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KARL MORELL
Of Counsel



July 14, 2006

217049

VIA HAND DELIVERY

The Honorable Vernon A. Williams
Secretary
Surface Transportation Board
1925 K Street, N.W., Suite 715
Washington, DC 20423-0001

**RE: Finance Docket No. 34892, State of Washington v. Palouse
River and Coulee City Railroad, Inc.**

Dear Secretary Williams:

Enclosed for filing are the original and ten (10) copies of the Answer To Complaint in the above-captioned proceeding.

Please date-stamp the extra copy of the Answer and return it with our messenger.

Sincerely yours,

A handwritten signature in cursive script that reads 'Karl Morell'.

Karl Morell

Enclosures

ENTERED
Office of Proceedings
JUL 14 2006
Part of
Public Record

BEFORE THE
SURFACE TRANSPORTATION BOARD

STB Finance Docket No. 34892

STATE OF WASHINGTON

V.

PALOUSE RIVER AND COULEE CITY RAILROAD, INC.

ANSWER
TO COMPLAINT

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Attorney for:
Palouse River and Coulee City Railroad, Inc.

Dated: July 14, 2006

BEFORE THE
SURFACE TRANSPORTATION BOARD

STB Finance Docket No. 34892

STATE OF WASHINGTON

V.

PALOUSE RIVER AND COULEE CITY RAILROAD, INC.

ANSWER
TO COMPLAINT

Pursuant to 49 C.F.R. § 1111.4, Palouse River and Coulee City Railroad, Inc. (“PCC”), answers the Complaint filed by The State of Washington (“Washington”) in this proceeding as follows:

1.1 PCC denies the allegations in paragraph 1.1 that PCC has violated its common carrier obligation and discontinued operations between Cheney, Washington and Coulee City, Washington.

2.1 PCC admits that Washington is a State as defined by 49 U.S.C. § 10102(8) and is a “state” for purposes of 49 C.F.R. § 1002.2(e)(1). Nevertheless, PCC denies that Washington is entitled to a waiver of the appropriate filing fee.

2.2 Admitted.

2.3 PCC admits that it provides freight rail service between Cheney, Washington and Coulee City, Washington on the Central Washington Branch (“CW Line”). PCC further admits

that the CW Line is one of four branches operated by the PCC in the State of Washington. PCC denies the implication that it ceased being the freight operator on the CW Line in November 2005.

2.4 Admitted.

2.5 PCC admits that Watco Companies, Inc. (“Watco”) is the indirect parent company of PCC and that Watco and PCC share certain common officers. PCC and Watco, however, are separate corporations each independently operated in conformance with the corporate governance laws of the States of Washington and Kansas, respectively.

3.1 Paragraph 3.1 states a legal conclusion to which no response is required. To the extent a response is deemed required, PCC denies the allegations in this paragraph.

3.2 Paragraph 3.2 states legal conclusions to which no responses are required. To the extent responses are deemed required, PCC does not have sufficient information at this time to admit or deny the allegations in this paragraph.

4.1 Admitted.

4.2 To the best of PCC’s knowledge, the allegations in paragraph 4.2 are accurate.

4.3 PCC does not have sufficient information at this time to admit or deny the allegations in this paragraph.

4.4 The allegations in paragraph 4.4 are at best misleading. Washington State Department of Transportation (“WDOT”) requested from PCC a report on the economics of the CW Line. Pursuant to that request, PCC prepared and presented to WDOT an honest assessment of the deteriorating business conditions on the Line. After reading the report, a representative of WDOT indicated that the State of Washington was no longer interested in acquiring the CW Line.

4.5 PCC admits that on or about October 5, 2005, PCC officials telephoned the shippers on the CW Line notifying them that a \$250 per car surcharge would be imposed effective on or shortly after October 25, 2005.

4.6 PCC admits that it posted a new tariff on October 25, 2005 imposing a \$250 per car surcharge. Through inadvertence, the issued date was listed as October 25th rather than October 5th. This inadvertent error, however, was harmless since PCC gave actual notice of the surcharge to the shippers on the CW Line on October 5th and, in any event, not a single car was tendered to PCC since the imposition of that tariff.

4.7 PCC denies that the new \$250 surcharge triggered the intense discussions between PCC and shippers on the CW Line. The discussions were initially triggered by the rebates shippers were insisting on receiving so as not to utilize the nearby transload service offered by the BNSF Railway Company. Once PCC notified the shippers of the surcharge, the discussions encompassed both the rebates and the surcharge.

4.8 PCC denies the allegations in this paragraph. The carload agreement was not signed by CWGG because CWGG was not able to meet the minimum car shipping requirements set forth in the agreement.

4.9 PCC denies that it ceased operations on the CW Line on November 4, 2005. Because there were no requests for service, PCC repositioned some of its locomotives in November 2005. Not all locomotives were removed notwithstanding the fact that no shipments were being tendered to PCC.

4.10 PCC denies the allegation that all "power" was pulled off the CW Line. PCC does not have sufficient knowledge at this time to admit or deny whether any charges were incurred by CWGG.

4.11 PCC admits that it issued an embargo for all stations between Cheney and Coulee City, effective December 30, 2005, due to "Track Conditions, sub-grade and surface conditions".

4.12 PCC denies that any cars were ordered by CWGG from PCC on or around May 5, 2006 or that PCC denied service. To the extent CWGG ordered empty cars from another railroad, PCC would have been able to deliver them to CWGG's facility because the embargo only applied to loaded cars. PCC denies that it was requested to move empty cars by CWGG on or around May 5, 2006.

4.13 PCC admits that representatives from the Washington inspected the CW Line on May 25, 2006 but the stated purpose of the inspection was to evaluate the Line for purposes of acquiring the Line from PCC and not to determine whether the embargo was justified. PCC denies that track conditions did not support an embargo. Because of sub-surface water conditions, the Line could not be safely operated until the Line dries out. PCC periodically inspected the Line and concluded that loaded cars could not be safely transported over the Line.

4.14 PCC cannot admit or deny what representatives from Washington saw on their inspection trip of the CW Line. PCC is also without information at this time to comment on the qualifications of the representatives as track inspectors. Based on PCC inspections, the CW Line was unsafe and the embargo justified.

4.15 PCC admits that the embargo was still in effect on the date this complaint was filed.

4.16 PCC denies that service on CW Line was discontinued in November 2005. PCC denies that shippers, their representatives and representatives of Washington have made numerous requests to negotiate the reopening of freight service on the CW Line. PCC has had

negotiations over the surcharge. PCC denies that it has refused all requests to reopen the CW Line.

4.17 PCC denies the allegations in this paragraph. PCC embargoed the Line on December 30, 2005 because of unsafe conditions. PCC has not received a single car order since the surcharge took effect. It is the surcharge and not the embargo that has resulted in the shippers on the Line looking for alternative transportation services. The surcharge was imposed in an attempt to make service on the CW Line profitable for PCC and not to drive away the traffic.

4.18 PCC denies the allegations in this paragraph.

4.19 PCC denies the allegations in this paragraph.

4.20 PCC denies that Watco has any legal obligation to repair or rehabilitate the CW Line. Permanently repairing the CW Line would have been a financial drain on PCC and jeopardized its ability to continue operations on the remainder of the PCC system.

4.21 PCC denies the allegations in this paragraph.

4.22 PCC denies the allegations in this paragraph.

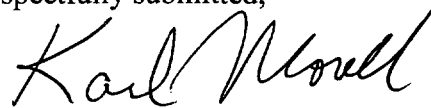
4.23 PCC denies the allegations in this paragraph.

5.1 PCC denies that Washington is entitled to any of the relief sought in this paragraph.

5.2 Notwithstanding the fact that the Board has granted the waiver, PCC denies that Washington is entitled to a waiver of the filing fees.

WHEREFORE, PCC having fully answered the Complaint requests that the Complaint be dismissed with prejudice and that no relief of any kind be awarded to Washington.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Karl Morell". The signature is fluid and cursive, with the first name "Karl" and last name "Morell" clearly distinguishable.

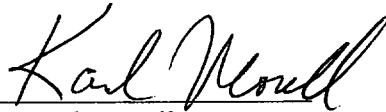
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Attorney for: Palouse River and Coulee City
Railroad, Inc.

Dated: July 14, 2006

CERTIFICATE OF SERVICE

I hereby certify that I have caused a copy of the foregoing Answer of Palouse River and Coulee City Railroad, Inc., to be served upon counsel for the State of Washington on July 14, 2006, by e-mail and first class mail, postage prepaid.


Karl Morell