

## Who You Gonna Call? Considerations for Retaining Outside Counsel to Conduct an Internal Investigation

When confronted with information suggesting that employees, consultants, or other business partners have engaged in serious misconduct (or to quote Ray Parker, Jr., “when there’s somethin’ strange...in the neighborhood”), most companies’ first reaction is to consult with a trusted outside firm with which the company has a long working relationship. Often that firm will be familiar with the company’s corporate transactions, management structures, culture, and compliance protocols. There is a natural tendency in tense, often fast-moving situations to assume that lawyers with the company’s go-to corporate counsel will have a shorter learning curve, easier coordination between the firm’s white-collar and other lawyers, and a greater investment in defending the client’s position.

But there are drawbacks to this approach. In a complex internal investigation, a company’s longtime corporate counsel can become subject to ethical conflicts, confirmation bias, divergent incentives, and other issues that may produce a suboptimal result for the client. As discussed below, companies facing potential criminal or regulatory investigations or any allegation of serious misconduct almost always will be better served by hiring counsel that does not have a long history of providing corporate or transactional advice to the company.

### I. Ethical conflicts

Ethical conflicts are particularly common where the firm has advised the company on an issue relevant to the investigation. Imagine a company that acquired a foreign subsidiary operating in a high-risk jurisdiction and received information a year later suggesting the subsidiary maintained a local bank account outside the company’s centralized cash management system from which it made payments to ostensible on-the-ground consultants. Many companies sensibly would assume that the law firm that advised on the acquisition—and presumably conducted due diligence in connection with the transaction—would be familiar with the facts and able to investigate quickly and efficiently. But where the firm that advised on the transaction then conducts an internal investigation, a number of thorny issues can arise. For example, if those outside lawyers are asked to determine what parent company executives knew prior to the acquisition, they may be required to conduct non-privileged and potentially hostile interviews of the same executives the lawyers previously advised. And to the extent that any executives may be implicated in the investigation, they could seek to rely on the firm’s advice as part of a defense, thereby turning lawyers from the firm into relevant fact witnesses.

### II. Cognitive biases

In addition to formal conflicts, a company’s longtime outside counsel may bring their own biases to an investigation. All people (including lawyers) rely on mental shortcuts in analyzing problems and making decisions. Psychologists have developed a lexicon for these processes, which include phenomena such as the “framing effect,” in which seemingly rational choices can be manipulated by the way in which the choices are presented;<sup>1</sup> “anchoring bias,” in which a rational

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<sup>1</sup> Daniel Kahneman & Amos Tversky, *The Framing of Decisions and the Psychology of Choice*, 211 Science 453 (1981).

actor places outside emphasis on an initial estimate or starting point;<sup>2</sup> and “confirmation bias,” in which a person evaluates evidence through a lens that is favorable to a preconceived notion.<sup>3</sup>

A company’s go-to outside counsel is particularly vulnerable to confirmation bias. Courts have recognized that “[m]otivated reasoning, motivated remembering, and confirmation bias are part of the human condition.”<sup>4</sup> Like anyone, lawyers are reluctant to conclude that the people with whom they have longstanding relationships have committed wrongdoing. As a result, lawyers conducting an internal investigation for an institutional client may be biased, however imperceptibly, to emphasize evidence that points to the innocence of the individuals whom those lawyers have advised, interacted with, and developed relationships with over time. This is particularly true where the lawyers’ own advice and conduct are implicated in the investigation. Even where the lawyers conducting the investigation do not include the relationship partner or other firm lawyers who have advised the company in the past, the investigating lawyers still may be inclined to believe that their colleagues provided sound advice and that the client acted appropriately, rather than objectively assessing the facts and identifying potential wrongdoing.

### III. Divergent incentives

Aside from confirmation bias, there are powerful incentives that can distort a law firm’s decision making in an investigation where the firm has provided advice regarding corporate governance, compliance, specific transactions, or other matters. Even where the firm’s lawyers can acknowledge, for example, misconduct by the executives from whom the lawyers have taken instructions, confronting those issues creates tricky reputational and financial problems for the firm. For one, the firm may be concerned about embarrassment resulting from the revelation that systemic problems or misconduct by high-level decisionmakers occurred under the firm’s nose. Similarly, the firm might fear that the company’s board of directors or other executives not implicated in misconduct will blame the firm, thereby jeopardizing the firm’s relationship with the company going forward.

### IV. These risks are not merely theoretical.

For example, one hedge fund under investigation for market timing and late trading practices retained as its defense counsel the same firm that had advised it in the transaction that had come under scrutiny.<sup>5</sup> It later alleged in a malpractice suit that the firm insisted on defending its advice to the fund

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<sup>2</sup> Daniel Kahneman & Amos Tversky, *Judgment and Uncertainty: Heuristic and Biases*, 185 *Science* 1124 (1974).

<sup>3</sup> Scott O. Lilienfeld, Rachel Ammirati, & Kristin Landfield, *Giving debiasing away: Can psychological research on correcting cognitive errors promote human welfare?*, 4 *Perspectives on Psychological Science* 390 (2009).

<sup>4</sup> *Oxbow Carbon LLC Unitholder Litigation*, CV 12447-VCL, 2017 WL 3207155, at \*6 (Del. Ch. July 28, 2017); see also *Mitchell v. State*, 454 P.3d 805, 812 (Or. Ct. App. 2019) (in evaluating ineffective assistance of counsel claim, “we must be aware of the distorting effect of hindsight, which includes a risk of confirmation bias, that is, a risk that, in hindsight, there may be a tendency to view counsel’s errors as having had no effect on what may seem to have been an inevitable or foreordained outcome” (quotation marks and citations omitted)); *United States v. Bonds*, 922 F.3d 343, 345 (7th Cir. 2019) (noting “serious risk of confirmation bias” in fingerprint analysis and describing measures examiners should take to minimize its impact).

<sup>5</sup> See *Veras Inv. Partners, LLC v. Akin Gump Strauss Hauer & Feld LLP*, 52 A.D.3d 370 (N.Y. 1st Dep’t 2008).

on the merits, rather than asserting an advice-of-counsel defense, which could have disqualified the firm from acting as counsel in that matter and made its attorney-client communications and work product discoverable.<sup>6</sup>

Simply put, a law firm operating under a “one firm” approach has a strong interest in defending and preserving the status quo, whether or not the status quo is in the client’s best interest. This is not to impugn full-service firms that develop longstanding relationships with institutional clients, or to suggest misconduct or ill will on their part. It is simply a recognition of innate cognitive biases, reluctance or inability to pursue defenses like advice of counsel, and other limitations on the firm’s ability to provide zealous, unconflicted advocacy for the client.

## **V. Independent counsel is better suited to advise companies as they navigate criminal and regulatory investigations.**

Unburdened by prior decisions and without preconceived notions about company executives, compliance programs, and other corporate systems, independent counsel is better suited to ask the difficult (but necessary) questions, confront systemic failures, and provide effective legal advice. This does not mean that a company facing an investigation necessarily should hire a law firm it has never worked with before. Prior engagements for discrete matters where the firm has particular expertise will not create the kind of problems that may arise with firms that regularly handle a company’s corporate matters.

Finally, in addition to providing better advice, independent investigative counsel typically will have greater credibility with their government counterparts, auditors, and other interested observers. Prosecutors and investigators are acutely aware of the issues described above, having learned through hard experience the ways in which cognitive biases, ethical conflicts, and divergent interests can work against the interests of a company under investigation. When independent counsel can appear as honest brokers, retained to help the company turn the page on past misconduct and empowered to root out wrongdoers, the internal investigation will have far more credibility.

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If you have any questions about the issues addressed in this memorandum, or if you would like a copy of any of the materials mentioned in it, please do not hesitate to reach out to:

**Gabriel Soledad**

Email: [gabrielsoledad@quinnemanuel.com](mailto:gabrielsoledad@quinnemanuel.com)

Phone: (202) 538-8180

**Daniel Koffmann**

Email: [danielkoffmann@quinnemanuel.com](mailto:danielkoffmann@quinnemanuel.com)

Phone: (212) 849-7617

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<sup>6</sup> See, e.g., N.Y.R. Prof. Conduct 3.7 (with limited exceptions, “lawyer shall not act as advocate before a tribunal in a matter in which the lawyer is likely to be a witness on a significant issue of fact”); *In re County of Erie*, 546 F.3d 222, 228 (2d Cir. 2008) (waiver occurs “when a client asserts reliance on an attorney’s advice as an element of a claim or defense”).

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