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FTS 2000
RECOMPETITION

Opportunity Exists For
Better Prices

Statement of
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Mr. Chairman and Members of the Committee:

I am pleased to participate in the Committee's hearings on the governmentwide FTS 2000 telecommunications program. My testimony today will largely draw from our recent report, prepared at the request of this Committee.¹ That report stated that the government is paying more than available commercial prices for FTS 2000 telephone service.² We also recognized that FTS 2000 contracts require the vendors to provide additional services not required for commercial customers. GSA, at the time of our report, had not determined the value of these additional services; we questioned whether they were worth the additional cost.

Since the publication of our report, GSA has released its draft Price Redetermination and Service Reallocation Document, which sets forth the general conditions that the FTS 2000 vendors must meet in the recompetition process. Our review of that document and further discussions with GSA convince us that GSA has a good strategy for obtaining prices below available commercial rates.

BACKGROUND

GSA awarded the FTS 2000 contracts to American Telephone and Telegraph (AT&T) Company and US Sprint Communications Company in December 1988, to replace the government's outdated FTS system with advanced telecommunications services. A major objective of FTS 2000 is to provide telecommunications services at a cost comparable to or below commercial levels.

FTS 2000 is a 10-year, multibillion-dollar program that is providing state-of-the-art voice, data, and video services to the federal government. Much has been accomplished since the contracts were awarded to AT&T and Sprint in December 1988. Transition from the old and expensive FTS network was completed in June 1990, 18 months ahead of schedule, and FTS 2000 now has over 1.3 million users for its switched-voice service. In fiscal year 1992, FTS 2000 is projected to handle nearly 3 billion minutes of switched-voice traffic.

When the contracts were awarded in December 1988, both vendors' average switched-voice prices were within range of the average commercial rate. However, in mid-1989, even before any agencies had moved their traffic onto FTS 2000, the average commercial rate for switched-voice service fell

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

² The commercial price we used was developed by the MITRE Corporation. It is comprised of a weighted average of AT&T's Software Defined Network tariffs over time.

precipitously. As a result, when transition to the network began in October 1989, FTS 2000 switched-voice prices were significantly higher than average commercial rates.

FTS 2000 PRICES WELL
ABOVE COMMERCIAL RATES

I would like now to review our recent report on FTS 2000 prices.

As reported, GSA has succeeded in getting FTS 2000 switched-voice prices reduced over the past 2 years. In October 1990 Sprint agreed to provide a volume discount worth about \$43 million over 2 years. Later, in August 1991, GSA obtained an agreement from Sprint to reduce its prices for fiscal year 1992, worth nearly \$37 million in additional savings to the government.

However, despite these positive steps, the government--nearly 3 years into the contracts--continues to pay considerably above commercial rates for FTS 2000 services. In total, we estimate that under FTS 2000 the federal government will pay \$148 million above commercial rates for switched-voice service for fiscal years 1991 and 1992.

We also reported that prices for data services are significantly higher than commercially available prices. In some cases, according to a May 1991 MITRE analysis, the government has been paying 60 percent more for certain data transmission services than it would on the commercial market. We recognized that, in recent months, both vendors have either offered or agreed to provide discounts on certain data transmission services.

Our comparison of FTS 2000 prices and the commercial sector contains an important caveat: FTS 2000 requires the vendors to provide a number of services not required for commercial customers; these additional services must be taken into account when comparing prices. At the time of our review, GSA could not quantify the incremental effect of these additional services on FTS 2000 prices. We continue to question whether these additional services are worth the millions of dollars we estimate the government will pay above commercial rates over 2 years. With its huge traffic volumes, coupled with mandatory use, FTS 2000 should have the best prices available in the industry.

In response to our report, GSA has agreed to develop a measure of comparable commercial rates that takes into account the value of any services provided under the FTS 2000 contracts that are not typically provided under commercial

contracts. GSA will use this measure during price redetermination to evaluate the vendors' bids.

AT&T's TARIFF 12 CUSTOMERS'
PRICES COMPARED WITH FTS 2000

Mr. Chairman, since our report was released, we have continued our research into commercial-sector pricing for long distance services, and have found further evidence that FTS 2000 prices are higher than available commercial rates. We reviewed a study of AT&T's Tariff 12 customers, developed by MBG Associates, Ltd., a telecommunications consulting firm in New York City. Tariff 12 is the vehicle through which AT&T offers integrated network communications services designed to meet the needs of large, sophisticated users. A number of large corporations have negotiated individualized arrangements under Tariff 12, often obtaining reduced pricing by combining a number of services in a package deal.³

Tariff 12 customers are high-volume users of telecommunications services; according to MBG's study, their voice traffic ranges from approximately 300,000 minutes to about 79 million minutes a month. However, FTS 2000--with total voice traffic of nearly 250 million minutes a month--is more than three times larger than even the biggest Tariff 12 customer.

Seven companies (including one group of companies), with over 20 million minutes of voice traffic each per month, have negotiated individual Tariff 12 options with AT&T. Of these seven, five are paying average prices for switched-voice service that are anywhere from 3 to 18 percent below FTS 2000 prices. The remaining two companies are paying average rates 9 and 30 percent higher, respectively, than FTS 2000.

Mr. Chairman, the various arrangements negotiated under Tariff 12 demonstrate the potential that exists for government negotiators during price redetermination. Given the continued effects that competition is having on the telecommunications industry, and the unprecedented traffic volume under FTS 2000, the government has an excellent opportunity to obtain highly favorable prices for its telecommunications services.

³ The July 1991 edition of MBG's study contains assessments of 89 different Tariff 12 options.

GSA'S PRICE REDETERMINATION
STRATEGY IS REASONABLE

I will now turn my attention to GSA's proposed strategy for conducting price redetermination during the fourth year of the contracts. As I mentioned earlier, GSA released a draft Price Redetermination and Service Reallocation Document to the public late last month.

We believe GSA's approach to conducting price redetermination is both appropriate and reasonable. A key objective of price redetermination is to obtain prices that are below those in the commercial sector. Toward that end, GSA has stated that its intention is to obtain prices, inclusive of any value-added services, below the lowest possible commercial prices. GSA is currently developing a methodology for evaluating vendors' prices, and will make this a part of its source-selection evaluation plan.

Price redetermination is intended to reduce prices by competing a target of each vendor's projected revenues. During this process, each vendor will be required to submit a single set of price tables for all contract services, features, and traffic volumes. GSA will then analyze each vendor's proposed price tables against three different scenarios, as follows:

- (1) Under Scenario 1, an estimated target of 40 percent of Sprint's forecast revenue is reallocated to AT&T.
- (2) Under Scenario 2, an estimated target of 40 percent of AT&T's forecast revenue is reallocated to Sprint.
- (3) Under Scenario 3, the estimated 60/40 percent revenue split between AT&T and Sprint, respectively, is maintained.

GSA will evaluate vendors' price and technical proposals and, on the basis of an equal evaluation of cost and quality, will select the scenario that represents the best overall cost to the government. According to the associate administrator responsible for the FTS 2000 program, GSA expects prices submitted by the vendors during price redetermination to be lower than available commercial rates. GSA believes the vendors have already recovered the up-front costs associated with additional contract requirements and thus can offer services below commercial rates.

FTS 2000: A CRITICAL JUNCTURE

In conclusion, GSA and FTS 2000 are now at a critical juncture. GSA's ability to effectively implement its price

redetermination strategy will have a profound impact on the future of FTS 2000. If GSA is successful in developing a process to obtain and maintain competitive prices for the government, FTS 2000's future success for the remaining 6 years will likely be assured. However, should GSA's strategy fail to produce acceptable prices from both vendors, GSA must consider other alternatives, including reallocating all FTS 2000 traffic to one vendor or abandoning FTS 2000 in favor of a new, full and open competition.

This concludes my remarks, Mr. Chairman. I would be happy to answer any questions you or other members of the Committee may have at this time.

