

March 1993

FTS 2000

GSA's Price Redetermination Yields a Reasonable Decision and Lower Prices



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Information Management and
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March 4, 1993

The Honorable John Glenn
Chairman, Committee on
Governmental Affairs
United States Senate

Dear Mr. Chairman:

As agreed with your office in October 1992, we reviewed the General Services Administration's (GSA) conduct of the recent Federal Telecommunications System (FTS) 2000 Price Redetermination/Service Reallocation (PR/SR). This letter is a follow-up to our December 18, 1992, briefing to your office and addresses whether (1) GSA made a reasonable decision in the PR/SR; (2) the vendors' proposed prices were fair and reasonable; (3) FTS 2000 prices are below the lowest known commercial prices; (4) adequate controls exist to ensure that FTS 2000 prices will remain competitive with commercial prices; and (5) GSA made, separate from PR/SR, a reasonable determination not to allocate 100 percent of the FTS 2000 traffic to either vendor.

To address these issues, we reviewed GSA's PR/SR document, source selection plan, and FTS 2000 traffic projections for the remaining years of the program. We also reviewed GSA's estimated costs to move traffic from one network to the other, the estimated cost of each alternative available to the government in the PR/SR, analyses of the vendors' bids, and methodology for comparing FTS 2000 prices with commercial prices. In addition we analyzed the previous and new Publicly Available Price Cap (PAPCAP) agreements for both vendors. Our work also included interviewing GSA, MITRE, American Telephone and Telegraph Co. (AT&T), and US Sprint officials. We did not independently validate agencies' traffic projections or the estimated costs to move traffic between vendors.

Results in Brief

GSA followed a well-defined, appropriate process for conducting the PR/SR. It consistently followed its source selection plan, which we previously reviewed and found acceptable. In addition, GSA used appropriate methodologies to develop data used to perform its analysis during the PR/SR process. As a result, GSA made a reasonable decision in maintaining the current 60/40 percentage revenue split between the two FTS 2000 vendors.

Through this decision, GSA made a major impact on FTS 2000 prices. PR/SR reduced prices by about \$450 million over the final 6 years of the contracts. Further, these new prices were generally below the lowest known commercial rates at the time of PR/SR. In addition, to ensure that FTS 2000 prices remain competitive with commercial prices, GSA recently negotiated with both vendors new PAPCAPS covering all services. These agreements appear reasonable and should ensure that the government pays competitive rates during the second term of the contracts.

Background

FTS 2000 is providing voice, data, and video telecommunications services for the federal government through 1998 at an estimated cost of \$10 billion to \$12 billion. As stipulated in the original FTS 2000 contracts, awarded to AT&T and US Sprint in 1988, GSA can target up to 40 percent of each vendor's revenue for recompetition at the end of the fourth and seventh years of the contracts. These recompetitions (PR/SRS between the incumbent vendors are intended to foster ongoing competition and ensure that FTS 2000 prices are competitive with commercial prices. GSA concluded the first PR/SR in September 1992, and announced its decision that each vendor would retain its current share of the projected FTS 2000 revenue. The prices bid by each vendor in the PR/SR became effective on December 7, 1992.

To further ensure that FTS 2000 prices remain competitive with commercial prices, GSA in December 1992 negotiated new PAPCAPS with both vendors covering all services. PAPCAPS are contract modifications, voluntarily agreed to by the vendors, that define how and when FTS 2000 price reductions should occur. These reductions are based on periodic comparisons of FTS 2000 prices with publicly available prices. These new PAPCAPS replaced previous agreements with AT&T for switched voice, dedicated transmission, switched data, and compressed video transmission services, and with US Sprint for switched voice and dedicated transmission services.

GSA's PR/SR Decision Was Reasonable

GSA asserts that its PR/SR decision to maintain the current revenue split was the best alternative available because it reduced FTS 2000 prices while minimizing disruption to participating agencies caused by moving traffic between vendors. We agree. By establishing a solid approach to conducting the PR/SR and closely following the methodology outlined in the source selection plan, GSA developed the necessary data to make a reasonable business decision from the alternatives available.

GSA Followed Its Source Selection Plan

GSA's source selection plan outlined in detail the decision-making process to be followed in PR/SR. In 1992, prior to the PR/SR, we reviewed this plan and found that GSA's approach to conducting PR/SR was both appropriate and reasonable.

As required, GSA evaluated three PR/SR scenarios on the basis of a single set of prices—covering all possible traffic volumes—submitted by each vendor. Under one scenario, AT&T would gain 40 percent of US Sprint's projected revenue for the life of the contract, while under a second scenario US Sprint would gain 40 percent of AT&T's projected revenue. Under the third scenario, each vendor would retain its current 60 percent/40 percent shares of the projected FTS 2000 revenue.

GSA then evaluated each of the three scenarios on the basis of an equal consideration of their costs and technical merits. The technical criteria focused on the quality of service provided by the vendors and the vendors' proposed approaches for moving traffic, if mandated by the PR/SR decision. The cost of each scenario comprised the vendors' bids for providing services over the lives of the contracts plus estimates of the government's cost to move traffic from one vendor to the other, as required by the scenario. GSA considered only those costs associated with the 40 percent of the revenue being recomputed.

GSA then compared the three scenarios. Initially, the technical scores and costs for the first two scenarios were compared and the more advantageous scenario was selected. Next, the technical score and cost for the selected scenario were compared with the technical score and cost for the third scenario. In addition, consistent with the source selection plan, GSA considered other factors, such as the disruption to agencies and the public of moving traffic from one vendor to the other and the ability of the government to recoup transition costs by the next PR/SR. Finally, on the basis of cost, technical merit, and these other factors, GSA selected the winning scenario.

GSA Used Reasonable Methodologies to Develop Key Data

The source selection plan required GSA to develop several key pieces of data to perform its analyses during the PR/SR process. These data included traffic projections for the life of the program, as well as estimates of government costs to move traffic between vendors for each of the scenarios.

The traffic projections were made on an agency-by-agency, service-by-service, and component-by-component basis. They were based on current traffic records, pending service orders, agency estimates, and judgments made by GSA and MITRE staff. These projections were then used to (1) determine 40 percent of the vendors' projected revenue to be competed in the PR/SR, (2) develop a generic set of traffic components for the vendors to bid on, and (3) develop the total usage costs for each scenario by applying the vendors' proposed prices to the projected traffic.

Per the source selection plan, government transition costs were to be added to the vendors' bids to determine the total costs of the first two scenarios. Government transition costs were developed from estimates submitted by the agencies comprising the majority of FTS 2000 traffic. While GSA officials made no independent validation of those submissions, they used other mechanisms to ensure that the estimates were reasonable. For example, GSA prescribed the format and general content of the submissions. GSA also compared the submissions of the individual agencies and made adjustments for anomalies, such as inordinately low or high cost estimates in specific categories.

We did not have sufficient time to independently validate each agency's submission for the traffic projections or transition costs. However, we reviewed GSA's methodologies for ensuring that the agencies' submissions were valid, and checked GSA's calculations of the total costs for the scenarios evaluated. We found the methodologies to be reasonable and found no errors in GSA's calculations of the total costs for the evaluated scenarios.

Vendors' Prices Appear Fair and Reasonable

The source selection plan required GSA to conduct numerous tests to determine the characteristics of the vendors' bids. For example, GSA compared each bid to both vendors' current price tables, the other vendor's bid, and commercial prices. In addition, GSA analyzed the structure of each vendor's bid to determine whether the proposed prices were fair and reasonable over all services and volume bands. After conducting these tests, GSA concluded that the vendors' prices were fair and reasonable. GSA also determined that neither vendor had "gamed" the PR/SR by bidding very high prices for a scenario in which they lost traffic to make that scenario less advantageous to the government because of its inflated cost. We reviewed GSA's testing analyses and conclusions and found them to be reasonable.

New FTS 2000 Prices Generally Below Lowest Commercial Prices Known at PR/SR

In September 1991 we reported that FTS 2000 prices were well above commercial prices.¹ We recommended to the Administrator, GSA, that accurate comparisons be made between FTS 2000 prices and commercial prices, taking into account the value of any services provided under FTS 2000 that are not typically provided under commercial contracts. It was GSA's intent during PR/SR to obtain FTS 2000 prices, inclusive of any value-added services, below the lowest known commercial prices. During the PR/SR process, GSA developed estimates of the lowest commercially available prices for each FTS 2000 service and compared each vendor's proposed prices with those commercial prices. GSA found that the proposed FTS 2000 prices were generally below the lowest known commercial prices.²

We reviewed GSA's commercial cost comparisons and found GSA's methodology and conclusions to be reasonable. However, three caveats noted by GSA should be mentioned:

- GSA could only compare FTS 2000 prices to known public tariffs, AT&T contracts filed with the Federal Communications Commission, and other government telecommunications contracts. GSA acknowledges that lower commercial prices may be available to very large private users, but information about those contracts is not publicly available.
- Direct comparisons between FTS 2000 prices and published tariffs are difficult because, for some services, FTS 2000 volumes are much higher than the highest volumes priced in published tariffs.
- Commercial prices for some services may have decreased since PR/SR. Therefore, comparisons made before the first calculation of the new PAPCAPS next month may indicate that some FTS 2000 prices are above commercial levels.

New PAPCAPs Should Ensure That FTS 2000 Prices Remain Competitive

On December 17, 1992, GSA negotiated new PAPCAPs covering all services with each vendor. GSA officials believe these new PAPCAPs will ensure that FTS 2000 prices remain competitive with commercial levels until the next PR/SR in December 1995. We reviewed the new PAPCAPs and agree that, if implemented as planned, they should ensure that FTS 2000 prices remain

¹FTS 2000: GSA Must Resolve Critical Pricing Issues (GAO/IMTEC-91-79, Sept. 11, 1991).

²Two prices bid in PR/SR were above the lowest known commercial prices. GSA considers information regarding the vendor(s) that bid these prices, the service(s) affected, and the specific prices bid to be source-selection sensitive. GSA anticipates that these exceptions will have minimal effect on the overall cost of the program and that next month the new PAPCAPs will lower the prices of the exceptions below commercial prices.

competitive with commercial prices. Included in the new PAPCAPS are three key points:

- GSA is now able to compare FTS 2000 prices to any single known lower commercial offering providing services comparable to FTS 2000. This improves on the old PAPCAPS, which generally computed commercial prices as the average of more than one known commercial offering.
- Comparisons with commercial prices will be made on a quarterly schedule, beginning in April 1993. This will enable FTS 2000 prices to respond more quickly to changes in the commercial marketplace since the old PAPCAPS were calculated semiannually.
- The new PAPCAPS apply to both vendors and to all FTS 2000 services.

The FTS 2000 vendors agreed to the new PAPCAPS contingent on continued mandatory use. If the government should decide to eliminate the requirement that federal agencies use FTS 2000, the old PAPCAPS could come back into effect. In recognition of this possibility, GSA is continuing to negotiate with US Sprint to complete its old PAPCAPS by adding agreements for switched data and compressed video transmission services.

GSA's Decision Not to Allocate All Traffic to One Vendor Was Reasonable

According to the contracts, GSA may at any time award 100 percent of the FTS 2000 business to one vendor. Separate from and following completion of the PR/SR process, GSA determined that making such a reallocation of traffic was not advantageous for the government at that time. In order to make this determination, GSA compared the costs of allocating 100 percent of the traffic to either vendor with the total cost of the scenario selected in the PR/SR. GSA also considered the estimated effect of losing competition between the two vendors and the estimated impact on agencies and the public of moving traffic from one vendor to the other. We reviewed GSA's process for making this determination and found the process and determination to be reasonable.

Conclusions

We do not know if the current FTS 2000 prices represent the absolute best prices available. However, within the context of the existing contracts, we believe GSA did a good job of conducting the price redetermination. The agency achieved prices below known commercial rates and negotiated mechanisms that should ensure that prices remain competitive.

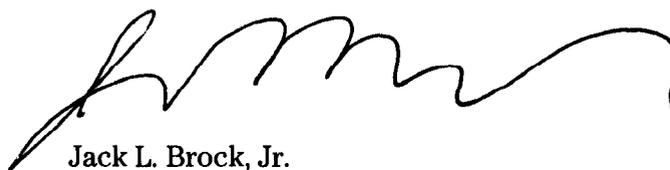
To examine broader issues of how the government should best obtain telecommunications services after the current contract expires, we are

examining—for your Committee—various alternatives in terms of their capabilities to provide state-of-the-art, cost-effective, and high-quality telecommunications services to the government.

We conducted our review from October 1992 to February 1993, in accordance with generally accepted government auditing standards. We provided a draft of this report to GSA officials, who generally agreed with the facts as presented. Their views have been incorporated as appropriate. As agreed with your office, unless you publicly announce the contents of this report earlier, we plan no further distribution of it until 30 days from the date of this letter. We will then send copies to the Administrator of General Services, the Chairman and Ranking Minority Member of the House Committee on Government Operations, and other interested parties. Copies will also be made available to others upon request.

If you have any questions about this report, please contact me at (202) 512-6406 or Linda Koontz, Assistant Director, at (202) 512-6209. Other major contributors are listed in the appendix.

Sincerely yours,



Jack L. Brock, Jr.
Director, Government Information
and Financial Management

Major Contributors to This Report

Information
Management and
Technology Division,
Washington, D.C.

Paul J. Bollea, Evaluator-in-Charge
Richard L. Sumner, Senior Evaluator
Randall C. Stoner, Staff Evaluator

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