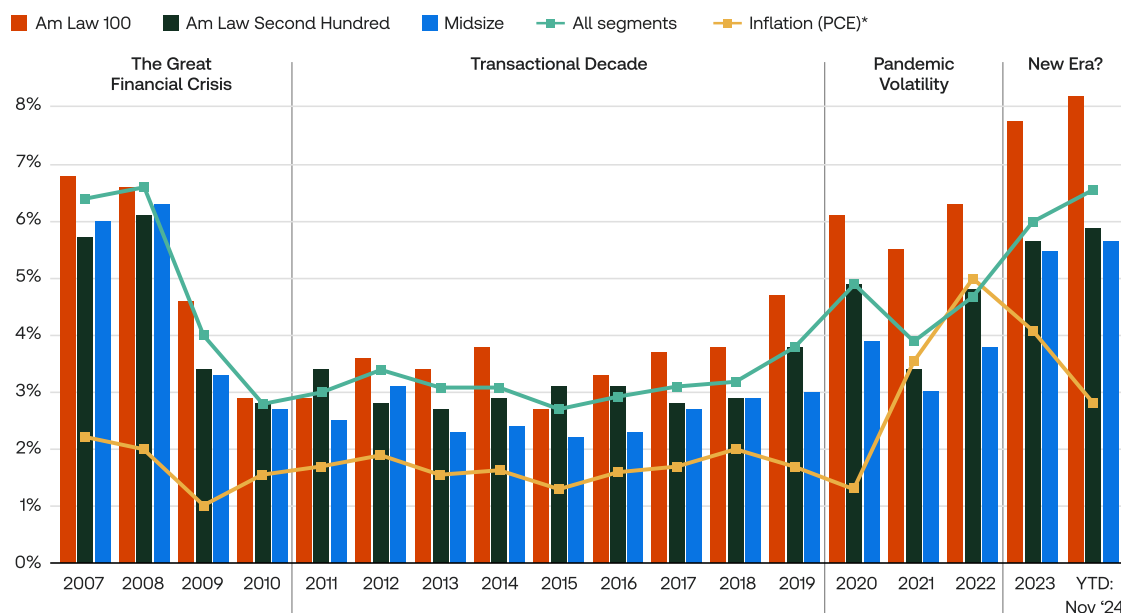
⁶ Mobile demand refers to the phenomena, prominent in 2022 and 2023, in which considerable volumes of work flowed from top level Am Law firms to smaller, less expensive Midsize firms. This greatly boosted Midsize demand and fees worked performance.

⁷ Fees worked growth is a firm's total billable hours for a given period multiplied by the average worked rate.

FIGURE 3:

Worked rate growth vs. inflation

Year-over-year percent change



PCE Inflation measure (as of October 2024) = Personal Consumption Expenditures Excluding Food and Energy.

Source: Thomson Reuters 2025

One possible reason for this high performance in rate growth may be that law firm hiring over the last couple of years has focused less on new associates and more on experienced laterals, changing the population distribution within firms, a trend we will explore in greater detail a bit later. Thus, as firms become more top heavy with experienced associates and partners, the average rate charged by the firm moves upwards as well, inflating rate growth as a result.

The TR Institute’s View:

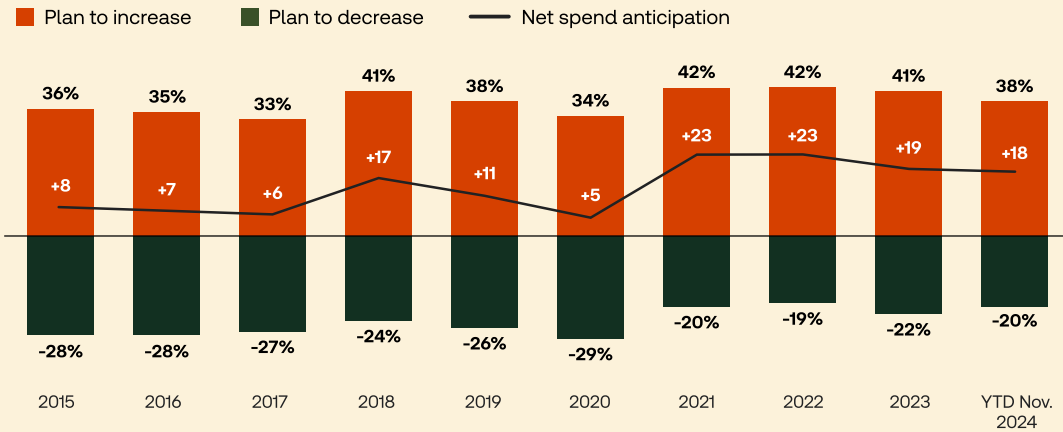
While these factors may have made 2024 an incredibly successful year for firms from a rate-setting perspective, it does beg the question for 2025: *if inflation remains relatively low, how much are clients prepared to push back on further rate increases?* As the record of the past several years plainly demonstrates, as long as law firms experience a *net gain* from rate increases — a situation in which client push back does *not* result in a drop in realization rates that cancels out the amount of any increases — it is likely that firms will continue raising rates. And there seems to be little evidence that realization rates are dropping rapidly enough at the moment to halt that process.

This conclusion is bolstered by data from law firm clients themselves. As noted in the Thomson Reuters Institute’s *Law firm rates in 2024* report,⁸ corporate general counsel, on balance, expect their spending on outside counsel to increase over the next 12 months. From the survey results⁹ very few see such expenses decreasing.

FIGURE 4:

Net spend anticipation

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



Source: Thomson Reuters 2025

8 *Law firm rates in 2024*; Thomson Reuters Institute (Sept. 17, 2024); available at www.thomsonreuters.com/en-us/posts/legal/law-firm-rates-report-2024.

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

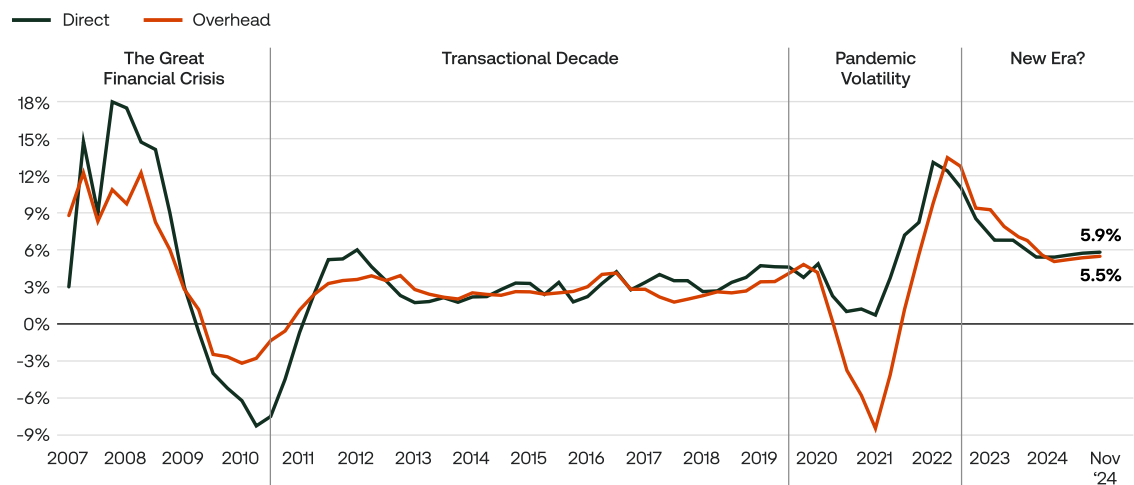
Expenses: The cost of chasing opportunity

The third historically atypical behavior of the market in 2024 related to expense growth, which leveled off from its pandemic heights, but is still at a level far in excess of historical norms. From 2012 to the beginning of the pandemic in 2020, law firms averaged an expense growth of around 3% for both direct and overhead expenses.¹⁰ Instead of returning to those levels, however, today's law firm expenditures continued to grow at a much faster pace, with an average expense growth north of 5% over the 12-month period ending in November 2024 and began trending up in recent quarters.

FIGURE 5:

Expense growth

Rolling 12-month change



Source: Thomson Reuters 2025

The TR Institute's View:

Unlike in previous years, expansion in expenses has been driven neither by rising associate costs nor inflation.¹¹ Related factors such as occupancy and office expenses also remained well below the average overhead rate. It should be noted, however, that early returns from the 2024 bonus season and the 2025 associate pay scales are on the historically high side and may lead to the re-ignition of another compensation war in the coming year.

In the present, however, higher expenses appear to be the table stakes for firms chasing the cornucopia of business opportunities available to them, as well as the cost of adapting to a shifting technological environment. Tech spending as well as knowledge management costs came in well above the historical average level, followed by outside services, marketing and business development, and (as an outlier) benefits.

¹⁰ 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.

¹¹ Associate compensation expenses grew less than 3% per associate on average.

Firm profitability and profit per lawyer

Over the 12-month period ending in November, the average law firm grew their profit per lawyer by 8.3%, returning to the records that firms set in 2020 and 2021. This is somewhat deceptive, however, considering 2022 was an especially poor year. In many ways, firms spent 2023 stanching the bleeding and 2024 has been a slow crawl back to where firms were before the early 2022 crash. Luckily, many firms seemed to have succeeded in returning to their peaks, with the average firm returning to nearly the same profit-per-lawyer (PPL) levels they experienced during the heights of the 2021 transactional boom.

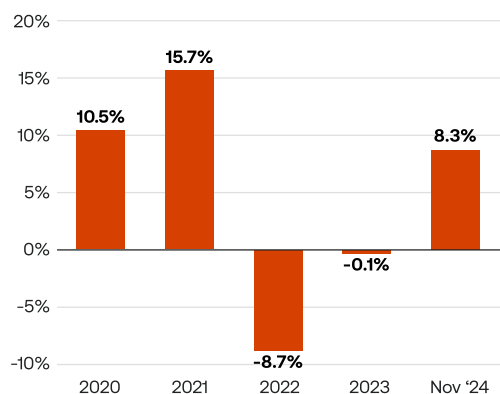
Yet there is more to this story than revenue and expenses. While PPL was solid in 2024, profits per equity partner (PPEP) were even better, reaching above 11.6% growth year-over-year. This growth beyond PPL is due in part to the increasing leverage of non-equity partners over equity partners that firms currently enjoy. This leverage provides greater profits to equity partners when good times are plentiful but forces them to bear greater expenses when they're not.

This kind of leverage is likely to accelerate as law firms continue to modify their structural and compensation models to meet current market realities.

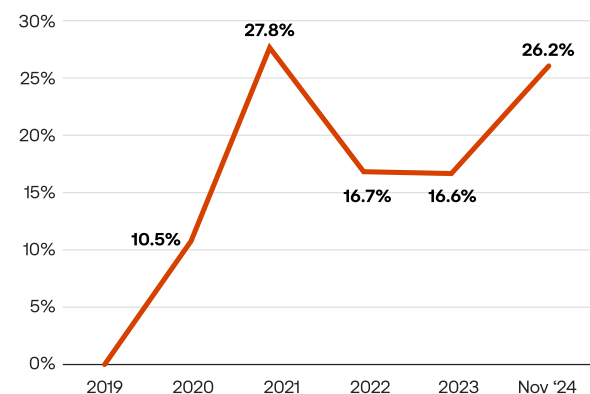
FIGURE 6:

Profit per lawyer growth

Rolling 12-month change



Profit per lawyer growth since 2019



Source: Thomson Reuters 2025

The successes of 2024 should not, however, be understood to be reasons to stand firm. Indeed, even as law firms enjoy strong financial tailwinds, the market in which they operate is evolving rapidly. Law firms themselves have also started to take new shapes, both in response to innovations they have witnessed as well as in anticipation of what may come.

The changing composition of law firms

Over the last several years, law firms have significantly shifted their hiring practices to adjust to myriad challenges — the pandemic, tight labor markets, and the potential impact of generative AI (GenAI). As a result, the overall composition of law firms has changed drastically over the last decade, with significant developments that likely are intertwined with the increasing commercial focus of law firms.

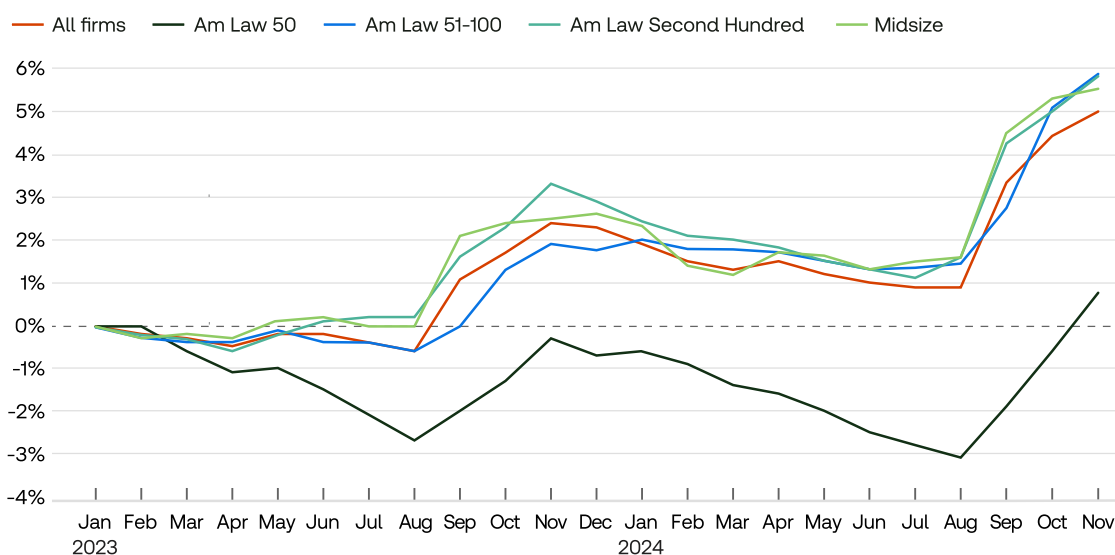
First, the pandemic delayed an entire class of law students at a time when firms were facing a surge of transactional demand, forcing lawyers into heavy work rotations that threatened burnout and ignited a talent war that saw associate salaries rise at an astonishing rate. This was followed by a rapid cooldown period, as legal demand slackened and firms tried to unwind from remote working models, with varying levels of success.¹²

Firms now seem to be returning to form when it comes to hiring, building talent from both luring lateral hires and bringing on more typical levels of first year associates, after having brought on notably smaller classes in 2023 when demand was more uncertain. However, while firms in the Am Law 51-200 and beyond have made notable gains in their scale, Am Law Top 50 firms have more or less been in a holding pattern with their late 2022 levels. While this segment has brought on a 2024 class in line with other segments, they have been more aggressive in trimming headcount through 2024 to a much greater extent than the other segments, as they were in 2023. Clearly, something else is happening here. While by no means destiny, other segments tend to follow the Am Law Top 50's path, meaning what is today a unique strategy for the segment may become the primary strategy for the market in a few years' time.

FIGURE 7:

Lawyer FTE growth – change since January 2023

Percent change since January 2023 | By segment



Source: Thomson Reuters 2025

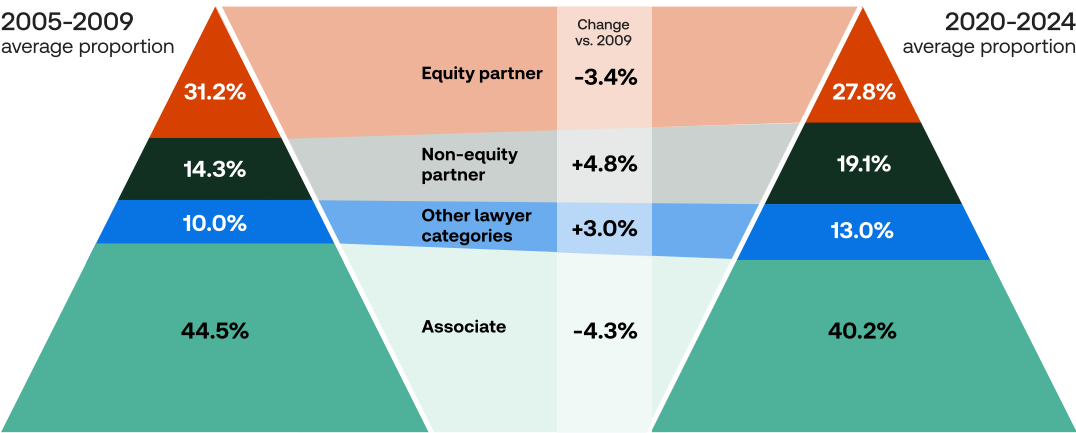
12 See the 2024 *Law Firm Office Attendance Policies Report*, Thomson Reuters Institute (April 8, 2024); available here: www.thomsonreuters.com/en-us/posts/legal/law-firm-office-attendance-policies-report-2024.

Over the past several years and particularly since the GFC, the composition and structure of law firms has been steadily changing. Firms have seen an increasing proportion of non-equity partners, and a reduction in the percentage of equity partners and associates. Within the equity partner and associate categories however, we have seen further shifts with a higher proportion of senior equity partners and associates rather than junior roles. For equity partners specifically - those partners who survived the GFC have accrued years of experience, further skewing the balance as fewer and fewer fresh partners have joined firms.

This indicates a growing difficulty for associates to advance to any level of partnership, as evidenced by a much-reduced class of partners with up to 10 years of experience across all segments, especially in Midsize law firms.

Indeed, the largest demographic changes for associates have occurred in the immediate aftermath of the GFC and have continued, albeit at a slower pace. What has been a more recent development, however, has been the bifurcation of the partnership, with a notable decrease in the ratio of *equity partners* as a proportion of the firm and a rise in the proportion of *non-equity partners*. While this effect was underway prior to the pandemic, the post-pandemic atmosphere has seen a further acceleration in this direction, in direct contrast to the structural proportion of associates, which remains unchanged since 2019.

FIGURE 8:
Law firm talent - population pyramid



Source: Thomson Reuters 2025

The next major challenge

As firms strategize on how to navigate economic changes, it's essential to recognize that they're also operating in a rapidly evolving technological environment, one in which the theoretical challenges of the past are becoming very real practical challenges today.

In the Thomson Reuters *2024 Future of Professionals Report*, published in July, the results of a survey of 1,253 legal professionals showed that more than three-quarters of them said that they believe AI will have “a *high or transformative impact* on their work over the next five years,” with 43% saying they believe the impact would be *transformative*.¹³ On average, survey respondents predicted that more than half of their work would utilize new AI-powered technologies within the next five years.¹⁴

Of particular concern to law firm leaders, however, was that 44% of respondents predicted that GenAI will result in a *decline* in the use of billable hours pricing models over the next five years. As the report states: “As routine work becomes more efficient, firms understand that they will need to develop new pricing models that reflect the *value* of work product provided, rather than simply the *time* it has taken.”¹⁵

Does rethinking the business model mean rethinking the billable hour?

While the billable hour, upon which law firms have become reliant, began simply as a way of valuing legal services, it mutated into the dominant model for the evaluation of lawyer performance; for measuring the economic value of matters, clients, and practices; and for setting economic goals. By the 1980s, the billable hour had become the linchpin of law firm management.

The billable hour model satisfied clients' demands for more insight into the work of their outside lawyers and enhanced productivity as firms adopted policies requiring lawyers to bill a certain number of minimum hours each year. However, the model itself contains inherent flaws that have become increasingly evident over time.

One of the most serious inherent flaws was the fact that the billable hour model defined value by focusing solely on *inputs* (that is, *time invested*) and not on *results* (the *value* of the matter to the client). As a consequence, the relationship between inputs and results became seriously distorted, and this distortion grew as the price of the inputs, in the form of hourly rates, soared over the past 40 years. Clients became increasingly aware of the distortion, particularly after the GFC, as evidenced by their demands for budgets or caps on legal fees for particular matters.

Despite this pushback, clients generally tolerated dramatic increases in hourly rates — rates in excess of \$1,000 per hour are no longer uncommon for many partners. The development and adoption of GenAI, however, could fundamentally alter this result. Although still in the early stages, the rapid growth of AI technologies promises to improve efficiency in the performance of legal tasks quite dramatically. As one legal commentator has noted, “[w]ithin a few years, depending on the nature of the tasks and how complex they are (or aren't), what once occupied 100 hours of a lawyer's time will take closer to 90, or maybe 70, or even 50.”¹⁶

¹³ *Future of Professionals Report – AI-Powered Technology & the Forces Shaping Professional Work*, Thomson Reuters (July 2024), <https://www.thomsonreuters.com/en/c/future-of-professionals.html>.

¹⁴ *Id.* at 10.

¹⁵ *Id.* at 23.

¹⁶ Jordan Furlong, *This Is How the Billable Hour Dies* (August 16, 2023), 4, <https://jordanfurlong.substack.com/p/this-is-how-the-billable-hour-dies>.

In such circumstances, it is hard to imagine that clients will not insist on being charged less for the services performed, at least if the value of such services continues to be measured on an *inputs* basis.¹⁷

In Formal Opinion 512, issued on July 29, 2024, the American Bar Association’s Standing Committee on Ethics and Professional Responsibility reviewed the lawyer’s ethical obligations in using GenAI tools in stunningly blunt terms. The committee stated that while GenAI tools “may provide lawyers with a faster and more efficient way to render legal services to their clients[...] lawyers who bill clients an hourly rate for time spent on a matter must bill for their actual time.”

The end goal, the committee continued, should be “solely to compensate the lawyer fully for time reasonably expended, an approach that if followed will not take advantage of the client.”¹⁸

The committee also recognized that the same standards should be applied to the use of GenAI in matters charged on a fixed fee or contingent fee basis.

*The factors set forth in Rule 1.5(a) also apply when evaluating the reasonableness of charges for GenAI tools when the lawyer and client agree on a flat or contingent fee. For example, if using a GenAI tool enables a lawyer to complete tasks much more quickly than without the tool, it may be unreasonable under Rule 1.5 for the lawyer to charge the same flat fee when using the GenAI tool as when not using it. A fee charged for which little or no work was performed is an unreasonable fee.*¹⁹

While ABA Formal Opinion 512 has been widely criticized for being overly broad in its application, it does underscore the inherent fallacy built into the billable hour model, even if that model is unlikely to go away anytime soon, if ever. As the use of GenAI tools continues to expand, however, it is becoming increasingly obvious that the legal profession must rethink how it defines *value* when pricing legal services. Continued reliance on an inputs-driven model is simply not viable in the long term.

Impact on lawyers

Apart from its key role in pricing legal work, law firms also have become reliant on the billable hour as the primary means for defining and evaluating their lawyers’ performances – perhaps overly so. Indeed, despite the obvious issues raised by such reliance, law firms have almost universally settled on the total number of hours that a lawyer bills as the primary measure of *productivity*,²⁰ logically implying that it must bear some direct relationship to firm profitability.

The problem is that over the past decade or so, our data has convincingly demonstrated that productivity (as so measured) simply is no longer directly tied to law firm profits. Over the last 10 years, we have seen law firm profits per lawyer grow year-over-year while at the same time, billable hours worked per lawyer have steadily and significantly declined. We are thus left with the obvious question of whether the billable hour metric is the best way to measure an individual lawyer’s contribution.

¹⁷ It is also worth noting that, in this scenario, rates could be driven down by other market forces as well. If all lawyers experience improved efficiencies at the rates noted, there will be a lot of excess capacity in the market, incentivizing firms to either reduce their number of lawyers or find ways of increasing the demand for their services. To accomplish the latter in a newly efficient market, firms would likely have to lower their fees to attract new business and that in itself could ultimately drive down hourly rates.

¹⁸ ABA Formal Opinion 512, *Generative Artificial Intelligence Tools* (July 29, 2024), 12.

¹⁹ *Id.*

²⁰ Even within Thomson Reuters Institute’s own reporting, the primary measure used for productivity has been the “average daily demand per full-time equivalent” – a metric based on the number of billable hours per lawyer reported per working day. And, in our annual *State of the US Legal Market* reports, we have, for many years, reported the decline in billable hours worked per lawyer – again using average billable hours worked by month by firm lawyers as the measure of productivity.

In a recent white paper on *Relative Performance Measures*, the Thomson Reuters Institute summed up the problem as follows:

In theory, a lawyer who bills a high number of hours, but with low collections and low overall profits would measure well on the current productivity metric, while a lawyer who completes a high number of tasks quickly on a fixed fee basis could be slighted for poor performance based simply on the fact that the work was completed quickly, even if it was highly lucrative to the firm...

Clearly, a new way of evaluating lawyers' contribution is needed.²¹

To be sure, most law firms would say that their internal processes take some account of a lawyer's profitability to the firm in making compensation and advancement decisions, however, it is clear that a lawyer's total number of billable hours usually remains the primary basis for such decisions.

To consciously use a system that undervalues genuine productivity and efficiency in favor of one that continues to focus primarily on how much time is required to complete a task has been at least a questionable business judgment in the past. Going forward, with the growth of GenAI technologies and their inevitable impact on law firm pricing models, it becomes an even more important issue.

The *Relative Performance Measures* paper suggests a new productivity metric to help firms assess the value of their individual lawyers in a more accurate way. This metric, called the *relative performance measure* (RPM), evaluates each lawyer's performance in generating fees in the firm's time and billing system, and the firm's ability to collect those fees, not just in absolute terms but as a measure relative to the performing lawyer's own peers. These peers are other lawyers similarly situated in terms of the nature of the firm, practice, status, location, etc., either within the lawyer's own firm or within a population of competitor firms.

In this way, the RPM model is a good example of the kind of creative thinking that is needed if the legal profession is going to replace the billable hour as the organizing assumption of law firm economics, value, and structure. Again, this is not something that will happen overnight. Rather, it will take time for the legal industry to wean itself from a system that has dominated it for 50 years. However, it is clearly time to begin experimenting.

²¹ *Relative Performance Measures – Building a Better Productivity Metric*, Thomson Reuters Institute (2024), 3. <https://www.thomsonreuters.com/en-us/posts/legal/relative-performance-measures-report-2024>

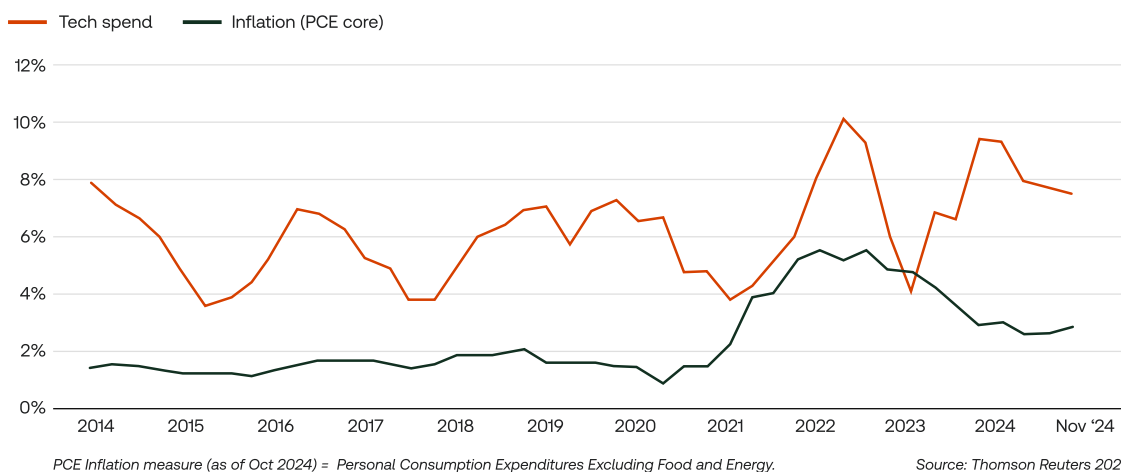
The challenge of technological debt

The broadening of GenAI technologies and their ultimate impact on the legal industry are inevitable, even though there is legitimate debate about the timing. There is no debate, however, over the idea that adapting to new technologies will be very expensive for law firms. Reflecting this reality, law firm spending on technology is growing at an unprecedented rate. Indeed, over the course of 2024, firms increased their technology spending at a historically high pace even as inflation receded.

FIGURE 9:

Tech spend vs. inflation

Rolling 12-month change



Complicating the issue is the fact that GenAI systems rely on quality data to function effectively and create competitive advantages. Law firms that are not up to date in managing their current data will be under increasing pressure to modernize their data management and processing capabilities. Putting off such modernization will leave them with obsolete systems that will impede their capacity to adopt the new technologies. Yet, the costs of modernization and tight expense budgets will tempt many firms to try and *patch up* their old systems to last a few more years rather than making current investments to solve their problems in the long term.

This leads directly to the problem of *technological debt*, a concept that is well known in other industries.

The concept of technological debt involves incurring future costs due to expedient but suboptimal decisions made during a period of technological development or implementation. These decisions often prioritize quick delivery over thoroughness or a continuation of the status quo instead of a costly or risky evolution, leading to complications and increased maintenance efforts down the line. The longer this tech debt is held, the greater the cost becomes until it finally reaches a breaking point.

In the end, of course, the technological debt must be paid if the organization is to survive. That payment, however, will be *in addition* to the costs that will still have to be invested in the new technology.

There are, however, proven techniques to minimize or sometimes even avoid the additional costs associated with technological debt. These include:

- Collaborative industry initiatives that involve joint research projects, shared training facilities, and industry-wide standards for workforce development;
- Use of simulation and modeling tools to play out the implications of new technology developments before trying to deploy them in the *real world*; and
- Development of a long-term technology roadmap that ensures that the industry remains adaptable and ready to leverage emerging technologies. Such a roadmap would include:
 - a comprehensive, multi-year vision that outlines planned upgrades, new technology adoption, and how these plans align with overall business objectives;
 - risk mitigation practices to safeguard against unexpected disruptions;
 - prioritized funding for technology upgrades and maintenance;
 - long-term, flexible planning for financial fluctuations by allocating resources for both prosperous periods and lean times; and
 - Regular reviews and updates of the roadmap to take account of changes in technology, market trends, and business priorities

Even if the full impact of GenAI is still five or more years away, firms are already incurring costs to update and maintain their current data management and processing systems. Full implementation of new GenAI technology will likely require additional *new* investment on top of these already sunk costs, and there probably will be a transition period in which firms will be funding *both* their new and their increasingly obsolete systems.

Dealing with these increased costs will be an economic challenge. It thus seems apparent that law firms need to begin developing long-range plans to meet this challenge and strategies to mitigate the potentially negative impact of their adoption of GenAI systems. Given the short-term capital structures of firms, the investment hurdles will be difficult. That means that starting these internal conversations and getting buy-in from key partners for the changes that will be required is a critical first step. However, the ongoing evolution of law firms, from a technological, commercial, and cultural perspective means that they are more prepared than ever to clear hurdles that may have once seemed unsurmountable.

Conclusion

The financial results from 2024 show the strong resilience of the US legal market. Driven by solid demand growth across both counter-cyclical and transactional practices as well as by continuing growth in worked rates, most law firms are well positioned to end the year with healthy growth in their profits per lawyer, notwithstanding expense levels that remain much higher than historic norms. These results reflect business decisions by many firms to modify their economic and compensation models to sustain profitability and to remain competitive in today's highly volatile talent market.

These changes, although sound from a business standpoint, would have been hard to imagine even a few short years ago. In the past year, firms continued to constrain growth in their equity partner ranks and increased their expectations for partner performance at all levels. To keep high-producing partners, firms often lowered the compensation of other partners, increased bonus pools, and widened the gap between their lowest and highest compensated partners. Most single-tier partnership firms have now converted to multi-tier structures, while others have ramped up their numbers of non-equity partners. Firms have also continued to reduce their historic rates of associate hiring and have continued to exert controls over additional direct and overhead expense growth.

In short, in 2024 we saw firms taking steps to ensure their continuing success in a changing market, even though their actions required fundamental changes in their traditional models. Going forward, it is quite likely that even more fundamental changes will be needed as a result of the rapid spread of GenAI technology and the transformative effects it is likely to have on the underlying economic assumptions that have guided law firms over the past 50 years.

Looking ahead

In 2025, law firms will be required to continue to navigate a complex landscape shaped by shifting demand and expense dynamics. According to predictive models based on our Financial Insights data, demand growth will likely weaken in 2025 compared to 2024, although it will likely not reach the low levels observed in late-2022 and 2023. This subdued demand will reflect the historic difficulty of firms' ability to achieve long-run demand growth, as well as uncertain broader conditions in the US and global economies.

That said, the results of the recent US election could boost firm demand above these levels, as higher levels of economic and geopolitical instability typically result in clients turning to their lawyers for risk reduction, at least in the short term.²²

Expense growth, on the other hand, is projected to remain at historically elevated levels, posing additional pressure on profits in combination with the revenue difficulties projected by lower demand. Factors include the ongoing implementation of GenAI technologies which, although promising in the long run, are currently costly and require significant attention.

Moreover, with inflation trending downwards and interest rates decreasing (which could add further upside for transactional practices), firms might contain expense growth through excess prepayments and by enhancing their collection efforts, potentially setting the stage for a stronger performance as the year progresses.

²² Engelland, B. *What does a second Trump term mean for law firms in 2025 and beyond?*; Thomson Reuters Institute (Dec. 16, 2024) (<https://www.thomsonreuters.com/en-us/posts/legal/trump-impact-law-firms>)

The primary change, of course, could be to the use of the billable hour pricing model. As routine work becomes more efficient, it will become increasingly necessary for firms to develop new models that reflect the value of the legal work performed and not just the amount of time it takes. This change will also impact the way firms measure and reward lawyer performance, as well as how they think about and plan for technology investments.

Visions of the firm of tomorrow

The changes currently underway have the potential to transform the delivery of legal services far more profoundly than any we have seen thus far. Despite the unprecedented changes to firms' commercial and talent models, firms have succeeded financially all the while. We expect the technological changes to provide further financial dividends for those firms that execute this evolution effectively. While they are not likely to occur immediately, they may well have a substantial impact within the next five years or so. Considering the time that will be needed to plan for and successfully implement new systems that can accommodate these dramatically new market realities, it would be prudent for firms to initiate processes now to prepare themselves for these changes. Given the resilience and flexibility that we have seen in the US legal market this past year, we have no doubt that firms are more than capable of taking on this extraordinary challenge in a way they were not just a few years ago.

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