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State Of Texas Legal Market: It Isn't Just About Oil

Law360, New York (August 26, 2016, 5:05 PM ET) -- *The drop in crude oil prices that began in 2014 has resulted in the industry's deepest downturn in decades. With falling commodity prices came lower earnings for companies, mass layoffs and bankruptcies. In this special series, we invited guest experts to help gauge how the downturn has affected the legal industry in Texas.*


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There has been significant speculation on the state of the legal industry in Texas as a result of the decline of oil prices. Specifically, some market watchers believe that law firms with significant energy-related practices have experienced precipitous declines in revenue and profits due to the dip in oil prices. To test this theory, we checked with several connections who have, or still want to have, "boots on the ground" (some of whom are quoted below).

Based on what we heard, the law firms in Texas are doing much better than the "doom and gloom" crowd expected or predicted, due primarily to 1) shifts in the client work types related to energy, 2) some work being moved back to the law firms from outside legal departments, and 3) the enormous size and diverse nature of the Texas economy. In other words, on a short-term basis, the overall storyline at a macro level is that the dip in oil prices is a relative nonevent when viewing the Texas legal market as a whole.

Shift in Work Types

The most obvious impact of the drop in the price of oil on the Texas legal market is a shift in the work types many firms are experiencing. As with most downturns, there is a movement away from large-scale mergers and acquisitions and infrastructure investments toward smaller asset acquisitions and dispositions, as well as restructurings, bankruptcies and litigation to get out of oil and gas leases. As Mike Pearson, co-chairman of Jackson Walker LLP's energy practice group, said, "since the end of 2014, with the collapse in commodity prices, we have seen new drilling activity dry up almost completely. The cost of wells makes it prohibitive to drill." Additionally, Jules Brenner, energy practice group leader for Strasburger & Price LLP, indicated that, "middle-market M&A, especially acquisitions and divestitures, have been extremely slow." It is worth noting that there have been many active deal discussions and proposals, but the majority of these deals die in the diligence phase.

Interestingly, there have been a number of deals that have closed with, what some market-watchers believe to be, inflated prices. As multiple sources indicated, a large amount of money has been — and remains — on the sidelines as companies try to time major investment decisions with the changing price of oil. Several became impatient with the waiting game and moved forward on acquisitions that are perceived to be overpriced compared to the deals available now.

Ailing companies in the oil production chain have predictably benefited bankruptcy and restructuring practices. One former oil company owner who sold prior to the decline in prices (and requested anonymity) told us that he knows of several companies that are laying off hundreds of workers/staff and that several countries that he used to do business with are going to experience large declines in demand for oil. He sees tough times ahead for the smaller companies and suppliers, which creates work for the lawyers who are trying to help struggling oil field service companies stay afloat.

Bruce Ruzinsky, head of Jackson Walker's restructuring and bankruptcy practice, noted that "bankruptcy practices have been significantly busier with a lot more workouts and a noticeable increase in the number of bankruptcy cases filed locally." Asset sale cases, debt-to-equity swaps and equity investments are all examples of the type of work he sees taking shape. Brenner echoes this sentiment, saying "there has been lots of bankruptcy work. Most are prepack deals to take out equity and convert to debt." Creditors in particular are generating a lot more work for law firms. Rob Reedy, managing partner of Porter Hedges LLP, perfectly summarized this point best by saying, "it's a down dip and an up dip in our business."

Some parts of the energy sector are doing reasonably well. Our contacts who work with midstream companies are reporting that select clients remain active. "There has been work on the transportation, pipeline and structural side of the energy industry," says Brenner. Additionally, an often-overlooked subsegment of the industry that is continuing to do well is in the startup/high-tech space (e.g., software providers serving the oil and gas industry). Joseph Tung, of Tung Law Firm, pointed out, "the industry is seeing much more in the way of efficiency improvements so clients that are in the high-tech space are doing better than those in traditional parts of oil and gas." This is, in part, because some oil and gas companies have been shifting their focus to efficiency in operations as a way to stay ahead of the fluctuating oil prices, in part, because they have long-term contracts with the oil companies that have not yet expired.

On the flip side, law firms that focus heavily on title and due diligence work related to exploration and production are experiencing strong headwinds. A prime example of this was Burleson LLP, which was forced to wind down in late 2015. While we know of a few firms in this space that have created highly scalable models and continue to practice profitably, it would not be surprising to see other title-heavy firms restructuring or seeking strategic combinations to help them through these uncertain times.

Shift to Buy Versus Make

While the largest oil producing companies appear to be adding lawyers to their in-house legal departments, Reedy sees an important trend with certain clients — shrinking in-house legal departments and a commensurate shift of the legal work outside to law firms. Tung sees this trend as well. Intuitively, this shift makes perfect sense as companies under financial duress downsize significantly. Unfortunately, the impacted in-house lawyers are not immune to the reductions in force needed to keep their former companies in business.

Texas Isn't Just About Oil

Texas is the second-largest contributor to the gross domestic product of the United States and, individually, has a larger economic engine than some countries. Per the U.S. Bureau of Labor Statistics, the state's leading nonfarm and nongovernment sectors include trade, transportation and utilities; education and health services; professional and business services; leisure & hospitality; manufacturing; and financial activities.

A quick review of the industries served by a sample of firms known for their energy practices indicates a broader alignment with the state's economy well beyond energy. While oil production is important to these firms, they also participate in other, more stable aspects of the economy.

Jarrett Hale, executive committee member of Hunton & Williams LLP, summed up this point best by observing that, "oil prices are hurting the boutiques focused on oil and gas as well as the oil services companies, but the economy is strong."

Conclusion — Everyone is Still Bullish on Texas

All of the firms that we spoke with on this topic said that they are continuing to pursue their Texas strategies, which have not changed as a result of depressed oil prices. Established firms are actively searching for laterals and strategic combinations. Given that Texas has a very large and dynamic economy with many parts not at all reliant on energy, "there is still an abundance of competition for talent," according to Hale. Most market watchers acknowledge that the vehicle for supercharged growth and investments in the economy and the legal marketplace (high-priced oil) is gone and the law firms are adjusting accordingly.

Has the drop in oil prices affected the thinking of those who want to be in Texas but are still looking for the right point of entry? We checked in with a few and their interest remains high, but their focus is more on Texas as a diverse marketplace that includes oil rather than on Texas as an oil marketplace. All parties acknowledge that the cost of entry for an oil-focused practice is very steep, and that price includes additional risks right now. While the current outsiders express new caution and concerns in their comments, each will jump at the right opportunity. One established partner in Texas, who prefers to remain unnamed on this topic, gauging outside interest by the pace of headhunter calls told us, "it has noticeably slowed down, but it hasn't stopped."

So, at the micro/personal level, the dip in oil prices has been very painful and for all who have lost their jobs, companies and livelihoods up and down the production line. At the industrywide, macro level for law firms (with notable individual exceptions such as Burleson) we have what is largely a nonevent. Most firms have, and will continue to, adapt with the evolving demands of this marketplace. Within the firms that are handling the challenge well, we see a set of common characteristics, such as acute market awareness based on the clients' perspectives, diversity of practice aligned around industries, and flexibility to adapt quickly. Hale summarized the overall situation with the observation that, "across the board, client behavior is changing but it's not related to oil and gas. It's a continuous function of the changing legal industry."

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