



Risk & Return: What Lawyers Need to Know[©]

Understanding Financial Concepts for Legal Practice

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Background – Chaka Patterson



- Partner at Alston & Bird (and former Partner at Jenner & Block and Jones Day)
- Professor at University of Chicago Law School
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Introduction: Key Takeaways

1. What risk and return mean in a financial context.
2. Their impact on legal decisions and agreements.
3. Practical ways to apply these concepts in legal practice.

Why Lawyers Need to Understand Risk and Return

- Risk and return affects business decisions, investments, and valuations.
- Lawyers frequently encounter these concepts in:
 - Mergers & Acquisitions (M&A)
 - Securities law and disclosures
 - Financial litigation and damages assessment
 - Contract negotiation and drafting

— What is Risk?

- **Definition:** The possibility of an outcome differing from expectations, often leading to loss.

Key Types of Risk

Type of Risk	Definition	Legal Example
Market Risk	Uncertainty due to changes in the market	Advising on M&A transactions
Credit Risk	Risk of default by a borrower	Loan agreements with default triggers
Operational Risk	Failures in processes, systems, or human errors	Internal fraud leading to compliance breaches
Liquidity Risk	Inability to meet short-term financial obligations	Bankruptcy asset recovery
Legal/Regulatory Risk	Non-compliance with laws or regulations	Securities offering lawsuits due to inadequate disclosures
Reputational Risk	Damage to an entity's reputation	Defamation lawsuits or corporate scandals

Quantifying Risk

Common Financial Metrics for Risk:

- Beta (β)
- Standard Deviation
- Value at Risk (VaR)
- Stress Testing

What is Return

Definition: The gain or loss on an investment or business activity over time.

Types of Returns:

- Expected Return
- Actual Return
- Risk-Adjusted Return
- Compound Return

— The Risk–Return Tradeoff

- Higher returns generally require higher risk.
- Key Concepts:
 - Diversification
 - Efficient Frontier
 - Capital Asset Pricing Model (CAPM)

— Legal Applications of Risk and Return

- Contract Drafting and Negotiation
- Securities and Investments
- Corporate Transactions
- Litigation
- Governance and Compliance

— Practical Example: M&A Transaction

Scenario	A company plans to acquire a high-risk startup.
Key Issues	A company's valuation is based on future growth projections.
Risks	Market/industry volatility, regulatory hurdles, and operational inefficiencies from underdeveloped infrastructure.
Return	High anticipated growth due to industry trends.
Legal Role	Draft indemnity clauses to protect against operational failures. Adjust deal terms for market risks. Advise on post-acquisition risk mitigation strategies.

— Practical Example: Investor Lawsuit

Scenario	An investor sues a financial advisor for recommending a high-risk investment that underperformed.
Key Issues	Was the investment aligned with the investor's risk tolerance? Did the advisor disclose risks adequately? How was the investment's risk assessed and presented?
Legal Role	Assess fiduciary duty and compliance with risk disclosure standards. Use financial expert testimony to analyze risk metrics. Calculate damages based on actual v.s. expected returns.

Key Takeaways



Risk and return are central to business and investment decisions.



Lawyers must identify, assess, and address risks in legal contexts.



Practical applications include contracts, compliance, litigation, and governance.



Collaborating with financial experts ensures robust legal strategies.



Essentials of Risk and Return: What Lawyers Need to Know[©]

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