B.C.D. 08-22 MAY 20 2008

EMPLOYER STATUS DETERMINATION
P. S. Technology, Inc.

This is the determination of the Railroad Retirement Board concerning the status of P. S. Technology, Inc., as an employer under the Railroad Retirement Act (45 U.S.C. § 231 et seq.) and the Railroad Unemployment Insurance Act (45 U.S.C. § 351 et seq.).

P. S. Technology, which was incorporated March 10, 1988, develops and maintains computer software for the railroad and transportation industry. In a decision dated August 7, 1995, the Board held P. S. Technology not to be a covered employer under the Acts (B.C.D. No. 95-74). P. S. Technology was a wholly-owned subsidiary of Rio Grande Holding, which had a controlling interest in an employer under the Acts. In the period 1991-1994, 2.6 percent of P. S. Technology's revenues were derived from its affiliated railroad, 46.2 percent from other United States railroads, and 38.9 percent from Canadian railroads. A majority of the Board found that, because of the small percentage of P. S. Technology's operations related to its rail affiliate, P. S. Technology was not performing a service in connection with railroad transportation, and therefore was not a covered employer under the Acts.

Patrick J. O'Malley, Assistant Vice President – Federal Taxes, Union Pacific Corporation, advised that Union Pacific Corporation acquired P. S. Technology (as an indirect subsidiary) on September 11, 1996. Mr. O'Malley stated that "Union Pacific and its rail affiliates used internally developed software until 1999 * * *, at which time Union Pacific and its affiliates began migrating to the software products developed by [P. S. Technology]." P. S. Technology revenue from Union Pacific Railroad as a percentage of total revenue was 22.8 percent in 2002, 9.8 percent in 2003, and 20 percent in 2004. Approximately 89 percent of P. S. Technology business is with railroads, the remainder with trucking and intermodal companies.

Additional information about PST has been recently submitted by Attorney Thomas Gies of Crowell & Moring LLP. In a letter dated December 18, 2007, Mr. Gies provides details as to factual changes in PST's business. First, Mr. Gies explained that PST has developed software products geared toward the transportation industry, including both railroad and trucking companies. When UP acquired PST in 1996, UP's carrier subsidiary, Union Pacific Railroad Co. (UPRR) did not use PST's products. PST's revenues from UPRR grew over time, averaging $1.5 million per year over the period 2002-2006. UPRR revenue averaged 18.6% of the total PST revenues over this period.

Mr. Gies explained that in 2007, PST started phasing out its trucking industry business, and focused on its core business, railroads. Revenue from UPRR dramatically increased during calendar year 2007 due to the start up of "iTrak Force" software development and due to the acceleration of the completion date for the CMTS software project. CMTS refers to Crew Management and Timekeeping System for both the freight and the transit rail operations. CMTS aims to match crews with trains along with timekeeping functions. PST's revenue from UPRR in 2007 is estimated at $4.5 million, representing 44.8% of PST's total revenue.

Beginning in 2007, UPRR awarded a contract to PST to develop a new software product called iTrakForce, which will be used as the timekeeping function for the railroad's non-operating work force, including work force in locomotive and freight car repair shops, engineering department personnel, and clerical workers.

Section 1(a)(1) of the Railroad Retirement Act (45 U.S.C. § 231(a)(1)), insofar as relevant here, defines a covered employer as:

> (i) any carrier by railroad subject to the jurisdiction of the Surface Transportation Board under Part A of subtitle IV of title 49, United States Code;
>
> (ii) any company which is directly or indirectly owned or controlled by, or under common control with, one or more employers as defined in paragraph (i) of this subdivision, and which operates any equipment or facility or performs any service (except trucking service, casual service, and the casual operation of equipment or facilities) in connection with the transportation of passengers or property by railroad * * *.

Sections 1(a) and 1(b) of the Railroad Unemployment Insurance Act (45 U.S.C. §§ 351(a) and (b)) contain substantially similar definitions, as does section 3231 of the Railroad Retirement Tax Act (26 U.S.C. § 3231).

Section 202.7 of the Board's regulations provides that service is in connection with railroad transportation:

> * * if such service or operation is reasonably directly related, functionally or economically, to the performance of

> obligations which a company or person or companies or persons have undertaken as a common carrier by railroad, or to the receipt, delivery, elevation, transfer in transit, refrigeration or icing, storage, or handling of property transported by railroad. (20 CFR 202.7).

Early decisions of this agency provided that manufacturing a product which is sold in the market place in arms-length transactions is not a service, even though an affiliate carrier of the company producing that product may make use of that product. See, *Carnegie-Illinois Steel Company*, Legal Opinion L- 39-811; *Wheeling Steel Corporation*, L-39-571; *Pullman-Standard Car Manufacturing Company*, L-40-403; and *Ford Motor Company*, L-40-304. This rule was circumscribed in Railroad Concrete Crosstie Co. v. Railroad Retirement Board, 709 F.2d 1404 (11th Cir. 1983), which will be discussed later in this determination.

The Board has previously held that under the facts presented in Nexterna, Inc., the manufacture, sale, and servicing of computer software may constitute the provision of services in connection with rail transportation. See Nexterna, Inc., B.C.D. No. 07-08 (decision on reconsideration). Nexterna's business was wireless two-way communications, data exchange and related technology marketed primarily to the transportation industry. It was formed as joint venture in which the Union Pacific Railroad (UP RR) owned 50 percent. The UP RR subsequently acquired all of Nexterna in 1998. The goal was initially to expand Nexterna's business to outside the railroad industry, but that never transpired.

Specifically, Nexterna's software was installed in locomotives and was used to monitor oil, motor temperature, fuel usage, speed and location. Nexterna also maintained the software. In 1998, 28% of Nexterna's sales were with the UP RR and climbed every year thereafter until 2002. In its decision the Board reviewed its decisions dealing with manufacturing and service and found that the provision of the software to the UP RR was a service in connection with railroad transportation. The Board found that Nexterna provided a product to the UP RR which, perhaps not essential, was extremely important to the operation of its trains.

See, also, B.C.D. No. 97-63, Union Pacific Technologies Transportation Systems, Inc. (holding the provision of computer services to be service in connection with rail transportation).

By reason of its acquisition by Union Pacific Corporation, P. S. Technology remains under common control with rail carrier employers. What has changed since the initial ruling by the Board regarding P. S. Technology, is that since 2002 a higher percentage of its revenue is attributable to services it performs for its rail affiliates. As stated above, PST's revenue from UPRR in 2007 is estimated at $4.5 million, representing 44.8% of PST's total revenue. PST describes itself as a manufacturer of software products. As the Board stated in the Nexterna decision, a company may perform a service in connection with the affiliate's rail transportation business when furnishing a substantial portion of its products to its affiliated railroad, or when furnishing a substantial portion of the needs of the affiliated railroad for its products. It is the provision of the product, not the process of manufacture, which is the service in connection with railroad transportation. The Board's decision in Nexterna cites Railroad Concrete Crosstie Corporation v. Railroad Retirement Board, 709 F. 2d 1404 (11 Cir. 1983). In that case, Crosstie, as its name implies, manufactured crossties and was its affiliate carrier's main supplier of these crossties. The court correctly recognized that crossties were essential to the carrier's operation and that having a "captive" supplier was advantageous to the carrier. Thus, manufacture of the crosstie itself was not the service. The service was the provision of a product essential to the carrier's operations. The Court determined that the manufacturing and supplying of crossties by a company to its affiliated carrier was service. The Court stated:

> Our opinion does not purport to hold that in all cases subsidiaries or affiliates that are directly or indirectly owned or controlled by a carrier and that manufacture products that are sold to the carrier will be held to be an employer under the Acts. Nor do we attempt to set any guidelines for determining when the amount of sales are substantial enough and the type of product so inextricably linked to the operation of the railroad that the sale of the product constitutes a "service...in connection with the transportation of passengers or property by railroad. .." We simply decide that in a case such as this, when the nature of the relationship and the volume of sales between Railroad Concrete and Florida East Coast indicate that the subsidiary is economically dependent on the parent, and when the type of product is so obviously essential to the functioning of the railroad, that the subsidiary's provision of the product constitutes a service to the parent within the meaning of 45 U.S.C.A. §§ 231(a)(1) and 351(a). Railroad Concrete Crosstie Corp. 709 F.2d at 1411.

In reviewing prior Board decisions on manufacturing, the Court noted the Board's General Counsel's opinion in Pullman Standard Car Manufacturing Company, L-40-403, to be very similar to the Crosstie case since Pullman manufactured rail cars which were essential to the operation of a railroad. The Court noted that most of the sales from Pullman were to unaffiliated rail carriers unlike Crosstie where almost 90% of the product was sold to the affiliated carrier. Therefore, the Board's analysis must consider not only the amount of product sold but the nature of the relationship between PST and the affiliated carrier. This is further highlighted by the recent 5th Circuit Court of Appeals Opinion in Trans-Serve, Inc. v. United States of America, (2008 U.S. App. LEXIS 5832). The facts of the Trans-Serve case were almost identical to Crosstie. The Court in Trans-Serve adopted the decision of the 11th Circuit finding Trans-Serve's sales, amounting to close to 90% of all revenue to its railroad affiliate, was considered service in connection with transportation. Significantly, the Court noted:

> Trans-Serve could not and would not have existed but for KCSR's need for a reliable source of quality ties. Trans-Serve is not truly a separate profit center. Crossties, like railway beds, tracks, switches and rolling stock, are essential to, and thus "in connection with", transportation by rail. As Trans-Serve is related to KCSR both functionally and economically, we affirm the district court's holding that Trans-Serve is a "railroad employer." Trans-Serve, Inc. v. United States of America, (2008 U.S. App. LEXIS 5832).

Unlike Crosstie, PST was not purchased directly by the carrier but was acquired as a result of the acquisition of the Southern Pacific Railroad. In fact, UP did not begin purchasing any of PST's products until three years after acquisition. Additionally, PST sold the majority of its products to unaffiliated entities even after the UP began its purchases. There is no indication that the sales were anything less than arms length. Also, the provision of software by PST was not of the nature described in either Crosstie or Trans-Serve. Its product was not as integral to railroad operations and certainly a few steps away from Nexterna where Nexterna's products were utilized directly in the locomotives. Further, there are no facts suggesting that PST was economically dependent on the UPRR, especially during the years 2002 – 2006 when 80% of sales by PST were to non-affiliated entities.

However, in 2007 the nature of the business changed and PST stopped developing software for the trucking industry and focused more heavily on

the railroad industry but more importantly it focused on UPRR's needs. The contract specifically required PST to develop ITrakForce for non-operating timekeeping. While UPRR sought bids from other non-affiliated software developers, only PST agreed to match UPRR's requirements. PST revenues as a result of this new contract doubled to over 40% and its economic independence from UPRR is less pronounced. In fact, development of the new software became PST's principal business activity.

Based on these facts, the Board concludes that PST's software development amounted to a service in connection with transportation commencing with the change of its business resulting from the additional contract to develop software for UPRR in January 1, 2007.

Viewing the evidence as a whole, the Board finds that prior to 2007 PST operations were similar to the manufacturing operations discussed in the Board's earlier decisions cited above, and that prior to 2007 PST was not performing a service in connection with railroad transportation. Commencing in 2007 however, PST's software became an important part of UPRR's operations, and the provision of that software placed PST within the reach of Crosstie, Trans-Serve, and Nexterna.

In conclusion, at some point the sale of a product by a subsidiary or an affiliate of a carrier becomes more than just the sale of a product. When the provision of that product to the carrier is important to the carrier's operations, that company provides a service in connection with railroad transportation and is thus covered under our statutes. The Board must engage in line-drawing when making these determinations, which by its nature is an imperfect act.

In this case, because of the dramatic change in the nature of UPRR's relationship with PST commencing in 2007, the Board finds that P. S. Technology is an employer within the meaning of section 1(a)(1)(i) of the Railroad Retirement Act (45 U.S.C. § 231(a)(1)(i)) and the corresponding provision of the Railroad Unemployment Insurance Act as of January 1, 2007.

Original signed by:

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