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LEGAL PROCESS #3

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8 SUPERIOR COURT OF THE STATE OF CALIFORNIA
9 FOR THE COUNTY OF SACRAMENTO

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11 HIGH-SPEED RAIL AUTHORITY and
HIGH-SPEED PASSENGER TRAIN
12 FINANCE COMMITTEE, for the STATE OF
CALIFORNIA,

13 Plaintiffs,

14 v.

15 ALL PERSONS INTERESTED IN THE
16 MATTER OF THE VALIDITY OF THE
AUTHORIZATION AND ISSUANCE OF
17 GENERAL OBLIGATION BONDS TO BE
ISSUED PURSUANT TO THE SAFE,
18 RELIABLE HIGH-SPEED PASSENGER
TRAIN BOND ACT FOR THE 21ST
19 CENTURY AND THE PROCEEDINGS
AND MATTERS RELATED THERETO,

20 Defendants.
21

CASE NO. 34-2013-00140689

[Assigned to: Hon. Michael P. Kenny]

DEFENDANT EUGENE VOILAND'S
OPPOSITION BRIEF

Hearing:

Date: September 27, 2013

Time: 9:00 a.m.

Dept.: 31

Action filed: March 19, 2013

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http://www.hsr.ca.gov/About/Legislative_Affairs/legislative_reports.html, last
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available at: http://www.sos.ca.gov/elections/sov/2008-general/sov_complete.pdf 10

1 **I. INTRODUCTION**

2 The California High-Speed Rail Authority and High-Speed Passenger Train
3 Finance Committee (jointly, “Authority”) filed this action under Code of Civil Procedure section
4 860 et seq. to validate bonds for the California high-speed rail project. The bonds should not be
5 validated.

6 The Authority’s high-speed rail project is one of the largest, most expensive, and
7 most complex public transportation infrastructure projects in the history of the state.
8 Nevertheless, the Authority has asked this Court to validate the legality of the project’s bonds
9 without providing the required plans and projections for spending the bond proceeds or for
10 financing the project. The Authority admits that it does not have this information, but argues that
11 these plans are mere surplusage at this stage and, in any event, the project’s complexity
12 precludes the formulation of these plans now. This is wrong. The Authority’s failure to provide
13 complete plans and projections now and prior to validation renders the application for bond
14 authorization defective under the State General Obligation Bond Law (Government Code, §§
15 16720 et seq.) and the Safe, Reliable High Speed Passenger Train Bond Act for the 21st Century
16 (Sts. and Hy. Code, §§ 2704 et seq.) (“Bond Act”).

17 **First**, as this Court has already ruled,¹ the funding plan the Authority adopted for
18 the Initial Operating Segment of the project violates several provisions of the Bond Act. For
19 example, the Authority’s funding plan does not clearly identify sources of funds available for
20 completion of the Initial Operating Segment. This Court cannot now validate the authorization
21 of bonds that will further this illegal funding scheme.

22 **Second**, the funding and usage scheme the Authority proposes threatens the
23 federal tax-exempt status of the bonds from the outset. The Bond Act states that the bonds will
24 enjoy federal tax-exempt status and commands the Treasurer to take any action necessary to
25 maintain the tax-exempt status of the bonds. This is logical, as tax exemption is one of the

26 _____
27 ¹ Voiland requests judicial notice, under Evidence Code § 452(d), of the Ruling on Submitted
28 Matter: Petition for Writ of Mandate, in *Tos, et al. v. California High-Speed Rail Authority*
 (“*Tos*”), Sacramento Superior Court Case No. 34-2011-00113919-CU-MC-GDS (August 16,
 2013).

1 principal selling points for municipal bonds. If the bonds here are not tax-exempt, their
2 marketability will suffer, and the high-speed rail project's entire funding scheme could be put at
3 risk. The Authority has not shown the Internal Revenue Service will find that the bonds will be
4 tax-exempt. The bonds would be tax-exempt only if used for a public purpose, or, if used for
5 private business purposes, they meet the strict standard of "qualified" exempt facility bonds. The
6 Authority has also failed to establish reasonable expectations for when the proceeds of the bonds
7 will be expended. This threatens their tax-exempt status under Section 149(g) of the Internal
8 Revenue Code. Until the Authority demonstrates how the bonds will retain tax-exempt status,
9 this Court cannot validate them.

10 **Third**, the Authority does not have a plan for using the bond proceeds. The
11 Authority asks the Court and the people of California to accept its assurances that the bond
12 proceeds will be used in accordance with the General Obligation Bond Law and the Bond Act.
13 But the Authority's failure to provide an expenditure plan violates both the letter and the intent
14 of the General Obligation Bond Law and the Bond Act. Further, while the Authority invites
15 future challenges to its use of the bond proceeds, such challenges would be essentially be
16 foreclosed by validating bonds now.

17 **Fourth**, the Authority has not shown that it has met the annual reporting
18 requirements of Government Code section 16724.4. If the Authority is not in compliance, then
19 the Court cannot validate the bonds.

20 For all these reasons, the Authority's requested validation must be denied.

21 **II. ARGUMENT**

22 Because a validation judgment is "forever binding and conclusive," (Code Civ.
23 Proc., § 870) the Authority bears the burden of demonstrating that its bonds meet the standard for
24 validation. As set forth below, the Authority has not met its burden. Therefore, the bonds
25 cannot be validated.

26 **A. The Authority's adopted funding plan for the Project's Initial Operating** 27 **Segment violates the Bond Act**

28 This Court recently ruled that the Funding Plan for the high-speed rail project

1 approved by the Authority on November 3, 2011, violates the Bond Act. This Court found that
2 the Funding Plan “simply did not identify funds available for the completion of the entire IOS.”
3 (*Tos*, at 8.) This Court also found that the Authority’s 2012 Draft Business Plan (November 1,
4 2011) failed to correct the 2011 Funding Plan’s deficiencies. (*Id.* at 8-9.)

5 The Authority’s further attempt to correct the 2011 Funding Plan’s deficiencies,
6 the Revised 2012 Business Plan released on April 12, 2012, also falls short. It, too, does not
7 identify the funding sources for completing the project’s Initial Operating Segment (IOS). The
8 Revised 2012 Business Plan states that approximately \$25 billion is required to complete funding
9 of the IOS beyond the first construction segment. Approximately \$20 billion of the additional
10 \$25 billion needed for the project is projected to come in the form of federal funds (see Revised
11 2012 Business Plan, Exhibit 7-10), but the source of these funds are identical to those stated in
12 the now-invalidated 2011 Funding Plan. (*Tos*, at 8 [finding that “all potential federal sources of
13 funds for construction beyond the ICS are described as theoretical possibilities and not as sources
14 of funds reasonably expected actually to be available starting in 2015.”].) The Revised 2012
15 Business Plan on which the Authority relies in this action fails for the same reason.

16 The Bond Act, approved by the voters as Proposition 1A in November 2008,
17 contains specific requirements for how high-speed rail bond proceeds may be used. Streets &
18 Highways Code section 2704.08 sets forth these requirements. Section 2704.08 provides that the
19 bond proceeds may not be used for more than 50 percent of the total cost of construction of each
20 corridor or usable segment thereof of the high-speed train system, except for a limited 7.5
21 percent of the principal amount of the bonds that may be used for environmental studies,
22 planning, and preliminary engineering activities, for acquisition of interests in real property and
23 right-of-way, for mitigation, and for relocation assistance for property owners displaced as a
24 result of the project. (Sts. & Hy. Code, § 2704.08(a).) The law further requires that not more
25 than 10 percent of the proceeds of the bonds shall be used for environmental studies, planning,
26 and preliminary engineering activities (Sts. & Hy. Code, § 2704.08(b)).

27 It is unclear how the Authority will satisfy these requirements. This uncertainty is
28 made worse in the Revised 2012 Business Plan, which states that “the funding plan assumes that

1 a total of \$8.2 billion in state Proposition 1A bond funds is available for construction after
2 environmental, planning, and administrative costs are applied. Of that amount, \$2.7 billion will
3 be used for the first segment and \$1.1 billion is set aside for blended improvements, leaving a
4 total of \$4.4 billion to contribute to funding the remainder of the IOS. Under the Authority's
5 Revised Plan, these funds will be used to match with federal funding to close the rail gap from
6 Bakersfield to Palmdale and complete the IOS." (Revised 2012 Business Plan at p. 7-14.) It
7 appears that the Authority intends to use \$4.4 billion of the bond proceeds to fund the
8 remainder of the IOS after the initial construction segment is built. But what is not clear is how
9 the Authority intends to satisfy Streets and Highways Code section 2704.08's requirements for
10 funding of the remainder of the IOS.

11 This Court has already found that the Authority's funding plans violate the Bond
12 Act. Validation is only proper and binding on the agency and all interested persons where "the
13 public agency has complied with statutory requirements." (*Friedland v. City of Long Beach*
14 (1998) 62 Cal.App.4th 835, 838.) Because the Authority has not complied with all statutory
15 requirements for issuing the bonds, this Court cannot validate bonds that would further the
16 Authority's illegal funding plan.

17 Since the bonds would be used to further an illegal funding scheme, the Authority
18 has not shown that validation is proper and the bonds should not be validated.

19 **B. *The Authority's failure to maintain the bonds' tax-exempt status violates the***
20 ***Bond Act and destroys the bonds' marketability***

21 The legislature intended any bonds or other obligations issued by the State to fund
22 the construction of a California high-speed train system to enjoy all possible federal tax benefits
23 to aid in their marketing and sale. (See Sts. & Hy. Code, § 2704.21 ["...the Treasurer may...
24 take any other action with respect to the investment and use of those bond proceeds, as may be
25 required or desirable under federal law in order to maintain the tax-exempt status of those bonds
26 and to obtain any other advantage under federal law on behalf of the funds of this state"].) This
27 makes sense because municipal bonds derive much of their market appeal from their tax-exempt
28 status under the Internal Revenue Code. (See 26 U.S.C. § 103(a).) This tax-exempt status is

1 critical for ensuring a wide market for such bonds, which in turn ensures that bond proceeds are
2 acquired at the lowest possible price. However, as explained below, it is apparent that the bonds
3 that the Authority seeks to validate may not qualify for tax-exempt status. This would run
4 counter to the intent of the Bond Act and calls into question the entire funding scheme for the
5 high-speed rail project. This Court cannot validate the bonds at issue here until the Authority
6 demonstrates that these bonds will enjoy tax-exempt status.

7 Section 103(a) of the Internal Revenue Code (26 U.S.C. § 103(a)) generally
8 exempts the interest on any state or local bond from the definition of gross income for federal
9 income tax purposes. However, Section 103(b) includes several exceptions to this blanket
10 exemption, including the exception for “private activity bonds,” which are not qualified bonds.
11 (See 26 U.S.C. § 103(b)(1).) Private activity bonds are defined in Section 141 of the Internal
12 Revenue Code. This multi-faceted definition looks at whether more than 10 percent of the bond
13 proceeds are used for a private business use, whether payment on more than 10 percent of the
14 bond proceeds is secured by property to be used for a private business use or derived from a
15 private business use, and whether the bond proceeds are used to make or finance loans to persons
16 other than governmental entities. (See 26 U.S.C. §§ 141(b) , (c).) Private activity bonds, unless
17 otherwise qualified bonds (see discussion *infra*), are not tax-exempt.

18 The Authority’s Revised 2012 Business Plan makes real this concern because of
19 its numerous references to private sector participation in the construction and operation of the
20 high-speed rail project. (See *generally* Revised 2012 Business Plan, Chapter 4: Business Model.)
21 And it is further compounded by the Authority’s failure to define a specific plan for spending the
22 bonds’ proceeds. If these bonds are not tax-exempt, they do not comply with the Bond Act and
23 cannot be validated.

24 While certain private activity bonds may be tax-exempt if they are “qualified
25 bonds” under Section 141(e) of the IRC, the Authority has provided no evidence that the bonds
26 would meet this test. Qualified bonds include “exempt facility bonds,” which are defined in
27 Section 142 of the Internal Revenue Code to be bonds issued as part of an issue where 95 percent
28 or more of the net proceeds of which are to be used to provide, among other things, “high-speed

1 intercity rail facilities.” (See 26 U.S.C. § 142(a)(11).) Additionally, a bond “shall not be
2 considered an exempt facility bond unless any proceeds not used within a three-year period of
3 the date of the issuance of such bond are used (not later than six months after the close of such
4 period) to redeem bonds which are part of such issue.” (26 U.S.C. § 142(i)(3).) The Authority
5 has provided no plan for spending the bonds’ proceeds and have even indicated that construction
6 of just the first construction segment of the high-speed rail project will take *longer* than three
7 years. (See, e.g., Revised 2012 Business Plan, p. 2-28 (showing that construction of the first two
8 segments, Fresno-Bakersfield and Merced-Fresno, would not be anticipated to be complete until
9 2017 and 2021, respectively).) The Authority’s 2011 Funding Plan and Revised 2012 Business
10 Plan do not show how the Authority will comply with Section 142(i)(3) to maintain the bonds’
11 tax-exempt status. This places not only the tax-exempt status of the bonds at risk, but the
12 project’s entire funding plan as well.

13 Lastly, the Internal Revenue requires a municipal bond issuer to have a reasonable
14 expectation regarding how spendable bond proceeds will be deployed in the years immediately
15 following the issuance of the bonds. (See 26 U.S.C. § 149(g)(2).) This requires the issuer of a
16 bond to reasonably expect that:

17 (A) 10 percent of the spendable proceeds of the issue will be spent
18 for the governmental purposes of the issue within the 1-year period
19 beginning on the date the bonds are issued,

20 (B) 30 percent of the spendable proceeds of the issue will be spent
21 for such purposes within the 2-year period beginning on such date,

22 (C) 60 percent of the spendable proceeds of the issue will be spent
23 for such purposes within the 3-year period beginning on such date,
24 and

25 (D) 85 percent of the spendable proceeds of the issue will be spent
26 for such purposes within the 5-year period beginning on such date.

27 The Authority cannot possibly satisfy these requirements because it has expressly disclaimed any
28 reasonable expectation regarding how the bond proceeds will be spent in the years following
their issuance. The Authority admits that “the nature of the project prevents resolving all use of
proceeds disputes before bonds are issued,” (Opening Brief at 6), but the Internal Revenue Code
provides no exceptions to its requirement to provide a reasonable expectation for how the bond

1 proceeds may be spent, even where the “nature of the project” might make it difficult.

2 A failure to maintain tax-exempt status at the outset of this financing process
3 would violate the terms and intent of the Bond Act, and it would call into question the long-term
4 marketability and effectiveness of the bonds at issue here. Without the advantages of tax
5 exemption enjoyed by most municipal bonds, the salability of the Authority’s bonds would be
6 materially impaired, and the State could be forced to pay significantly more money to purchasers
7 of the bonds. This would make the project even more expensive. The Authority has not
8 explained how the high-speed rail project would be financed if it is unable to sell the bonds, or if
9 the prices for those bonds are unfavorable. This Court must deny the Authority’s validation
10 request because fundamental questions remain unanswered about the bonds’ tax-exempt status.

11 Fundamental questions remain unanswered about the tax-exempt status of the
12 bonds and the financing scheme for the project. The Bond Act requires that the tax-exempt
13 status be settled. Since it is not, the Authority has not met its burden to demonstrate why
14 validation of the bonds is proper.

15 ***C. The Authority has no plan for using the bonds proceeds and any future***
16 ***challenge to their use would be unfairly prejudiced by a premature validation now***

17 The Authority is seeking validation of approximately \$9 billion in bonds without
18 providing a detailed, specific plan for the use of their proceeds. This is not permitted under the
19 General Obligation Bond Law and precludes validation.

20 The General Obligation Bond Law sets specific limitations on the use of state
21 general obligation bond proceeds. Permitted uses of general obligation bond proceeds include
22 the construction or acquisition of capital assets, grants or loans or repayment of previous debt
23 incurred for construction or acquisition of capital assets, the costs of the state agency charged
24 with administering the bonds, and the Treasurer’s costs related to sale and payment of the bonds.
25 (*See Gov. Code, § 16727.*)

26 However, the costs of the state agency charged with planning and constructing the
27 project for which the bonds are issued is not an authorized use of bond proceeds. For example,
28 while the costs associated with the High-Speed Passenger Train Finance Committee would be a

1 permitted use of the proceeds, any costs associated with the High-Speed Rail Authority would
2 not be permitted uses. (See Gov. Code, § 16727(d).) Because the Authority has no plan for how
3 it will spend the bond proceeds, it has not provided any assurance that it will not use the them to
4 pay salaries, for instance, at the High-Speed Rail Authority. Before the bonds can be validated, a
5 detailed expenditure plan is required to show compliance with Section 16727. This is
6 particularly the case here since the Revised 2012 Business Plan commits approximately \$4.4
7 billion of bond proceeds to completing the IOS. The Authority's attorneys' assurances that the
8 Authority's expenditures will comply with the General Obligation Bond Law is not enough. The
9 Authority must provide a detailed expenditure plan before the bonds can be validated.

10 At the same time it refuses to provide an expenditure plan is accompanied, the
11 Authority admonishes the defendants here that they may still challenge the *use* of bond proceeds
12 after validation. (See Opening Brief at 6.) But this is an empty promise for at least two reasons.
13 First, as discussed above, the authorization and issuance of the bonds is premised on the
14 Authority's funding and business plans. Were this Court to validate the authorization of the
15 bonds now, it would implicitly approve the funding plans and business plans on which the bonds
16 rely. Since the use of the bond proceeds would be based on the same plans, any future challenge
17 to the use of the bond proceeds would be unfairly prejudiced by this Court's earlier validation of
18 the bonds.

19 Second, the validation action could also foreclose future challenges to the bond
20 proceeds' use. The validation statutes' estoppel provision states that a validation judgment is
21 "forever binding and conclusive, as to all matters therein adjudicated or which at that time could
22 have been adjudicated, against the agency and against all other persons, and the judgment shall
23 permanently enjoin the institution by any person of any action or proceeding raising any issue as
24 to which the judgment is binding and conclusive." (Code Civ. Proc., § 870.) In fact, courts have
25 interpreted the validation statute to bar future challenges to public agencies' expenditures of
26 public funds after the statute of limitations for validation actions expired.

27 In *Walters v. County of Plumas* (1976) 61 Cal.App.3d 460, a citizen challenged
28 the County of Plumas's new tax on solid waste units. Included among the causes of action was a

1 challenge to **an expenditure of public funds** - the county's guarantee of payments on new
2 heavy solid waste disposal equipment. The suit was filed beyond the 60-day statute of
3 limitations applicable to validation and reverse validation actions. (*See* Code of Civil Procedure
4 section 860 [setting 60-day statute of limitations for such actions].) The court found that the
5 attack on the public expenditure was barred by the validation statute, because of the possibility
6 that such a challenge "might well impair the county's ability to maintain an adequate waste
7 disposal program." (*Walters v. County of Plumas* (1976) 61 Cal.App.3d 460, 468.) While the
8 Authority invites future challenges now, it makes sense that the Authority will argue that any
9 future challenges that impair the ability to maintain the project are time barred because, as in
10 *Walters*, they should have been raised in this validation action.

11 If the Court validates the bonds now, there is a real risk that the Authority will
12 have free rein to spend validated proceeds without adequate public accountability. The
13 Authority must be required to submit a complete and detailed funding and expenditure plan prior
14 to validation of the bonds, so that they may be held accountable as the project moves forward.

15 **D. *The Authority has not shown compliance with the General Obligation Bond***
16 ***Law's reporting obligations***

17 Section 16724.4 of the Government Code (part of the General Obligation Bond
18 Law) subjects any state bond measure approved by the voters after January 1, 2004 to an annual
19 reporting process. Under these reporting requirements, the lead state agency administering the
20 bond proceeds must report to the legislature and the Department of Finance no later than the
21 January 1 of the second year following the enactment of the bond measure and at least once a
22 year thereafter. (Gov. Code Sec. 16724.4(a).) The annual report must include the following:

- 23 (1) A list of all projects and their geographical location that have been funded or
24 are required or authorized to receive funds;
- 25 (2) The amount of funds allocated on each project; and
- 26 (3) The status of any project required or authorized to be funded.

27 Here, the Bond Act was approved by the voters as Proposition 1A on the November 4, 2008

28

1 General Election ballot.² Therefore, under Government Code section 16724.4, the Authority was
2 required to report to the legislature annually starting in 2010. The Authority has provided no
3 evidence that it has done so. A search of the Authority's web pages, including the "Legislative
4 Reports" section on the Authority's web site,³ indicates that it has not done so. If the Authority
5 has not satisfied this obligation, then the bonds' authorization of the does not comply with the
6 General Obligation Bond Law. This Court cannot validate bonds that do not comply with the
7 General Obligation Bond Law.

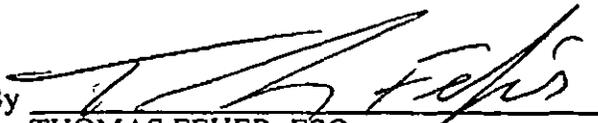
8 Because the Authority has not shown that it has complied with all statutory
9 requirements, the bonds should not be validated. (*See Friedland v. City of Long Beach* (1998) 62
10 Cal.App.4th 835, 838.)

11 **III. CONCLUSION**

12 For all the foregoing reasons, the Court should deny the Authority's validation
13 requests.

14 Dated: August 22, 2013

LeBEAU-THELEN, LLP

15
16
17 By 
THOMAS FEHER, ESQ.
Attorneys for Defendant
EUGENE VOILAND

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26 ² Statement of Vote, November 4, 2008 General Election, California Secretary of State, p. 6,
available at: http://www.sos.ca.gov/elections/sov/2008-general/sov_complete.pdf.

27 ³ Legislative Reports, California High-Speed Rail Authority, available at:
28 http://www.hsr.ca.gov/About/Legislative_Affairs/legislative_reports.html, last visited August 19,
2013.

PROOF OF SERVICE

I am employed in the County of Kern, State of California. I am over the age of 18 years and not a party to this action. My business address is LeBeau-Thelen LLP, 5001 East Commercenter Drive, Suite 300, Bakersfield, CA 93309.

On August 22, 2013, I served the following document described as:

DEFENDANT EUGENE VOILAND'S OPPOSITION BRIEF

by serving a true copy of the above-described document in the following manner:

BY OVERNIGHT/EXPRESS MAIL

I personally enclosed a true copy of the above-described document in a sealed envelope designated by United Parcel Service ("UPS") addressed as shown on the below by placing said envelop(s) for ordinary business practices from Kern County. I am readily familiar with this business' practice of collecting and processing correspondence for overnight UPS mailing. On the same day that the correspondence is placed for collection and mailing, it is deposited in the ordinary course of business with UPS in a sealed envelope with delivery fees paid/provided for at the facility regularly maintained by UPS.

(See attached Service List)

I declare that I am employed in the office of a member of the Bar of, or permitted to practice before, this Court at whose direction the service was made and declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct.

Executed on August 22, 2013, at Bakersfield, California.



Tisha Fuentes

SERVICE LIST

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