

**INTRODUCING RISK MANAGEMENT CONCEPTS TO  
BUSINESS LAW STUDENTS:  
IT'S MORE THAN CONTRACTS**

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**I. INTRODUCTION**

Traditional business law and legal environment courses have focused on legal rules and strategies for avoiding litigation, the risk of adverse judgments, and potential liability for non-compliance with statutory and common law duties, breach of contract, and violations of the criminal law. Discussions of risk are generally limited to legal risks and the use of contractual provisions such as waivers, hold harmless provisions, and limitations of liability to reduce exposure to liability, and thereby more effectively manage identified legal risks.

This article argues that legal studies courses, particularly those taught in business colleges, should expand student understanding of risk beyond this traditional legal framework by incorporating broader risk management principles into our classes. We begin by discussing the rationale for including a risk management dimension in legal environment and business law courses. We then examine concepts of risk and risk management to familiarize legal studies faculty with an understanding of the basic vocabulary and the primary techniques for managing risk. We conclude by offering teaching strategies and specific exercises to enable

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instructors to incorporate more risk principles into undergraduate and graduate legal environment and business law classes.

## **II. RATIONALE FOR INCORPORATING RISK MANAGEMENT PRINCIPLES**

Historically, business management, risk management, and law developed as separate disciplines, each with its own understanding of risk. Management focused on risks to capital and the impact of those risks on corporate value and by extension to shareholders. Thus, management looked at risk when making simple decisions whether to proceed with a project or how much capital to put at risk. More complex decisions involved the use of insurance to transfer risk; derivatives contracts through options, futures and forward delivery contracts; and portfolio management with allocation, risk-adjusted returns, and risk-weighted capital measures.

In contrast, risk managers focused on harms to workers, corporate property, and consumers, as well as losses arising from general liability. As risk management became part of the business lexicon, risk managers expanded beyond concerns of general liability and began to proactively assess “the types and levels of risk appropriate for achieving the organization's strategic goals”<sup>1</sup> and avert harm to corporate value. Today’s risk managers deal with far more than identifying and managing personal and property exposures due to perils and hazards; they also analyze risks facing any functional area within the firm to advise management on how to “finance” specific strategic, financial, and operational risks through retention, transfer and insurance.

Lawyers, however, because they are trained to look at risk as legal liability arising from activities causing compensable harm, or regulatory non-compliance, or errors in judgment, used the term

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<sup>1</sup> Stephen M. Bainbridge, *Caremark and Enterprise Risk Management*, 34 J. CORP. L. 967, 969 (2009).

“risk management” to mean reducing potential liability, primarily through effective use of contracts and insurance, while conducting lawful, profitable activities. Thus, lawyers helped the firm manage and allocate reasonable risk through hold harmless provisions, indemnity clauses, warranties and disclaimers, or they used warnings, disclaimers and comparative fault to prevent or reduce liability for defective products, personal injury, and other torts. Corporate counsel also saw compliance with regulatory requirements and internal and external standards of care as additional legal tools to avoid liability for economic losses resulting from breach of duty or professional malpractice. As lawyers today need to know more about risk management than the standard tools of disclaimers, hold harmless agreements and indemnity, risk management has become a frequent topic for the corporate lawyer in publications like the *National Law Review*,<sup>2</sup> while the American Bar Association’s *Journal* has at least three websites on risk.<sup>3</sup> Similarly, the Association of Corporate Counsel (ACC) provides risk management materials for corporate counsel.<sup>4</sup>

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<sup>2</sup> See, e.g., Emily Holbrook, *Risk Management: Art or Science?* NAT’L L. REV. 2013 WLNR 14263703 (June 11, 2013); Emily Holbrook, *What Makes a Great Risk Manager: Q&A With Michael Lopez of Booz Allen Hamilton*, NAT’L L. REV. 2013 WLNR 11673038 (May 12, 2013); Jared Wade, *The Resurgence of Treasury Risk Management*, NAT’L L. REV., 2013 WLNR 11266510 (May 8, 2013);

<sup>3</sup>The *Financial Insurance Law Blog* available at [http://www.abajournal.com/blawg/Financial\\_Insurance\\_Law\\_Blog/](http://www.abajournal.com/blawg/Financial_Insurance_Law_Blog/), *A Byte of Prevention: Risk Management Tips and Tidbits* available at [http://www.abajournal.com/blawg/A\\_Byte\\_of\\_PreventionA\\_Risk\\_Management\\_Tips\\_and\\_Tidbits/](http://www.abajournal.com/blawg/A_Byte_of_PreventionA_Risk_Management_Tips_and_Tidbits/) and *Risk Worldwide* available at [http://www.abajournal.com/blawg/Risk\\_Worldwide/](http://www.abajournal.com/blawg/Risk_Worldwide/).

<sup>4</sup> See, e.g., “General Counsel as Risk Manager – For This I Went to Law School?” on the program for the ACC’s Second Institute for Corporate Counsel, May 10, 2013, available at <http://www.acc.com/chapters/sfbay/iacc.cfm>. The ACC has other materials on risk management for the corporate counsel, including *Enterprise Risk Management & the Law Department’s Strategic Role*, ACC’s CLO Thinktank Executive Report, ASSOCIATION OF CORPORATE COUNSEL, (May 2008),

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“Risk is a concept underlying virtually every business discipline”<sup>5</sup> and determines whether a business makes or loses money. This has caused managers, risk managers and lawyers to draw closer together over the years, and broaden their understanding of risk to include some common frameworks for addressing risk in the real world. In the past twenty years, for example, business has added risk management to its vocabulary and practices. What was once called simply “business judgment” now embraces risk management, and risk management has become enterprise risk management with a C-suite title of Chief Risk Officer. Lawyers, particularly general counsel, now include evolving risk – and solutions -- within their legal advice and judgments.

As corporate counsel have expanded their understanding of risk beyond liability to include strategy and operations, business law classes can address this broader dimension of risk and help students understand that contractual provisions, standards of care, and compliance efforts are risk management tools that can be strategically used to add value to the firm. The next section introduces legal studies faculty to some of this basic vocabulary and fundamental principles of risk management, so that these

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<http://www.acc.com/community/clo/thinktanks/upload/Enterprise-Risk-Management-the-Law-Department-s-Role.pdf>. The ACC’s Mini-MBA Business Education program has a Risk Management Track. Recent courses include *Risk Management & In-House Counsel* (April and October 2013), program available at <http://www.acc.com/education/businessedu/programs/riskmgmt.cfm>; *Applying Risk Management Principles and Practices in Transactional Work* (October 2011), outline of session available at <http://www.acc.com/legalresources/resource.cfm?show=1300993>; *Enterprise Risk Management, Integrated Assurance and Role of In-House Counsel* (June 2010), program description at <http://www.acc.com/legalresources/resource.cfm?show=965464>; and *Risk Management: The Role of Corporate Counsel in a Changing World* (January 2010) at [www.acc.com/chapters/Canada/upload/CanadaJan20program-2.pdf](http://www.acc.com/chapters/Canada/upload/CanadaJan20program-2.pdf).

<sup>5</sup> James R. Garven, *Risk Management: The Unifying Framework for Business Scholarship and Pedagogy*, 10 RISK MGMT AND INS. REV 1, 4 (2007).

concepts can be incorporated into legal environment and business law classes at both the undergraduate and graduate levels. We also provide examples to illustrate these concepts so that instructors unfamiliar with risk management terminology can more easily introduce them to their classes.

### III. DEFINITIONS AND BASIC PRINCIPLES OF RISK MANAGEMENT

Explaining the concepts of risk and liability is a good place to start. Although they are related concepts, business students should be aware that risk is business, while liability is law. The classical definition of risk is “uncertainty concerning the occurrence of a loss.”<sup>6</sup> Pure risk is the possibility of loss or no loss. For example, if your house is destroyed, you have incurred a loss, while if it isn’t destroyed, there is no loss. Risk also creates the opportunity for profit and businesses and investors seek profitable opportunities by assessing and taking measured risks.<sup>7</sup> This possibility of gain or

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<sup>6</sup> GEORGE E. REJDA, *PRINCIPLES OF RISK MANAGEMENT AND INSURANCE* (12<sup>th</sup> ed., 2013) at 2 and 5. This textbook and other introductory risk management textbooks can provide the business law instructor with an excellent overview of basic risk management terminology and concepts. *See also*, GEORGE L. HEAD, *RISK MANAGEMENT – WHY AND HOW: AN ILLUSTRATIVE INTRODUCTION TO RISK MANAGEMENT FOR BUSINESS EXECUTIVES* (International Risk Management Institute, 2009), available at <http://www.ktd-ins.com/assets/IRMI-Brochure.pdf> and the articles identified at note 19 *infra*.

<sup>7</sup> E.g., FRANK K. REILLY AND EDGAR A. NORTON, *INVESTMENTS*, 4th ed. (Dryden Press, 1982) at 9; KENNETH J. ARROW, *ESSAYS IN THE THEORY OF RISK-BEARING*, (Markham Publishing Co, 1971) at 1-7. Robert H. Brockhaus, Sr., *Risk Taking Propensity of Entrepreneurs*, 23 *ACAD. OF MGMT. J.* 509 (1980) (finding entrepreneurs and managers had comparable levels of risk taking, contrary to previous studies). Laurent Josien, *Entrepreneurial Orientation: An Empirical Study of the Risk Propensity Dimension of Entrepreneurs*, 18 *ACAD. OF ENTREPRENEURSHIP J.* 21, 22 (2012), finds that risk-taking is a propensity of “macroentrepreneurs” “who see their involvement with their business as the primary vehicle for pursuing self-actualization, ... are innovative and creative and have a tremendous risk-taking propensity.”

loss is called speculative risk. In recognition that uncertainty can produce either positive or negative outcomes,<sup>8</sup> the contemporary definition of risk embraces both.

Traditional risk management addresses the loss side only, using contracts to minimize loss exposure and insurance to transfer and finance losses that do occur to the firm's property or capital, particularly when the firm's acts cause a compensable harm. Thus, risk managers attempt to reduce loss exposure, perils and hazards. Loss exposure is simply the possibility of a loss. Any business asset may be exposed to a loss, from real or personal property to personnel to intangibles like the firm's reputation or intellectual property. The direct cause of the loss suffered is called a peril and includes weather, fire, collision, negligence, theft or other criminal behavior, as well as economic conditions or changes in consumer preferences that may cause a firm to lose value.

Hazards are conditions that increase the frequency or severity of a loss and are typically categorized as physical, moral, attitudinal and legal hazards. Physical hazards should be easy for students to understand. For example, defective wiring or a gas leak are hazards that increase the probability of a fire, while stored flammables and accumulated trash are hazards that can provide fuel for the fire, increasing its magnitude or severity. Similarly, icy road conditions are a physical hazard that increases the likelihood of collisions. Legal hazards are the conditions or legal "time bombs" that increase the risk of liability, e.g., unsafe work conditions that can lead to worker injuries and liability for workers' compensation, inadequate quality control that results in defective products that harm consumers, failure to adequately protect intellectual property, or careless drafting of contracts. Legal hazards also include characteristics of the legal system itself that may increase the frequency or severity of a loss, such as uncertainty of outcome or adverse jury verdicts with large awards

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<sup>8</sup> MICHAEL W. ELLIOT, *RISK MANAGEMENT PRINCIPLES AND PRACTICES*, 1st ed. (American Institute for Chartered Property Casualty Underwriters, 2012) at 1.4.

to the injured plaintiff. Moral hazards refer to the possibility that someone will intentionally cause a loss. Thus, faking an accident, filing a false claim or inflating a claim, and arson are all examples of moral hazards. Finally, careless and indifference to the possibility of a loss that may be covered by insurance are called attitudinal or morale hazards. Leaving a house or office unlocked or leaving the car keys in the ignition, for example, are attitudinal hazards that increase the frequency and/or severity of theft, while obtaining insurance to cover speeding tickets increases the likelihood that the driver will speed and possibly cause an accident.

Traditional risk management uses a number of loss prevention and control strategies to reduce the possibility of loss exposure from various hazards by minimizing the frequency of the risk occurring or the adverse impact should it occur. In addressing liability exposures from physical hazards, for example, companies may tighten security, improve lighting and floor conditions, install sprinkler systems, implement stronger warnings, increase inspections for latent hazards, or restrict access to dangerous areas. Other risk management techniques attempt to prevent, reduce or mitigate loss. Companies may avoid a risk altogether by getting rid of the activity that exposes them to that risk. Pharmaceutical companies may cease manufacturing high risk vaccines, while sporting goods companies may choose not to manufacture or sell trampolines to avoid any liability risk from injured users. Another risk management technique is to make back-ups, which risk managers call duplication, so that if an item fails, a back-up is available to prevent the loss. For example, a winery may have two wine cellars or two wine tanks for storage so that if one fails or becomes contaminated, they still have a good batch to bottle and market. Diversification is another loss reduction technique that involves spreading the exposure so less is exposed at anyone one place. When companies divide inventory among several warehouses, for example, they are engaging in diversification.

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It is not always advantageous to avoid or reduce risk altogether, and companies may retain some risks as a cost of doing business, transfer some risks by shifting them to an insurer or another party via contract, and also finance risk through insurance, reserves or credit. Where losses are anticipated to be relatively small, even if they occur fairly frequently, a company may actively or passively retain some of that risk, while implementing other loss control strategies to minimize the extent of the loss. For example, companies that deliver goods and products will finance some of the risk of accidents by insuring their fleet vehicles; if they assume a high deductible, they are actively retaining more of the risk than if they seek a lower deductible. In addition to insurance, risks can also be transferred through contractual provisions, such as hold harmless clauses and exclusions from liability or leases drafted that hold tenants liable for damage to the leased premises.

Table 1 provides a summary checklist of key concepts of risk management that faculty can introduce to their legal studies students.

TABLE 1

Basic Risk Management Concepts
Objectives of Risk Management <ul style="list-style-type: none"><li>➤ Balance Risk and Reward (e.g., business continuity or growth) to reflect risk appetite<sup>9</sup></li></ul>
Goals to Manage Risk <ul style="list-style-type: none"><li>➤ Identify tolerable uncertainty, legal and regulatory compliance, survival business continuity, earnings stability, profitability and growth, as well as social responsibility and the economy of risk management operations<sup>10</sup></li></ul>
Risk Terminology <ul style="list-style-type: none"><li>➤ Loss exposure – thing exposed to loss, such as personnel, property, liability and income</li></ul>

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<sup>9</sup> ELLIOT, *supra* note 8 at 1.15.

<sup>10</sup> *Id.* at 1.15 -- 1.19.

- Perils – the cause of the loss
- Hazards – Conditions that increase the frequency or severity of a loss are hazards, such as moral hazard (intentionally causing the loss), morale or attitudinal hazard (carelessness or indifference), physical hazard, and legal hazard.<sup>11</sup>

#### Techniques to Treat these Risks

- Avoidance (ceasing or never taking the risk) and separation (isolate one loss exposure from another)
- Duplication (use spares and backups)
- Diversification (spread the loss exposures)
- Prevention (reduce the frequency of loss)
- Reduction (reduce the severity of loss)<sup>12</sup>
- Retention (keep the risk within the firm)
- Transfer and Financing Risk (allocate the risk through contractual terms, insurance or other financial arrangements)<sup>13</sup>

#### Categories of risk

- Perils and hazards to property and people
- Operational, e.g., how the firm actually does its business, including people, process, systems and external events, sometimes defined as anything not market or financial
- Financial, e.g., interest rate, counterparty, price, credit and currency
- Strategic risks, e.g., acts and events of competitors and financial markets, political and legal changes, the economy and society<sup>14</sup>

Beyond these traditional risk management tools, today's risk managers use more tools, techniques, and risk models to categorize

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<sup>11</sup> *Id.* at 3.3-3.4, 3-8-3.16. REJDA, *supra* note 6 at 4-11.

<sup>12</sup> ELLIOT, *supra* note 8 at 3.5

<sup>13</sup> *Id.* at 8.3-8.9.

<sup>14</sup> REJDA, *supra* note 6 at 63-65. HAROLD D. SKIPPER AND W. JEAN KWON, RISK MANAGEMENT AND INSURANCE, (Blackwell Publishing, 2007) at 21-22. ELLIOT, *supra* note 8 at 1.28, 4.3-4.8, 4.13-4.34.

and assess the urgency of risks facing the enterprise, including speculative financial risks, strategic risks, and newer operational risks like cyber-risks, privacy and terrorism that were rarely (if at all) contemplated even a generation ago. Reflecting this dual view of risk as gains or losses, Elliot offers a contemporary definition of risk management as “[t]he process of making and implementing decisions that enable an organization to optimize its level of risk” to manage risks, “both positive and negative, to meet its objectives.”<sup>15</sup> Enterprise risk management takes risk analysis to a higher level and looks at the full spectrum of risks, including perils and operational, financial, and strategic hazards, and how these risks impact the firm’s value.

#### **IV. INCORPORATING RISK AND RISK MANAGEMENT IN THE LEGAL STUDIES CURRICULUM**

Legal studies classrooms provide an excellent opportunity to introduce students to the terminology of risk and uncertainty. Law classes already devote considerable attention to uncertainty, encouraging students to apply the law to particular situations that may have uncertain facts and produce uncertain legal consequences. Students may also be asked to analyze and/or draft contractual provisions to reduce those uncertainties by transferring some of the risk to other parties to the transaction.

In this section, we offer teaching strategies and specific assignments that add risk as a dimension to legal analysis in undergraduate and graduate legal environment courses, as well as traditional business law electives. With the exception of a social media project created by two of our colleagues (discussed later), the authors designed each of these in-class exercises and assignments to enhance student understanding of the risk dimension of legal issues and the impact of legal decisions on the firm. These are not simply abstract assignments; each has been

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<sup>15</sup> *Id.*, *supra* note 8 at 1.5.

implemented and revised in the specified course over a series of semesters to produce the time-tested iterations that appear in the appendices.

A. *THE INTRODUCTORY UNDERGRADUATE LEGAL ENVIRONMENT COURSE*

Businesses are exposed to a variety of potential loss exposures. Many of these are legal liability risks and thus within the scope of legal studies course content. For example, companies can incur loss from the destruction or loss of property of others, injuries that occur on its own premises, liability caused by defective products, or liability resulting from environmental pollution. Employment issues such as sexual harassment, wrongful discharge and retaliation, or work-related injuries can also create loss exposures. Criminal acts ranging from shoplifting to employee theft to theft of intellectual property and trade secrets create losses. Depending on the nature, probability and magnitude of the loss exposure, companies develop risk management strategies to avoid, control, retain, transfer or insure against potential losses.

In the typical legal environment course, these topics are presented primarily in terms of legal issues and liability. These legal issues can also be examined from a risk perspective to add another dimension to the discussion. At Georgia State University, successful completion of the legal environment course is a prerequisite for admission to the college and upper-division business classes; accordingly, the course is primarily taken by freshman and sophomore level students who have not yet had business courses beyond introductory accounting and economics. Rather than formally introducing these students to risk terminology and basic risk management principles, we recommend more explicitly discussing existing content with the added dimension of risk to illustrate why and how law can be used to add value to the firm. In addition, existing assignments can be adapted to include a risk dimension as students focus on the legal issues.

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Legal environment of business courses typically introduce students to features, advantages and disadvantages of non-corporate and corporate business entities. In teaching this content, we typically guide our students through the evolution of business entities from sole proprietorships and general partnerships, which expose their owners to unlimited personal liability, to the corporate form, which limits owner liability, to the modern adaptations of limited liability companies and limited liability partnerships. If instructors are not doing so already, we recommend that they explicitly articulate the differences in owner liability from the perspective of investor risk.<sup>16</sup> Similarly, discussion of intellectual property, tort and product liability law, contract law, and agency and employment law can be expanded to more intentionally remind students of the risks that gave rise to the legal question before them and how the law can be used to reduce, allocate, or transfer that risk, in addition to simply resolving the legal dispute.

Another strategy to increase student awareness of risk in the standard legal environment course is through experiential learning or what is sometimes called fieldwork. Such assignments will often be tied closely to liability issues, though instructions can be broadened to include business and financial risk and other risk concepts. For example, students in many legal studies classes are assigned to write a Court Observation paper that requires them to attend a court proceeding and then describe what they witnessed, the legal and procedural issues raised during their observation, and how what they observed relates to what they have learned in class. As part of the paper, students can be asked to explicitly identify and address concepts of risk, e.g. liability and financial risks, perils and hazards, and risk management strategies that might have averted the dispute underlying the legal proceeding.

Alternatively, students could take a walking tour of a retail or commercial complex or even their campus to identify property and

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<sup>16</sup> This also ties the discussion of risk management back to corporate finance. See Garven, *supra* note 5 at 3.

liability exposures. Zoos and aquariums can also be excellent venues for students to assess risks; in addition to obvious liability sources that may cause personal injury, they also allow students to look at compliance with state and federal laws concerning animal welfare, providing a different dimension to examine liability. Students could be asked to submit digital photographs of potential premises liability risks and hazards, accompanied by a one or two paragraph essay in which they both describe the risk and explain what mitigation measures, if any, the owner should have taken to reduce risk exposure. Sample instructions for such a project appear in Appendix A.

Another project suitable for either an undergraduate or MBA legal environment class relates to social media, a topic very rich with potential risk and harm as companies (and their employees) embrace Facebook, twitter, blogs, intranets, Linked-In and similar sites. This topic resonates with students and they seem to find many of the legal and risk issues easy to grasp. In one social media project, for example, students were asked to choose a specific industry and then to draft a social media policy framed to match a company's culture within that industry.<sup>17</sup>

### *B. BUSINESS LAW COURSES*

Because contracts have long been used to avoid certain risks or to allocate others between the parties, the traditional business law class with its emphasis on common law and UCC contracts is an appropriate course in which to incorporate risk management principles and strategies. At Georgia State, we have renamed the course "Legal Transactions and Risk" to reflect its expanded coverage of and emphasis on risk. This class is available as an upper-division business elective that is primarily taken by juniors

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<sup>17</sup> Perry Binder and Nancy R. Mansfield, *Social Networks and Workplace Risk: Classroom Exercises from a U.S. and EU Perspective*, 30 J. LEGAL STUD. EDUC. 1 (March 2013).

and seniors, many of whom are accounting and finance majors. In addition, we are offering a new course, Contracts Risk, that can be used toward the RMI major.

Because students enrolled in both courses are business majors nearing the end of their undergraduate career who have taken at least one other legal studies class, the instructor can more fully integrate a risk management perspective into the legal content. This requires not only instructor familiarity with the definitions and basic principles, but also the use of assignments to reinforce this added dimension. The definitions of risk and risk management summarized earlier in this article should provide the needed preparation to introduce these concepts. Students can be assigned to read an introductory chapter from a risk management textbook;<sup>18</sup> there are also numerous articles and books available to deepen instructor and student understanding of risk and uncertainty beyond the overview of risk management terminology and basic principles provided earlier in this paper.<sup>19</sup>

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<sup>18</sup> One such textbook is GEORGE E. REJDA, *PRINCIPLES OF RISK MANAGEMENT AND INSURANCE*, *supra* note 6.

<sup>19</sup> ROBERT I. MEHR AND BOB A. HEDGES, *RISK MANAGEMENT IN THE BUSINESS ENTERPRISE*, (Richard D. Irwin, Inc., 1963) at 15, (“Risk is defined as ‘uncertainty regarding a loss.’”). JAMES L. ATHEARN, *RISK and Insurance* (2d ed, 1969) at 641 (“Risk may be defined as either (a) the possibility of loss or (b) the possibility of unfavorable deviation from expectations, because any unfavorable deviation from expectations is a loss.”). Oliver G. Wood, Jr., *Evolution of the Concept of Risk*, 31 J. OF RISK AND INS. 83, 91 (March 1964). Athearn collects many definitions in his article. CHARLES O. HARDY, *RISK AND RISK BEARING* (Chicago: The University of Chicago Press, 1923) at 1 (“Risk is uncertainty....”). There are many other definitions of risk used within the spheres of economics and risk and insurance, but this basic definition is sufficient for undergraduates. For other definitions, *see, e.g.*, Robert M. Crowe and Ronald C. Horn, *The Meaning of Risk*, 34 J. OF RISK AND INS., 459, 462 (Sept. 1967) (“In this paper, risk is defined as the possibility that a sentient entity will incur loss.”) FRANK H. KNIGHT, *RISK, UNCERTAINTY AND PROFIT* (Boston: Houghton Mifflin Co., 1921) at 233 defined risk as measurable uncertainty (“The practical difference between the two categories, risk and uncertainty, is that in the former the distribution of the out- come in a group of instances is known (either through calculation a priori or from statistics of past experience), while in the case of

One of the authors teaches the course Legal Transactions and Risk annually. For the past several years, she has used two to four insurance cases on the first day of the semester to introduce students to risk and insurance concepts, as well as the importance of careful drafting of contracts to minimize risk exposure. Students are presented with the facts and pertinent insurance policy provisions for each case and then assigned the role of the judge and asked to decide whether the insurance policy covers the claim being asserted. The cases were chosen to “hook” student interest, as well as to lay the groundwork for issues that will continue to surface throughout the semester. In one case, students are asked to decide whether an accidental death benefit clause applies to the insured’s death from acute cocaine poisoning,<sup>20</sup> while in another, they have to decide whether the insured’s mother, as beneficiary of his life insurance policy, was entitled to recover under the policy after he died of a gunshot wound to the head. The insurance company had denied her claim, after concluding that he had made false statements in bad faith about his drug use and prior hospitalization for a gunshot wound on his insurance application, thus voiding the policy.<sup>21</sup> The two other cases result from car accidents, but also pose compelling facts; in, one the insured claimed the insurance company acted in bad faith in delaying her

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uncertainty this is not true, the reason being in general that it is impossible to form a group of instances, because the situation dealt with is in a high degree unique.”) SKIPPER AND KWON, *supra* note 14 at 20 (“risk as the relative variation of actual from expected outcomes.”). Douglas Hubbard gives two definitions, a long and a short: “The probability and magnitude of a loss, disaster or other undesirable event,” and “Something bad could happen,” DOUGLAS HUBBARD, *THE FAILURE OF RISK MANAGEMENT: WHY IT’S BROKEN AND HOW TO FIX IT*. (Wiley, 2009).

The authors’ prefer the economic definition of risk which embraces the possibility of gain (recognized in finance, too) as well as loss, but this is not important for the pedagogical point made here.

<sup>20</sup> *Weil v. Federal Kemper Life Assurance Co.*, 7 Cal.4<sup>th</sup> 125, 27 Cal.Rptr.2d 316, 866 P.2d 774 (Cal. 1994).

<sup>21</sup> *Cummings v American General Life Ins. Co.*, 2008 U.S. Dist. LEXIS 37157 (E.D. Pa., 2008).

claim,<sup>22</sup> while in the second, the insured claimed the insurance company failed to negotiate a settlement in good faith.<sup>23</sup> The cases intrigue the students and keep their interest for two hours on the first day of class, and provide an excellent opportunity to introduce the importance of contracts – and carefully drafted contracts – as a strategy to manage potential liability risk.

After formally introducing risk terminology and basic principles in a subsequent class, the exercise in Appendix B helps students understand and apply that terminology to a variety of business risks. This in-class activity firsts asks students to identify five risks confronting a business. For each identified risk, students then suggest a business strategy to prevent, reduce or manage that risk. Finally, the activity asks them to classify the risk management strategy using appropriate terminology, e.g., risk control (avoidance, loss prevention) or loss control (separation, duplication, diversification<sup>24</sup>) or risk financing (e.g., retention, non-insurance transfer, or insurance).<sup>25</sup> In conjunction with this activity, students also read and analyze extensive excerpts from an automobile insurance policy in class, which further reinforces their understanding of both risk and insurance terminology. This exercise asks them to identify, explain and apply provisions in the policy related to perils, moral hazard, insurable interest, indemnification and subrogation clauses, exclusions, the good faith obligations of the parties, the insured's duties following an accident, and risks retained by the insured.

Hold harmless clauses and non-compete provisions in contracts illustrate two types of clauses that can be used to reduce the liability exposure of a business, although we contend students should realize that risk management is not limited to using

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<sup>22</sup> *Goodson v American Standard Ins. Co. of Wisconsin*, 89 P.3d 409 (Colo., 2004).

<sup>23</sup> *Berglund v. State Farm Mutual Auto. Ins. Co.*, 121 F.3d 1225 (8<sup>th</sup> Cir. 1997).

<sup>24</sup> Arthur L. Flitner (ed.) *FOUNDATIONS OF RISK MANAGEMENT AND INSURANCE* (The Institutes, 2010), at 3.3.

<sup>25</sup> REJDA, *supra* note 6.

contracts to avoid or shift liability. Consequently, Appendix C asks students to draft an exculpatory clause for a skydiving club and a non-compete clause for a bakery's employment contract. When students submit their completed assignment, there is considerable class discussion about what terms each clause should contain, as well as the difficulty of drafting language that will adequately protect the client's interests and avoid these particular risks.

Similarly, we require a semester-long contract-negotiation simulation in Legal Transactions and Risk. Students have negotiated and drafted contracts for the sale or lease of a home, home improvement contracts, sale of a business, commercial leases, employment contracts, and both domestic and international sales of goods contracts.<sup>26</sup> The project not only reinforces the importance of careful drafting to protect the client's interests, but also provides students with an opportunity to enhance their negotiation skills, oral and written communication skills, and critical thinking skills as they are subsequently asked to revise their draft contracts as "new" facts emerge that change their exposure to risk.

Essay questions on exams for both courses can require students to articulate and apply risk principles as part of their legal analysis. We have provided two sample questions in Appendix D. As part of the final exam for Legal Transactions and Risk, students also write a take-home essay in which they identify and briefly explain three legal doctrines studied in the course that they believe are of particular importance to managers. For each legal doctrine, they identify and explain a business risk that ignorance of the legal rule

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<sup>26</sup> One of the authors has been using the contract simulation project in her business law classes for nearly 25 years. Although she has created most of the fact patterns students use in negotiating their contracts, she has also adapted and expanded the international sale of goods exercise created by Marisa Anne Pagnattaro and described in *From the Factory to the Playroom: Mattel, Inc. – Shenzhen Union King Sales Contract Exercise*, 28 J. LEGAL STUD. EDUC. 357-383 (Fall 2011).

could create, and then how managers could use their knowledge of that doctrine to reduce their company's exposure to litigation and liability that could be caused by that risk. Full instructions and a grading rubric for the take-home essay are also in Appendix D. Requiring students to integrate risk management strategies into their legal analysis, the essay question enables the instructor to quickly assess whether students are attaining this explicit course objective.

*C. THE MBA LEGAL ENVIRONMENT COURSE*

Attention to risk management has become a part of corporate governance in general.<sup>27</sup> Undergraduate legal environment students are introduced to corporate governance and the business judgment rule at a basic level. At the graduate level these doctrines can be developed in the context of risk.

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<sup>27</sup> See, e.g., The Corporate Laws Committee, ABA Section of Business Law, *Corporate Director's Guidebook-Sixth Edition*, 66 BUS. LAW. 975 (2011) ("Strategy and risk are interrelated, and directors cannot understand and guide strategy without also focusing on risk. Corporations must manage risks appropriately. Although not engaged in day-to-day risk management, directors are charged with its oversight" at 978; and "The board's oversight function involves monitoring the corporation's business and affairs including, for example, financial performance, management performance, compliance with legal obligations and corporate policies, and evaluating appropriate risk management structures" at 985). See also, Coral Ingley and Nick Vander Walt, *Risk Management and Board Effectiveness*, 38 INT'L STUDIES OF MGMT. & ORG. 43 (Fall, 2008); Martin Lipton, et al., *Risk Management and the Board of Directors*, 18 CORP. GOV. ADVISOR 1 (May/April 2010); E. William Bates II and Robert J. Leclere, *Boards of Directors and Risk Committees*, 17 CORP. GOV. ADVISOR 15 (Nov/Dec 2009); Cynthia M. Krus and Hannah L. Orowitz, *The Risk-Adjusted Board: How Should the Board Manage Risk*, 17 CORP. GOV. ADVISOR 1 (March 2009); Brenda Boulwood, *Risk in the Boardroom*, GLOBAL ASS'N OF RISK PROFESSIONALS, (Nov. 26, 2012) <http://www.garp.org/risk-news-and-resources/2012/november/risk-in-the-boardroom.aspx>.

The firm's management of risk is becoming one component of the business judgment rule, falling within the firm's duty of care.<sup>28</sup> The Delaware Chancery Courts have addressed this in at least three cases,<sup>29</sup> most explicitly in *In re Goldman Sachs*, where the court

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<sup>28</sup> See also Bainbridge, *supra* note 1; Robert T. Miller, *Oversight Liability for Risk-Management Failures at Financial Firms*, 84 S. CAL. L. REV. 47 (2010); Michelle M. Harner, *Barriers to Effective Risk Management*, 40 SETON HALL L. REV. 1323, 1324 (2010) (“ERM is an integrated risk-management framework that seeks to improve knowledge of and communication about potential risks throughout the firm, starting with the board and senior management team. Indeed, the board and senior management team are vital to creating a risk culture. This Article considers the impact of boardroom dynamics and U.S. corporate culture on risk-management practices.”); Wulf A. Kaal & Richard W. Painter, *Initial Reflections on an Evolving Standard: Constraints on Risk Taking by Directors and Officers in Germany and the United States*, 40 SETON HALL L. REV. 1433, 1442-43 (2010) (“Arguably, the business judgment rule finds a middle ground between excessive risk and excessive risk aversion while taking into account the interests of shareholders, corporate directors, and sometimes other constituencies.”); and David Rosenberg, *Supplying the Adverb: The Future of Corporate Risk-Taking and the Business Judgment Rule*, 6 BERKELEY BUS. L.J. 216, 220 (2009) (“The widely accepted notion that the business judgment rule should protect virtually all risk-taking by corporate directors goes too far. Under Delaware law, a director should be liable for risky decisions that go wrong if the plaintiffs can show that the director knew that the decision was, to use Chancellor Allen's phrase, “too risky” [footnote omitted] or if the director did not even care to find out what the risks were.”)

There are difficulties with using risk management a basis for finding liability under the business judgment rule, as noted in Robert T. Miller, *The Board's Duty to Monitor Risk After Citigroup*, 12 U. PA. J. BUS. L. 1153, 1164 (2010).

<sup>29</sup> *In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959 (Del. Ch. 1996) (“it would, in my opinion, be a mistake to conclude that our Supreme Court's statement in *Graham* concerning ‘espionage’ means that corporate boards may satisfy their obligation to be reasonably informed concerning the corporation, without assuring themselves that information and reporting systems exist in the organization that are reasonably designed to provide to senior management and to the board itself timely, accurate information sufficient to allow management and the board, each within its scope, to reach informed judgments concerning both the corporation's compliance with law and its business performance. [¶] Obviously the level of detail that is appropriate for such an information system is a question of business judgment.”). *In re Walt Disney Co. Derivative Litig.*,

said, “The Director Defendants exercised their business judgment in choosing and implementing a risk management system that they presumably believed would keep them reasonably informed of the company's business risks.”<sup>30</sup> As early as 1996, the Delaware court was noting the risk taking, and therefore the risk factors, that directors must consider under the business judgment rule. “Shareholders' investment interests, across the full range of their diversifiable equity investments, will be maximized if corporate directors and managers honestly assess risk and reward and accept for the corporation the highest risk adjusted returns available that are above the firm's cost of capital.”<sup>31</sup> One of the first and foremost writers of risk, Charles O. Hardy, explained the connection best in his 1923 textbook, *Risk and Risk-Bearing*: “it is the persistent element of uncertainty which makes necessary the exercise of business judgment, and make possible the reaping of business profit.”<sup>32</sup>

The Securities and Exchange Commission has added risk management to corporate management's responsibilities and disclosure requirements.<sup>33</sup> The *Proxy Disclosure Enhancements*

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825 A.2d 275, 289 (Del. Ch. 2003) (“the facts alleged in the new complaint suggest that the defendant directors *consciously and intentionally disregarded their responsibilities*, adopting a “we don't care about the risks” attitude concerning a material corporate decision. Knowing or deliberate indifference by a director to his or her duty to act faithfully and with appropriate care is conduct, in my opinion, that may not have been taken honestly and in good faith to advance the best interests of the company.”)

<sup>30</sup> *In re Goldman Sachs Group, Inc. Shareholder Litig.*, 2011 CIV.A. 5215 VCG, 2011 WL 4826104 (Del. Ch. Oct. 12, 2011), *aff'd by (sub nomine)* at *SEPTA v. Blankefein*, 44 A.3d 922 (Del. May 3, 2012), and cited without comment in *In re Goldman Sachs Mortgage Servicing Shareholder Derivative Litig.*, --- F.Supp.2d ---, 2012 WL 3293506 (S.D.N.Y. Aug. 14, 2012).

<sup>31</sup> *Gagliardi v. TriFoods Int'l, Inc.*, 683 A.2d 1049, 1052 (Del. Ch. 1996).

<sup>32</sup> CHARLES O. HARDY, *RISK AND RISK-BEARING* (1923) at xiii.

<sup>33</sup> Mary Ann Gadziala, *Speech by SEC Staff: SEC Risk Management and Compliance Examination*, 2003 Fiduciary and Investment Risk Management Association, Fiduciary and Risk Management Seminar (Feb. 26, 2003), SECURITIES AND EXCHANGE COMMISSION,

final rule requires listed companies to disclose in the management narrative “risks arising from the registrant's compensation policies and practices for its employees [that] are reasonably likely to have a material adverse effect on the registrant, discuss the registrant's policies and practices of compensating its employees, including non-executive officers, as they relate to risk management practices and risk-taking incentives.”<sup>34</sup> The SEC’s announcement of the Rule explained:

The disclosure enhancements we are adopting respond to this focus [on informed voting and investment decisions], and will significantly improve the information companies provide to shareholders with regard to the following:

Risk: by requiring disclosure about the board’s role in risk oversight and, to the extent that risks arising from a company’s compensation policies and practices are reasonably likely to have a material adverse effect on the company, disclosure about such policies and practices as they relate to risk management...<sup>35</sup>

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<http://www.sec.gov/news/speech/spch022603mag.htm>. Carlo V. Di Florio, *Speech by SEC Staff: The Role of Compliance and Ethics in Risk Management* NSCP Meeting, (Oct. 17, 2011), SECURITIES AND EXCHANGE COMMISSION, [HTTP://WWW.SEC.GOV/NEWS/SPEECH/2011/SPCH101711CVD.HTM#P52\\_13272](HTTP://WWW.SEC.GOV/NEWS/SPEECH/2011/SPCH101711CVD.HTM#P52_13272), (“The board of directors (if one exists in the organization) is responsible for setting the tone at the top, overseeing management and ensuring risk management, regulatory, compliance and ethics obligations are met.”)

<sup>34</sup> 17 C.F.R. § 229.402.

<sup>35</sup> Final Rule, Proxy Disclosure Enhancements, 17 C.F.R. § 229.402 (effective Feb. 28, 2010) and available at <http://www.sec.gov/rules/final/2009/33-9089.pdf>. (last accessed 30 June 2013).

The SEC also requires boards to disclose cyber risks,<sup>36</sup> a topic previously left to the chief information officer. As a result of cases like *Caremark* and *Goldman Sachs*, SEC rules, and new obligations imposed by the Dodd-Frank Act that require financial services companies with at least \$10,000,000,000 assets to have risk committees at the board level,<sup>37</sup> a new sub-discipline called “governance, risk and compliance” has come into being.<sup>38</sup>

To explore governance and risk issues, MBA students can be required to write a series of papers that evaluate corporate risk and governance information disclosed in the SEC filings of Fortune 500 companies. In a project developed by one of the authors for her graduate legal environment class, teams of MBA students are assigned Fortune 500 companies to research during the semester. One portion of the project requires them to carefully read their

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<sup>36</sup> CF Disclosure Guidance: Topic No. 2, Cybersecurity, Division of Corporate Finance, *Securities and Exchange Commission* (Oct. 13, 2011), F [http://www.sec.gov/divisions/corpfin/guidance/cfguidance-topic2.htm#\\_ednref3](http://www.sec.gov/divisions/corpfin/guidance/cfguidance-topic2.htm#_ednref3).

<sup>37</sup> Dodd-Frank Act, § 165(h). The Dodd-Frank Wall Street Reform and Consumer Protection Act requires financial market utilities (FMUs) to manage risk proactively. *See e.g.*, PriceWaterhouseCooper, *The Evolution of Model Risk Management* (May 2013) available at <http://www.pwc.com/us/en/financial-services/regulatory-services/publications/dodd-frank-closer-look/model-risk-management.jhtml>. This white paper takes a closer look at guidance by the Office of the Controller of the Currency and the Federal Reserve Board to oversee financial services companies’ risk management. On January 10, 2014, the Federal Reserve Board proposed revisions to the risk management standards in Regulation HH for FMUs designated “systemically important” that were initially issued in July 2012. The proposed revisions would establish a new standard for general business risk, as well as separate standards to address credit and liquidity risks.

<http://www.federalreserve.gov/newsevents/press/other/20140110b.htm>

<sup>38</sup> *See e.g.*, Mark L. Frigo and Richard J. Anderson, *A Strategic Framework for Governance, Risk, and Compliance*, 90 STRATEGIC FIN. 20 (Feb. 2009); ROBERT R. MOELLER, *COSO ENTERPRISE RISK MANAGEMENT: ESTABLISHING EFFECTIVE GOVERNANCE, RISK, AND COMPLIANCE PROCESSES* (Wiley, 2011); Eric Krell, *All Hands on (the GRC) Deck!*, BUS. FIN. MAGAZINE (May/June 2009) at 24; and Gary Dickhart, *Risk: Key to Governance*, INTERNAL AUDITOR, (Dec., 2008) at 27.

assigned company's 10-K annual reports and 10-Q quarterly reports over a three-year period to identify any material litigation, contingent liabilities and risk, as well as other, non-legal risks disclosed in these SEC filings that might affect profitability and shareholder investment, such as cyber-risk, unforeseeable increases in raw materials costs (fuel costs for transportation companies), unanticipated work stoppages due to natural disasters or wars (if so identified in a company's reports), and other broadly defined risks. The students are required to write a Risk Assessment Paper that reports their findings and recommendations. In a second paper later in the semester, students research the company's governance structure and executive compensation metrics from its posted governance documents, proxy statements, and other SEC filings. The instructions and grading rubric for the Risk Assessment Paper are in Appendix E.<sup>39</sup>

Case studies are also an excellent tool for adding a risk dimension to an advanced legal environment of business course, typically at the graduate level. Depending on the maturity and capabilities of the particular students, seniors and honors students may also be able to discern distinctions, contexts, and abstraction of case studies in addressing risk, uncertainty and consequences.<sup>40</sup>

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<sup>39</sup> For a discussion of the full project, as well as instructions for each of the component papers, see Susan Willey and Peggy Sherman, *Mining for Gold: Utilizing SEC Filings to Develop MBA Students' Understanding of Legal Concepts*, 27 J. LEGAL STUD. EDUC. 321-355 (Summer 2010).

<sup>40</sup> Similarly, case studies can be used in undergraduate courses. In a freshman class that explored risk in society, students looked at the problem of piracy of ships off the Somalia coast as an exercise to understand risk and consequences. While the risk of capture and ransom was obvious, so was the anticipated student solution to shoot the pirates, until students began to consider other possible consequences. For example, when do the sailors shoot and what happens if the pirates shoot back or sink the ship? What response is likely to be safer to the crew and when does international maritime law apply? The current Somali piracy was compared to the Barbary Coast piracy. Extensive class discussion followed on risk management.

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One of the authors has developed several case studies for his graduate legal environment of business classes – which could be adjusted for undergraduate students – on risk and liability arising from the manufacture and distribution of violent video games or alternatively from the sale of “junk” food that consumers claim have caused myriad health-related issues, including obesity and diabetes. Another case study requires students to examine the Atlanta Public Schools’ cheating scandal to look at the risk of cheating on a variety of stakeholders, from the superintendent, to principals and teachers, to students and their families, and to the school system and the community as a whole.

Another teaching strategy to incorporate risk analysis into the graduate legal environment class is to weave one or more “risky” products throughout the course and encourage students to assess various legal risks associated with the products as different substantive legal topics are studied by the class. For example, one of the authors teaches the MBA legal environment course in an online format annually. For the first week’s discussion boards, she posted an open-ended challenge asking students to identify legal risks associated with the development, production, marketing, sale and/or use of autonomous (driverless) cars, 3-D printing, and so-called “smart eyewear” devices, such as Google Glass, and then to suggest strategies to minimize and manage those risks. Most students commented on the risk of intellectual property infringement for all three products, suggesting patents and trademarks to protect the products from infringement by competitors, as well as requiring employees to sign confidentiality, non-disclosure, and non-competition agreements to reduce the likelihood that a disgruntled or greedy employee might attempt to sell that intellectual property to a competitor. In discussing autonomous cars, students also explored whether the driver or the manufacturer would be liable if the driverless car were in an accident and the driver, passengers, passengers in other vehicles, or bystanders were injured as a result of defective software controlling the vehicle. Similarly, students focusing on 3-D

printing considered who might be liable for potential legal risks if functional weapons are created by 3-D printing and used in the commission of criminal or terrorist acts. For all three products, students also identified numerous other risks, including regulatory and privacy risks. When they studied common law and UCC contracts two weeks later, students were asked to revisit their risk assessments and explore which (if any) of the identified risks could be avoided, reduced or transferred through warranties, limitations on remedies, hold harmless clauses, or other contractual provisions. Later in the semester as students study intellectual property, tort and product liability law, agency law, securities regulation and insider trading issues, they will be asked to either reassess their initial risk analysis in light of their deeper understanding of these substantive legal topics or to apply these legal rules to hypotheticals created to illustrate additional potential liability risks associated with autonomous cars, 3-D printing, and Google Glasses.

## **V. CONCLUSION**

Businesses face a broad array of risks, not just legal risk and risk managers use more than legal tools to effectively manage those risks to produce gains, while limiting losses. The study of risk adds another dimension to business law courses beyond the legal concept of liability, which conveys only legal risk. A business law course can incorporate a broader concept of risk into its program through many ways, thereby bringing a more contemporary business understanding of risk to the legal studies curriculum.

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APPENDIX A: PREMISES LIABILITY EXTRA-CREDIT ASSIGNMENT

After reading the material on negligence and premises liability in the textbook, find an item or property condition that might expose the landowner to a liability claim. Look in stores, parks and playgrounds, parking lots, apartment complexes, public buildings, or even the campus. Photograph the item or condition and then in a paragraph,

- identify where the picture was taken,
- explain what in the photo constitutes negligence and why, and
- make suggestions as to what the owner should do to mitigate potential liability.

Each submitted picture/explanation is worth up to 5 points. You may submit up to 5 photographs (with explanations), assuming that you are eligible for EC based on attendance. Note: You must take the picture and are not permitted to simply download pictures of dangerous conditions on premises from the internet to use for this assignment.

APPENDIX B: IDENTIFYING STRATEGIES TO REDUCE BUSINESS  
RISK

Directions: Working in groups of no more than 3, complete the following table.

- In the Column 1, identify 5 risks that a business may confront.
- In the Column 2, suggest at least 1 way the business might prevent, reduce or manage that risk.
- In the Column 3, categorize your recommendation in column 2. Are you suggesting a risk control method (e.g., avoidance, loss prevention, or loss control) or a risk financing method (e.g.,

retention, non-insurance transfer, or insurance) as the best way to prevent, reduce or otherwise manage the risk in column 1.

Risks Confronting Business	Strategies to Prevent or Reduce that Risk	Category of Risk Strategy

APPENDIX C: EXERCISE ON DRAFTING CONTRACT CLAUSES TO REDUCE RISK

EXCULPATORY CLAUSES

You are the president of the newly formed University's Skydiving Club. Provided that you can obtain financial sponsorship, you hope to sponsor 4-5 jumps yet this spring, culminating in an exhibition jump at the campus spring festival.

Although your current members are all experienced skydivers, you anticipate recruiting students who have never participated in the sport. To join, new members will have to take skydiving lessons at the airport before they can participate in any club-sponsored jumps.

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You are concerned about the club's potential liability, should a member be injured or killed during a jump. To reduce the club's exposure to liability, draft an exculpatory clause (a waiver that holds the club harmless for injuries to jumpers) that each member would be required to sign before each club-sponsored skydiving event.

Note: Although you may look at exculpatory clauses that you find on the web for content ideas, write the Skydiving Club's clause in your own words. Provide a bibliography of all websites you consult that includes URLs.

*Covenants Not to Compete*

Assume that you are a partner in a bakery in St. Louis, Missouri, that specializes in exotic, expensive pastries. The business has grown quickly in its first four years, and now sells its products to stores and restaurants throughout Missouri, Illinois and Iowa. Sandra has applied for a management position and appears to be the perfect candidate. She has five years' experience as a food wholesaler and a reputation as a superb amateur chef. Sandra would analyze the market for new products, create new pastries and other foods, and assist in selling new and existing products. Sandra would work with company chefs, salespeople, and customers – just about everyone.

*Draft a noncompete clause for Sandra's contract that would prohibit Sandra from working for a competitor or starting her own bakery. You may want to include protections for the bakery's trade secrets, customer lists, and confidential information.*

Note: Although you may look at non-competition clauses in employment contracts that you find on the web for content ideas, write the bakery's clause in your own words. Provide a bibliography of all websites you consult that includes URLs.

EXHIBIT D: INCORPORATING RISK INTO EXAM QUESTIONS

*Sample Essay Questions for Course on Contracts and Risk:*

Essay 1: Atlanta wants to offer rental bicycles (bike share) like other cities, such as New York, Boston, Montreal and London. Bike share systems provide iconic, sturdy bikes at self-service docking stations and a new easy way to get around the city. People can use the bikes by becoming long- or short-term members. For 1-day (\$10) or weekly memberships (\$25), users can sign up at any station kiosk with a credit card. Annual memberships (\$95) are with on-line enrollment; the member receives a key that is similar in shape and size to a flash drive. The key can be swiped at any dock in the system to unlock a bike. A person pays by credit card or swipes his or her key, takes a bicycle, and can return it to any docking station anywhere in the city. A small monitor on the bike displays nearby docks and open spaces. Sensors on the bikes and the docking stations provide for latching and unlatching, and determining if the bike has been returned, as well as when and where. Sometimes the technology can fail, so a returned bike is not registered as returned, and a full dock can report space available on the display when actually it is full. Atlanta will lease space to the bike share company (BSC) for the docks; BSC will own the docks and the bicycles. *Identify the majors risks Atlanta will be exposed to in creating this program, and therefore what needs to be in the contract between Atlanta and BSC. State the relevant risk provisions and your recommendations as to how those provisions should read. For example, in discussing technology risk, identify the specific risks to the city and specify how a contractual provision would address them.*

Essay 2: Evaluate the risks in this contract. You may assume it is in proper legal form and contains the usual legal requirements, and specifies things like Georgia law will apply, etc.

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Georgia Power Co and Paul Bunyon Tree Cutting Co. make this contract effective February 24, 2014. Paul Bunyon undertakes to deploy 20 trucks with 4-person crews and equipment to trim tree branches that surround or interfere with power lines in Fulton and Dekalb Counties, Georgia. Power lines are those running from pole to pole on streets, not lines running to buildings. Branches are to be trimmed so that no branch is closer than 5 feet from a power line, except that dead branches will be trimmed to the trunk of the tree rather than merely 5 feet from the power line. Paul Bunyon will cart away tree trimmings and dispose trimmings as recyclable wood products or for composting.

Georgia Power will provide a list of high-risk areas for Paul Bunyon to begin work. This list to be provided by March 15, 2014. Paul Bunyon will work on these areas first. Paul Bunyon will do its own surveys, or obtain from Georgia Power its surveys, of secondary areas to be trimmed. Thereafter, Paul Bunyon will deploy its trucks in any manner designed to complete all tree trimming in the counties by November 1, 2014.

Paul Bunyon will provide reports to Georgia Power on the 10<sup>th</sup> of each month of its progress towards the scheduled November 1, 2014 completion. If by August 10, Paul Bunyon has not attained 65% completion, then the parties will discuss measures to get to 85% completion by October 1.

Paul Bunyon is the sole provider to Georgia Power for this work in these counties provided completion targets are met. Paul Bunyon may not delegate or assign any work. All crews must be employees of Paul Bunyon.

*Take Home Essay and Scoring Rubric:* (20 points):

Knowledgeable managers can use law strategically to defuse legal “time bombs” by anticipating and reducing the risk of litigation

and liability. This requires awareness that a legal problem exists, assessment of the potential risk, and formulation of strategies to avoid the legal problem, lessen its adverse impact and/or prevent its recurrence in the future.

In a thoughtful and well-written essay, discuss three specific legal doctrines/rules that managers could (should) use to more effectively manage risk within their companies. Each of the legal rules you select should be from a different chapter that we studied this semester. For each doctrine you select, explain:

- ◆ the potential business risk that ignorance of that legal doctrine could create (or that inappropriate use of the law could exacerbate),
- ◆ the legal rule and its application to business, and
- ◆ how managers could use their knowledge of this doctrine to reduce their company's exposure to litigation and liability.

The university honor code applies. Do not discuss the question (or your answers) with classmates, friends or family until after you turn in your essay when you come to take the in-class portion of the final. Good luck!

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*SCORING RUBRIC FOR GRADING THE RISK TAKE-HOME-ESSAY*

Name				Points
Legal “time bomb” selected to discuss				
Potential business risk (1 pt x 3)				
Legal rule and application (2 pts x 3)				
Risk Management Use (2 pts x 3)				
Essay Format (3)				
Mechanics of Writing (2)				
Total (out of 20 pts)				

APPENDIX E: MBA RISK ASSESSMENT PAPER

The SEC requires companies to report material litigation, contingent liabilities and risk in their annual and quarterly reports. Research the annual and quarterly SEC filings (including footnotes) of your assigned Georgia Fortune 500 company for the past three years and then write a paper addressing the topics below.

- Since this is your first team paper on your assigned company, please provide an introductory paragraph or two about the company and its primary product or service, as that may help put its identified risks in a more understandable context (e.g., uncertain fuel costs would be more important to Delta or Home Depot than to Aflac).
- Describe any *material litigation* identified in the company's annual reports. How were the cases resolved or are they still pending? [You may need to check quarterly reports for updates on pending litigation or announced resolutions.]
- What *liability risk* and *contingent liabilities* does the company identify in its filings? The SEC requires companies to report risk in Item 1A and Legal Proceedings in Item 3. More detailed information is usually included in Items 7 and 7A as well as in the Notes to the Consolidated Financial Statements.
- What other, *non-legal risks* does the company identify in its SEC filings that might affect profitability and shareholder investment, e.g., unforeseeable increases in raw materials costs (fuel costs for transportation companies), unanticipated work stoppages due to natural disasters or wars (if so identified in a company's reports), etc.
- Do the identified risks and liabilities fall into certain categories (e.g., employment or intellectual property issues)? How does the company portray these risks? Does the company use any *cautionary language* in describing these risks? If so, provide examples.

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- If you were a shareholder, would these risks concern you? Why or why not? What additional information would you like included in the Risk sections? Why?

Points	Grading Criteria
45-50	Exceptional paper that shows original thought, analysis and creativity. Research shows considerable depth and there are more links to specific references or identification of page numbers within PDF documents. Written as a cohesive narrative, the paper goes beyond a mere summary (or answers to specific questions) and provides examples to support its analysis and conclusions.
40-44	Research shows more depth and originality than an adequate paper, but links are still broad and general and/or writing has awkward wording or too many grammatical/typographical errors.
35-39	Research and writing are adequate. Paper summarizes content, but with little analysis or conclusions. Links to information and data are fairly broad and not very helpful to readers interested in looking at the actual provision.
0-35	Research is incomplete and/or writing is not up to the standard expected of MBA students.

