

IN THE SUPREME COURT OF THE STATE OF CALIFORNIA

CHARLES CORBALIS AND LINDA J. CORBALIS

Petitioners

vs.

**SUPERIOR COURT OF CALIFORNIA FOR THE
COUNTY OF SANTA CLARA**

Respondent,

BERLINER COHEN and LOGIES, SKIRTCH & CO.,

Real Parties in Interest

**PETITION FOR REVIEW BY THE SUPREME COURT
REQUEST FOR IMMEDIATE STAY OF ALL PROCEEDINGS**

After a Decision By the Court of Appeal
Sixth Appellate District, No. H031756
Santa Clara County Superior Court, No. 1-06-071586

Honorable Joseph H. Huber, Judge

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PETITION FOR REVIEW BY THE SUPREME COURT

After a Decision By the Court of Appeal
Sixth Appellate District, No. H031756
Santa Clara County Superior Court, No. 1-06-071586

JOSEPH H. HUBER Judge

TO THE HONORABLE RONALD GEORGE, CHIEF JUSTICE,
AND TO THE HONORABLE ASSOCIATE JUSTICES OF THE
SUPREME COURT OF CALIFORNIA:

Plaintiffs and Petitioners Charles Corbalis and Linda J. Corbalis
("Petitioners") hereby petition for Review by the Supreme Court after an
Order by the Court of Appeal, Sixth Appellate District summarily denying
their petition for a writ of mandate or other appropriate writ.

A copy of the Court of Appeal's Order filed August 22, 2007, is
included in the Appendix.

STATEMENT OF THE CASE

A. Issues Presented for Review

The petition presents the following related issues for decisions by
this Court:

1. Whether an action by a client against his attorney
alleging legal malpractice should be stayed pending resolution of any
underlying proceedings having a bearing upon the legal malpractice action?

2. Whether an action by a client against his attorney alleging legal malpractice should be stayed pending resolution of any underlying proceedings having a bearing upon the issue of liability or damages in such legal malpractice action?

3. Whether an action by a client against his attorney alleging legal malpractice should be stayed pending resolution of any underlying proceedings if continuation of the legal malpractice action could substantially prejudice client's interest in the underlying proceedings?

B. Grounds for Review

Petitioners recognize that grant of review by this Court after summary denial of a petition for a writ of mandate by the Court of Appeal is highly unusual. However, as shown below, the legal issues involved here are of great importance to litigants and general public of California.

This malpractice action by Petitioners against Berliner Cohen, a law firm ("Berliner") and against Logies, Skirtich & Co., an accounting firm, ("Logies") alleges negligence and other wrongful conduct on the part of Berliner and Logies in their tax advice to Petitioners in a real estate transaction that could potentially result in up to \$30 million tax liability on the part of Petitioners. Proceedings are currently pending both before the Internal Revenue Service (the "IRS") and the Franchise Tax Board (the "FTB") to determine Petitioners' tax liability.

Section 340.6, subdivision (a) of the Code of Civil Procedure provides for a one year statute of limitation in actions for legal malpractice. Petitioners had to file this action well before the underlying tax proceedings were completed to protect against the running of the statute of limitations. However, as a result of ongoing proceedings before the IRS and the FTB, neither the amount of Petitioners' damages, if any, nor the nature and extent of the Defendants' negligence, has yet been determined. Petitioners filed a motion for stay of this action which was denied by the Superior Court. Petitioners' petition for an appropriate writ was also summarily denied by the Court of Appeal.

Under this Court's decision in *Jordache Enterprises, Inc. v. Brobeck, Phleger & Harrison* (1998) 18 Cal.4th 739, 750, ("*Jordache*") the one-year statute of limitations for legal malpractice begins to run, after discovery, as soon as Plaintiff suffers "impairment or diminution of a right or remedy." This is so regardless of whether the impairment can be quantified as damages, is permanent or substantial in amount.¹ In *Adams v. Paul* (1995) 11 Cal.4th 583, 593 this Court decided the issue of what

1. With respect to a malpractice lawsuit against accountants, this Court held in *International Engine Parts, Inc. v. Feddersen and Company* (1995) 9 Cal 4th 606, 619-620 that in cases "where the alleged malpractice is not discovered until the time of the audit, . . . the malpractice tort is not complete until the audit is finalized." (Emphasis added.)

constitutes “actual injury” for the purpose of accrual of a cause of action for legal malpractice. Citing *Montrose Chemical Corp. v. Superior Court* (1993) 6 Cal.4th 287, 301 (“*Montrose I*”) and other cases, this Court also noted that in case of premature lawsuits, a trial judge has the inherent authority to stay the malpractice action until the underlying action was resolved. In *Montrose I* this Court held that declaratory relief actions about insurance coverage should be stayed if the existence of coverage depends on matters to be resolved in the underlying third-party action.

However, this Court has not directly addressed the issue of whether a legal malpractice action should be stayed in situations where, as here, it is uncertain whether the Plaintiff has suffered any damages, and the amount of such damages; a determination that is subject of a pending underlying litigation, or as in this case, a pending determination by the IRS and the FTB. As shown below, this issue is of particular importance in the context of a legal malpractice action because of the potential loss by the Plaintiff of attorney-client privilege in the proceedings before the tax authorities.

Both Federal and California law provide privilege to a taxpayer with respect a tax advice they receive from their attorneys and/or CPA’s. Specifically, section 7525 of the Internal Revenue Code expressly provides a privilege to a taxpayer with respect to all matters pertaining to tax advice. California Revenue and Taxation Code section 21028 provides similar

protection to taxpayers with respect to the California taxes. However, due to Evidence Code section 958, this privilege cannot be asserted against the attorney defendant in a legal malpractice action. If the Plaintiff is compelled to produce documents and other information to the Defendant attorney which are otherwise privileged, both the IRS and the FTB then has the power to subpoena such documents from the Defendant attorney. (See Internal Rev. Code § 7602; Rev. & Tax Code §§ 19504, 19504.7.) In the absence of stay of the action, grave prejudice can result to the Plaintiff as the IRS and the FTB would then have access to information that is otherwise privileged.

This result is clearly untenable in that it defeats the important public policy principles relating to protection from disclosure of attorney-client privilege information. In addition, to the loss of valuable attorney-client privilege, the concerns expressed by this Court in *Montrose I* and other decisions for staying actions during the pendency of the underlying proceedings in other contexts, including to avoid waste of judicial resources, inconsistent adjudications, and prejudice to parties, are all present in this situation. (See Argument I, C, *infra*.)

This case presents an opportunity for this Court to decide the important legal issues squarely presented for review on complete record.²

C. Statement of Relevant Facts and Procedural History

1. Petitioners Lawsuit Against Defendants

Petitioners filed this lawsuit against Berliner and Logies for malpractice relating to state and federal tax matters and resulting in apparent tax liability. The complaint was filed in abundance of caution to protect the statute of limitations after Petitioners received an unfavorable Notice of Proposed Assessment on their 2001 tax return from the FTB, to which Petitioners filed a timely protest. The protest is still under consideration by the FTB. In addition, the IRS is in the process of auditing their returns for the years 2001-2004, and no Notice of Proposed Assessment has been received from the I.R.S. (See Exhibit 1, pp. 1-3.)³

2. Petitioners have filed a Motion for Protective Order against Defendant Berliner's discovery requests, seeking among others things, information and documents otherwise protected from disclosure by the attorney-client privilege and Petitioners' constitutional rights of privacy. This motion, currently scheduled for hearing on September 7, 2007 before the Superior Court, is vigorously opposed by Defendant Berliner

3. All references to Exhibits are to the Exhibits included in the Appendix submitted by Plaintiffs in the Court of Appeal in support of their petition for an appropriate writ.

The Complaint states that Petitioners purchased land in Cupertino for development as a school site and as residential housing. They retained Berliner, a law firm specializing in real estate and tax matters, and Logies, a CPA firm with similar specialties, to provide a business plan and tax advice. Petitioners relied on those Defendants' advice in the expectation of receiving significant tax deductions on the Cupertino transaction. Instead, Petitioners have been provisionally assessed millions of dollars for back taxes, penalties, and interest. (Exhibit 1, pp. 1-3.) The Complaint contains Causes of Action for legal and accountant malpractice, breach of fiduciary duty, misrepresentation, and breach of contract. (Exhibit 1, pp. 3-7.)

2. Petitioners' Motion for Stay of Action

On April 9, 2007, Petitioners filed a motion for stay of all proceedings on the ground that until the audit is complete, the amount and at least theoretically, the fact of Petitioners' damages will remain uncertain, so that absence of a stay will waste judicial resources, risk inconsistent adjudications, and potentially prejudice both parties. (Exhibit 6, pp. 29-32.)

The declaration of Petitioners' tax attorney submitted in support of the stay motion pointed out that unfavorable tax assessment is still not final. The FTB audited Petitioners' 2001 state tax return and issued a notice of proposed assessment, contesting among other things Petitioners' treatment of items related to sale of the Cupertino property. Petitioners'

timely protested the Notice, and the matter remains before the FTB. At the same time, the IRS has begun an audit of Petitioners' 2001-2004 tax returns. An IRS audit is a protracted process. Like the FTB audit, Petitioners will be given an opportunity to protest any proposed deficiency assessment, which becomes final—if at all—only after an appeals office conference.⁴ If the outcome of that audit is unfavorable, it may result in substantial added federal tax liability for the entire 1996-2004 period and is likely to affect Petitioners' California tax liability as well. (Exhibit 5, pp. 20-22.)

Logies did not oppose the motion. Berliner's opposition consisted primarily of arguments in favor of its concurrent motion to compel arbitration. Berliner further argued that even a six-month stay might result in loss of relevant evidence. (Exhibit 7, pp. 35-37.) In its sur-reply memorandum, Berliner also argued the action should not be stayed because allegedly Petitioners' motion amounted to an admission its damages are "wholly speculative." (Exhibit. 9, at 55:12-54:2.) Berliner proffered no declaration or other evidence in opposition to the motion.

4. See generally *International Engine Parts, Inc. v. Feddersen & Co.* (1995) 9 Cal.4th 606, 612 ("*Feddersen*") and authorities cited.

3. Superior Court's Denial of Petitioners' Motion for Stay of Action

After a hearing on May 1, 2007, the Superior Court took the motion under submission. (Exhibit 10, p. 10.) By its Order dated May 30, 2007, the Superior Court denied Petitioners' motion expressing no reasons for its decision. (Exhibit 11.)

4. The Court of Appeal's Denial of Petitioners' Petition for an Appropriate Writ

On or about July 5, 2007, Petitioners filed a petition for an appropriate writ to set aside the Superior Court's Order denying Petitioners motion for stay of all proceedings. By an order dated August 22, 2004, the Court of Appeal summarily denied Petitioners' petition. (See Appendix.)

ARGUMENT

I. REVIEW SHOULD BE GRANTED FOR SETTLEMENT OF IMPORTANT QUESTIONS OF LAW

We acknowledge that an erroneous Appellate Court's decision, by itself, is insufficient for this Court to grant review. However, the issues of law presented by this petition are of compelling public importance that should be decided by this Court. Therefore, review should be granted to "settle an important question of law." (Cal. Rules of Ct., rule 8.500(b)(a).)

A. The Legal Issues Raised by this Petition Are of Compelling Public Importance

In *Jordache*, this Court made it clear that the one-year statute of limitations for legal malpractice begins to run, after discovery, as soon as plaintiff suffers “impairment or diminution of a right or remedy,” regardless of whether the impairment can be quantified as damages, is permanent or substantial in amount. While Petitioners’ tax liability as a result of defendants’ alleged negligence, if any, is yet to be determined, arguably the statute began to run. (*Jordache, supra*, at pp. 750-752; 760, and cases cited; see also Exhibit. 1, 3:22-23.) Therefore, to be on the safe side, this action had to be filed before either the amount of Petitioners’ damages as a result of Defendants’ negligence, if any, or the nature or extent of Defendants’ negligence could be established in the underlying tax proceedings.

In *Adams v. Paul, supra*, 11 Cal.4th 583, 592, this Court recognized that where a malpractice action arises out of an underlying lawsuit which remains pending, early accrual of the short limitation period may create “concerns for the premature filing of legal malpractice claims and the risks of inconsistent claims or judgments.” Citing *Montrose Chemical Corp. v. Superior Court* (1993) 6 Cal.4th 287, 310, this Court observed that the remedy for such concerns is to stay the malpractice action

until the underlying case is resolved, just as declaratory judgment actions about insurance coverage should be stayed if the existence of coverage depends on matters to be resolved in the underlying third-party action. (*Id.* at 592.)

However, to our knowledge, this Court has never addressed the issue of whether a Superior Court should issue the stay of a legal malpractice action when the client's damages, if any, have not yet been determined as a result of pendency of some other proceedings before the IRS and the FTB. This is particularly so not only because failure to stay could potentially result in the Plaintiff's loss of valuable attorney-client privilege but also because it could jeopardize Plaintiff's position in both in the underlying proceeding and in the legal malpractice action. (See Argument I, B, C, *infra.*) Therefore, review should be granted for settlement of this important questions of law raised by this petition.

B. Grave Prejudice May Result To a Taxpayer if Such Actions Are not Stayed Pending Outcome of the Underlying Tax Proceeding

1. Potential Loss of Attorney-Client Privilege Against the IRS and the FTB

It is clear that Petitioners had no choice but to file this action to protect statute of limitations against Berliner. Further, as of this date, it has not been determined whether such tax audits will ultimately result in any tax

liability on the part of Petitioners. If no such tax liability is found, or if it is determined that any such tax liability was not as a result of Berliner's negligence, then this action against Berliner would be dismissed. The fact that a tax audit may not result in a determination of taxpayer's liability as a result of a tax professional's negligence was expressly recognized by this Court in *International Engine Parts, Inc. v. Feddersen and Company* (1995) 9 Cal 4th 606, 619-620. In that case, this Court held that a taxpayer's cause of action for *accountant* malpractice, arising from an underlying audit, does not accrue "until the date of the [final] deficiency tax assessment or finality of the audit process:"

I]n cases involving the negligent filing of tax returns, where the alleged malpractice is not discovered until the time of the audit, and the malpractice tort is not complete until the audit is finalized. The taxpayer's tax returns may have been selected for audit for a number of reasons, some unrelated to the alleged accountant malpractice. Indeed, "actual injury" represents a legal term of art which recognizes that an inchoate or potential injury cannot give rise to a professional malpractice action until there has been an actual determination that the accountant's alleged negligence is related to the deficiency assessment. Once the audit process is finalized, however, the harm caused by the accountant's negligence is no longer contingent and the taxpayer's cause of action in tort for alleged malpractice against the accountant accrues under section 339, subdivision 1. (Id at. 909-910; emphasis added.)

Therefore, it remains unclear whether Berliner's and Logies' alleged negligence is related to any loss that may be suffered by the Petitioners. In the meantime, however, Petitioners are confronted with the real possibility of losing attorney-client privilege with respect to their communications with Berliner and Logies which could substantially jeopardize their position in the underlying tax proceedings.⁵

Internal Revenue Code section 7525 provides that as to the IRS, the taxpayer has the privilege which attaches to "tax advice" and related communications and papers generated with the taxpayer's counsel, accountant and/or tax preparer, except for the tax returns themselves and the immediate work papers used in the preparation of the tax returns. Further, the common law attorney-client privilege recognized by state and federal law applies to communications between taxpayers and their counsel.

Section 7525 of the Internal Revenue Code was enacted by the IRS Reform Act of 1998, P.L. 105-206, and made effective July 22, 1998. In essence, Section 7525 created a statutory attorney-client privilege providing that the same common law protections of confidentiality which apply to

5. The important public policy considerations behind attorney-client privilege have been articulated by this Court on many occasions. (See e.g., *City and County of San Francisco v. Superior Court* (1951) 37 Cal.2d 227, 235.)

communications between a taxpayer and an attorney, also apply to communications, pertaining to "tax advice", between a taxpayer and any "federally-authorized tax practitioner" to the extent the communication would be considered a privileged communication if it were between a taxpayer and an attorney.

Further, the investigative accountant engaged by counsel in connection with an audit or assessment is subsumed under the attorney-client privilege. (See *United States v. Kovel* (2d Cir. 1961) 296 F.2d 918, 920-921.) California Revenue and Taxation Code section 21028 provides similar protection to taxpayers with respect to California taxes.

However, as a result of Evidence Code section 958, such privilege cannot be asserted against Berliner with respect to many documents and other discoverable information.⁶ If Petitioners are compelled to produce documents and other information to Berliner, which are otherwise privileged, the IRS and the FTB then has the power to summon or subpoena such documents from Berliner or its attorneys. Such power is provided to the IRS under section 7602 of the Internal Revenue Code.

6. "There is no privilege under this article as to a communication relevant to an issue of breach, by the lawyer or by the client, of a duty arising out of the lawyer-client relationship." (Evid. Code § 958.)

California Revenue and Taxation Code sections 19504 and 19504.7 grants similar power to the FTB.

In summary, the IRS and the FTB do not have the authority to obtain otherwise privileged information from the Petitioners, their lawyers or accountants. However, if the Petitioners are forced to provide such information and documentation in this action, it would likely be deemed no longer subject to the statutory privilege set forth in the Internal Revenue Code section 7525 and California Revenue and Taxation Code section 21028.

Needless to say that production of such documents and information to the IRS and the FTB simply because Petitioners were compelled to file the action to prevent the running of statute of limitation, could jeopardize their position in the IRS and the FTB proceedings. The Courts below simply ignored the potentially serious and devastating consequences of the denial of stay.

2. Other Substantial Prejudice Recognized by this Court in Montrose I and Other Cases

Potential loss of the attorney-client privilege is not the only detriment suffered by Petitioners in the absence of stay of action. The substantial prejudice to a Plaintiff in the absence of stay when the underlying action is still pending in an insurance coverage context was succinctly stated by this

Court in *Montrose I* as follows:

To eliminate the risk of inconsistent factual determinations that could prejudice the insured, a stay of the declaratory relief action pending resolution of the third party suit is appropriate when the coverage question turns on facts to be litigated in the underlying action. For example, when the third party seeks damages on account of the insured's negligence, and the insurer seeks to avoid providing a defense by arguing that its insured harmed the third party by intentional conduct, the potential that the insurer's proof will prejudice its insured in the underlying litigation is obvious. This is the classic situation in which the declaratory relief action should be stayed. (*Id.* at 301-302).

Indeed, if there is a risk of inconsistent factual determinations and prejudice to the insured, it is an abuse of discretion to deny a proper motion for stay. (*Montrose Chemical Corp. v. Superior Court ("Montrose II")* 25 Cal.App.4th 902, 907-910.) Cognizable prejudice exists if the insurer is permitted to "join forces with" the plaintiff in the underlying case to defeat coverage, or if the insured must pay to litigate the same issues in two courts:

When the courts talk about prejudice to the insured from concurrent litigation of the declaratory relief and third party actions, they are saying, in effect, that the insurer must not be permitted to join forces with the plaintiffs in the underlying action as a means to defeat coverage. Another form of prejudice exists when the insured is compelled to fight a two-front war, doing battle with the plaintiffs in the third party litigation while at the same time devoting its money and its human resources to litigating coverage issues with its carriers. And of course, there is the collateral estoppel issue. If the declaratory relief action is tried before the underlying litigation is concluded, the insured may be collaterally

estopped from relitigating any adverse factual findings in the third party action, notwithstanding that any fact found in the insured's favor could not be used to its advantage

(*Montrose II, supra*, at p. 909-910; see also, *David Kleis, Inc. v. Superior Court* (1995) 37 Cal.App.4th 1035, 1044-1045; *Haskel, Inc., supra*, 33 Cal.App.4th 963, 979.) A motion for stay should be denied “only where there is no potential conflict between the trial of the coverage dispute and the underlying action.” (*David Kleis, Inc., supra*, 37 Cal.App.4th 1035, 1045.)

The same considerations should apply when the malpractice case arises out of an incomplete tax audit. In *International Engine Parts, Inc. v. Feddersen and Company, supra*. 9 Cal 4th 606, 619-620, this Court held that a taxpayer’s cause of action for *accountant* malpractice, arising from an underlying audit, does not accrue “until the date of the [final] deficiency tax assessment or finality of the audit process.” Otherwise needless lawsuits would be filed and a needless adversarial relationship created between taxpayers and their accountants. (*Id.*, at p. 621.) This rule “avoids requiring the client to allege facts in the negligence action that could be used against him or her in the audit, without first allowing the accountant to correct the error (or mitigate the consequences thereof) during the audit process.” (*Id.*)

Feddersen was decided under a different statute and does not affect the statute of limitations in attorney malpractice actions. However, its logic and rationale should be extended by this Court to cases alleging legal malpractice against a tax attorney where, as here, the underlying audit proceedings are still pending. If Petitioners are prematurely required in discovery to identify specific negligent conduct on the part of Berliner, they likely will be prejudiced in the tax proceedings, because such allegations imply that Petitioners' tax returns were improperly prepared. (*Feddersen, supra*, 9 Cal.4th 606, 621.) Thus by pressing Petitioners for immediate discovery in the negligence case, Berliner *impermissibly* "joins forces with" hostile auditors. (*Montrose II, supra*, 25 Cal.App.4th 902, 910.)

Berliner is represented by seasoned counsel. It knows that the statute of limitations required Petitioners to bring this action before the completion of the tax proceedings. It must also know that by characterizing specific representations or omissions by Berliner as negligent Petitioners could prejudice their position in the ongoing tax proceedings. Yet, Berliner has vigorously opposed every effort by Petitioners to stay this action or discovery in this action until the underlying tax proceedings are resolved. Clearly, Berliner is attempting to *join forces* with the tax authorities against its former clients—a tactic this has been condemned and characterized as "impermissible" and which could cause substantial prejudice to Petitioners.

(Montrose II, supra, 25 Cal.App.4th 902, 910.)

**II. REQUEST FOR STAY OF ACTION PENDING
DETERMINATION OF THIS PETITION**

Defendant Berliner has propounded substantial written discovery and also noticed Petitioners' deposition. For the reasons set forth in this petition, compliance with such discovery requests could cause irreparable harm to Petitioners as a result of potential waiver of important privileges. Therefore, Petitioners request an immediate stay of all proceedings in the trial court, including discovery, until the determination of this petition. (See Cal. Rules Court, rule 8.116(a).)

CONCLUSION

For all the foregoing reasons, Petitioners respectfully request that review should be granted. Petitioners also request that all further proceedings in the Superior Court should be stayed pending the determination of this petition.

Dated: 9/4/07

GUY KORNBLUM & ASSOCIATES
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By _____

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CERTIFICATE RE: WORD COUNT

This is to certify that the total number of words in APPELLANT'S PETITION FOR REVIEW DO NOT EXCEED 8400. The total number of words in this petition is _____. This word count is based upon the computer program used to prepare the brief

Dated: 9/4/2007

Guy O. Kornblum