UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

INFORMATION MANAGEMENT
& TECHNOLOGY DIVISION

B-215077

JUNE 11, 1984

The Honorable Ray Kline
Acting Administrator of General Services

Dear Mr. Kline:

Subject: GSA's Telecommunications Procurement Program Requires Comprehensive Planning and Management (IMTEC-84-10)

For the past several months, we have followed the events associated with the divestiture of the American Telephone and Telegraph Company (AT&T) (United States v. American Telephone and Telegraph Co., 552 F. Supp. 131 (D.D.C. 1982)) and the Federal Communications Commission's (FCC's) Second Computer Inquiry [77 FCC 2d 384 (1980)]--known as the Computer II decision. These decisions helped create a competitive environment for both telephone services and equipment, which increases the alternatives available to the government. In addition, the decisions require the government to take a more active role in managing and procuring telecommunications if it is to prevent service interruptions and avoid cost increases.

This report addresses how the General Services Administration (GSA) manages and procures telecommunications equipment and services. In performing this review, we wanted to see how GSA, which traditionally has ordered telephone services and equipment from AT&T, has adapted its telecommunications procurements to the more competitive environment. We found that GSA has taken several actions to adjust to new market conditions. However, these actions have been characterized by a lack of sufficient planning to meet both long-term needs and the requirements of federal procurement regulations. GSA needs to take timely corrective actions to keep pace in this rapidly developing area.

OBJECTIVE, SCOPE, AND METHODOLOGY

Our objective was to examine GSA's recent actions and middle range planning efforts and evaluate their appropriateness in the more competitive telecommunications environment.

We conducted our work from September to December 1983 at GSA headquarters in Washington, D.C., and at GSA offices in Regions II, VIII, and IX (New York, Denver, and San Francisco). We discussed with GSA officials their past and present actions and future telecommunications plans. We reviewed GSA directives and analyzed current Requests for Proposals (RFPs) and previous GSA procurements. In addition, we attended inter-agency briefings and reviewed

minutes of the Inter-agency Telecommunications Committee, which provides a forum for federal agencies to discuss telecommunications issues.

We spoke with attorneys in GSA's Office of Information Resources Procurement and Office of the Inspector General and to attorneys in AT&T's Office of General Counsel. We read appropriate court decisions regarding recent actions and made independent determinations on two recent GSA telecommunications procurements.

We also spoke with telecommunications officials in other departments and agencies to learn about their experiences in procuring equipment and services to meet telecommunications needs. Departments and agencies contacted include the Defense Communications Agency, Federal Aviation Administration, National Telecommunications and Information Agency, Office of Management and Budget, Social Security Administration, and the Departments of Agriculture, Energy, Justice, State, and Transportation. Finally, we spoke with officials from AT&T, AT&T Information Systems (AT&TIS), Bell Atlantic, Rolm Corporation, and General Telephone and Electric Sprint to get their perspective on the new telecommunications environment.

We performed our review in accordance with generally accepted government auditing standards.

CHANGING PROCUREMENT ENVIRONMENT PRESENTS NEW CHALLENGES FOR GSA

Two legal decisions have made the telecommunications market more competitive. The first decision--Computer II--deregulated, effective January 1, 1983, all new Customer Premise Equipment (CPE), such as handsets and terminal equipment. A related FCC decision (FCC 83-551), released December 15, 1983, prescribed a graduated, albeit rapid, total deregulation of AT&T's embedded (that is, already installed) CPE beginning January 1, 1984.

In terms of GSA's procurement activities, Computer II has had considerable immediate impact. Deregulation removed the tariff from CPE.[1] Without the tariff, GSA managers have to solicit competitive offers or use GSA rate schedules (catalogs of equipment and prices offered to the government by approved vendors) for most procurements formerly obtained on a sole-source basis. In

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[1]The tariff, which is a schedule approved by the FCC and/or state public utility commissions, governs any applicable charge, regulation, or practice associated with a regulated telecommunications service. Previously, prices for telecommunications equipment were subject to a tariff, which often enabled GSA and other government agencies to sole-source (that is, buy equipment and/or services from one supplier rather than solicit competitive bids from several suppliers). The tariff was justified as a fair, reasonable, and practicable charge because it had been set by public commission.

addition, GSA, which relied on tariff rates for meeting most service requirements, must develop operating and contracting strategies to permit ordering, installation, and maintenance of the deregulated CPE.

The second legal decision affecting GSA's telecommunications activities is the breakup of AT&T. One result of the government's anti-trust settlement with AT&T was that AT&T would divest itself of its 22 Bell operating companies (BOCs). Although both local and long distance services remain under tariff, GSA, which used to procure end-to-end services from a single company, AT&T, must now procure local and long distance services from different companies.

Another result of the AT&T divestiture is that many changes have been proposed in tariffs and access arrangements. Over $4 billion in telephone rate increase requests are pending with state public utility commissions. FCC recently ruled that, beginning in June 1984, a $2.00-per-line fee each month for access to the long-haul switched telephone network would be applied to Centrex customers, a central office-based system widely used by the federal government. As a consequence of these new and pending increases, GSA must be able to react quickly to a changing cost environment.

The restructuring of the telecommunications industry has presented many challenges for GSA. In the short run, GSA was faced with maintaining basic services beginning January 1, 1984, when its embedded CPE became deregulated. For the longer term, GSA is faced with estimating telecommunications needs, designing RFPs, and competitively procuring large amounts of telecommunications equipment (such as switches, modules, handsets, etc.) in a cost effective manner.

GSA'S PROCUREMENT PROGRAM NEEDS MANAGEMENT ATTENTION

In managing government telecommunications procurements, GSA has not yet adjusted to the new telecommunications environment. Decisions have resulted in actions that lack sound legal basis and that do not consider future requirements. Moreover, GSA is continuing to act without sufficient management attention by implementing a multifaceted program before developing a comprehensive plan to coordinate its actions. As a result, the first of many large procurements is late.

Improper planning resulted in a procurement action that was legally questionable and of uncertain benefit

The Computer II decision to deregulate new CPE in 1983 was made in 1980. At that time, the FCC said that, after further consideration, it might deregulate embedded CPE. Computer II was, in fact, the culmination of a process begun in 1968 when the FCC ruled that CPE other than AT&T equipment could be attached to AT&T telephone lines.

Although GSA knew in 1980 that deregulation would change the way terminal equipment was managed and maintained, it did not perform cost analyses of lease versus purchase or consider future service options. It also did not purchase CPE or arrange for continued maintenance of leased CPE during the years before deregulation actually took place. Instead, GSA took two controversial actions immediately before divestiture that it says were advantageous in maintaining basic service for the period immediately after divestiture on January 1, 1984. First, GSA issued an RFP on November 1, 1983, to purchase CPE, such as telephone instruments and associated key equipment. Second, it novated (that is, recognized a successor in interest to an existing contract) federal government telecommunications agreements involving CPE it could not purchase.

In issuing the RFP, GSA planned to (1) buy CPE currently leased by GSA and other government agencies from the BOCs or (2) obtain equivalent equipment and follow-on services. GSA sought to generate competition between the BOCs and AT&TIS (a new subsidiary of AT&T, established to market deregulated services and equipment) because the BOCs owned the embedded CPE until January 1. After that date, title would pass to AT&TIS. GSA said that if it did not attempt to buy CPE before divestiture, neither the BOCs nor outside companies would be able to compete with AT&TIS on the sale of CPE and thus establish a reasonable price.

The closing date for submission of initial proposals was November 28, 1983, and 11 BOCs submitted timely proposals to sell the embedded CPE. However, no operating company competed against any other operating company for the same equipment. GSA actively encouraged AT&T to submit an offer (contingent on title to the embedded CPE passing to AT&TIS after divestiture). However, AT&T decided that it did not have enough time to submit a timely offer. AT&T's primary reason: the FCC did not deregulate embedded CPE and thereby did not establish price predictability until November 23, 1983--5 days before the due date for submission of initial proposals.

GSA subsequently awarded a contract for approximately $23 million to Bell Atlantic and was negotiating with Southern Bell until Southern Bell withdrew its offer. AT&T then moved for an order in the United States District Court to require Bell Atlantic to cease and desist from performance of its contract with GSA.

The United States District Court Judge assigned the contract from Bell Atlantic to AT&TIS on December 28, 1983. In ruling that Bell Atlantic lacked authority to sell the embedded CPE without AT&T's approval, the judge stated:

"Prior to divestiture, [the operating companies] have no independent discretion vis-a-vis AT&T; to the contrary,

> they are subject to AT&T's ultimate control just as they have been for a hundred years."

Further, in referring to GSA's attempted purchase from Bell Atlantic, the judge said:

> "It is difficult to believe that anyone could have seriously thought that [Bell Atlantic] had the right, consistent with the scheme of the decree, to sell the embedded CPE just a few days before it was required to surrender it to AT&T and by this means to pyramid its position into long-term CPE marketing advantages."

We believe that the circumstances of the RFP limited the potential offerors to at most one, AT&TIS, and that the RFP was thus essentially a sole-source rather than a competitive procurement.

Concerning offers from the BOCs, it was clear at all times to GSA, the BOCs, and AT&T that AT&T and the BOCs were one and the same entity prior to divestiture. Accordingly, GSA had no reasonable basis to expect that the BOCs could legally compete on this procurement without AT&T's approval. In fact, although several BOCs attempted to sell CPE to GSA, AT&T did not approve the offers as the parent corporation and was successful in having the contract with Bell Atlantic voided.

Further, GSA did not claim that it expected offers from outside companies on the sale of CPE. Since there were only 5 weeks between the closing date for submission of initial proposals and the date when the CPE was required to be in place and that much CPE was needed in each region, it was impractical, in our opinion, for outside companies to submit offers.

GSA's judgment that AT&T would submit an offer was also questionable since the FCC had not ruled on deregulation as of the date the RFP was issued. In fact, AT&T refused to consider submitting an offer until the FCC made its ruling on deregulation.

We question GSA's assumption that AT&TIS would have an effective monopoly over CPE after divestiture. It is not at all clear that the BOCs or outside companies would not be able to market their own new CPE after divestiture and, thus, be in a position to compete at a future date. For example, telecommunications technology is rapidly advancing, and numerous companies are even now marketing telecommunications equipment.

In sum, GSA's position that the opportunity buy would promote competition between AT&T and the BOCs which might otherwise be unobtainable after divestiture appeared unreasonable. AT&T and the BOCs were the same entity before divestiture; the short timeframe of the procurement made offers by outside companies on the sale of CPE impractical; the FCC had not yet ruled on deregulation and, thus, had not established price predictability on which AT&T could

base its offer; and the BOCs and other companies may well be able to provide competition after divestiture, in view of technological advances and a growing market in telecommunications equipment.

We also found that the cost analysis GSA used to justify its CPE purchase was incomplete; therefore, claimed benefits were uncertain. GSA based its analysis on the cost to purchase $23 million of equipment from Bell Atlantic and $2 million of equipment from Southern Bell (which subsequently withdrew its offer). GSA concluded that the $25 million purchase of over 187,000 single and multiline phones was cost effective. GSA based its analysis on comparisons of that sum with (1) replacement through GSA schedules, (2) offers by AT&TIS after January 1, 1984, and (3) continued leasing until replacement through competitive procurement.

We consider this cost analysis incomplete because of the following:

--GSA, which eventually purchased equipment already in place, received no competitive offers to help establish the reasonableness of prices. Consequently, GSA did not compare the cost benefits of its purchase to that of purchasing all new equipment.

--The comparison with an AT&TIS offer is not based on an actual offer, but on an FCC decision (FCC 83-551) which, in effect, sets a ceiling on the sale prices that AT&TIS can charge. An FCC attorney said that there was no information in the order that could be used to establish firm sale prices.

To maintain services, GSA also novated lease agreements involving embedded CPE it did not purchase. Novations are normally routine, involving changing names on a contract, as when companies merge or are bought. However, the novated agreements in this case also included a "Supplemental Agreement" to replace the terms and conditions of the tariff, which was eliminated when the FCC deregulated embedded CPE on November 23, 1983. The Supplemental Agreement mirrors the terms and conditions of the previous lease agreements, except that (1) prices for continued use of the embedded CPE are being negotiated and (2) the exact terms of the tariff were not transferred, largely because the regulatory bodies, which were an integral part of the tariff scheme, no longer exercise authority. The novation agreements expire on January 1, 1986.

On July 25, 1983, GSA's Counsel to the Inspector General sent a memorandum to GSA's General Counsel contending that the novation agreements were, in fact, proposed sole-source procurement contracts in contrast to valid novations under Federal Procurement Regulations (FPR) §1-26.4 (amend. 121, November 1973), since the agreements involved not only recognition of new successors in interest, but also negotiation of new terms. The Counsel to the Inspector General concluded that since the proposed novations appeared to constitute new contracts, and not continuations of

existing contracts, it was arguable that the proposed novations circumvented the requirement in the FPR to compete or otherwise justify sole-source procurements with determinations and findings.

GSA's General Counsel responded that the need to negotiate new terms and conditions arose because of the FCC's decision to deregulate embedded CPE. Thus, by operation of law, the novation agreements were proper.

We believe that, since the need to negotiate new terms and conditions arose by operation of law, GSA's decision to novate the existing lease agreements was reasonable under the circumstances.

The CPE purchase and the novations were done to ensure service continuity and to fix costs during the divestiture process when CPE would pass from the BOCs to AT&TIS. A transition period will also occur in December 1986, when the 3-year novations just negotiated by GSA expire. GSA could not furnish us with competitive procurement schedules for the CPE covered by the novations. Because procurements have usually taken from 18 months to more than 3 years to complete, it is important that GSA's plans ensure that the agency will not again turn to controversial last-minute methods to fill the government's telecommunications requirements.

GSA needs to adequately plan for its proposed procurements

GSA is continuing to procure telecommunications equipment and services without adequate planning. The agency is embarking on a $500-million program to upgrade local and regional services and save telecommunications costs before adequately defining its telecommunications goals and developing alternative operating and contracting strategies for achieving them. GSA's procurements are behind schedule because of inadequate planning for the first of at least 10 large procurements.

In 1974, the Comptroller General required that GSA procure telecommunications competitively (RCA Alaska Communications, Inc., B-178442, June 20, 1974). Although GSA has done some competitive procurements since then, it is only now beginning to develop comprehensive schedules for replacing entire networks of telecommunications equipment. GSA will procure equipment and services for several states in the same RFP, in what is called Aggregated Switch Procurements (ASPs).

GSA's Deputy Assistant Administrator for Central Information Services told us that the agency will soon award a technical services contract that will include developing a 5-year procurement plan to tie together the planned ASP procurements, FTS long distance switch procurements, and another $500-million procurement for the National Capital Region. The plan should be ready by summer 1984. GSA also intends to issue an RFP for a 4-year technical services contract, which will help the agency develop requirements, as

well as conduct requirements analyses and specifications for the ASPs.

Although coordination of procurements and definitions of requirements and specifications for the ASPs is not complete, GSA has already issued the RFP for the first ASP, which covers the New England area. GSA has also planned the schedule for award and cutover of the remainder of the ASP program (at least nine more ASPs).

The first ASP calls for replacing equipment in at least 15 current switch locations serving more than 100 agency locations in 6 states. Maintenance for terminal equipment, rewiring to accommodate equipment moves, user training, and day-to-day network service management are included. The contract will run for 10 years. Each additional ASP will have comparable scope.

Such large procurements require considerable efforts to define needs, analyze the economics of telecommunications technologies, specify selection criteria, and coordinate staffing and management. If these variables are not developed before actual procurements begin, problems may occur that delay RFPs, or they may show up after contract awards are made.

The first ASP has already demonstrated the effects of inadequate planning. GSA had to suspend the RFP for the New England area twice since its issuance; once because of vendor confusion about certain clauses and a second time because GSA decided to amend the RFP to include the FTS switches. In April 1984, the FTS switches were deleted because vendors claimed they could not meet the desired delivery date. Because of these problems, the procurement of the first ASP has been delayed almost three quarters of a year.

No contract award has yet been made for any ASPs. However, the following example shows how problems can occur after contract award because of defects in the RFP. In a recent $20-million telecommunications procurement for a single location, GSA had substantial problems in completing site arrangements to install telephone-switching equipment. Neither the RFP issued by GSA nor the final contract specified the switch installation site, and it took the agency several months after the contract award to designate the site to house the new switch. Moreover, the local telephone company had not been consulted and disagreed with the site designated. After more than a year of extensive negotiations and legal actions, the telephone company agreed to connect the new GSA switch to its existing equipment at the site designation.

GSA estimates the cost of the ASP procurements to be more than $500 million. GSA intends to issue RFPs to competitively replace all of its telecommunications systems nationwide by 1987 and to complete service cutover to the successful contractors by 1989. We believe that GSA should reconsider this schedule because the

first ASP is already late and planning for ASP requirements is still underway.

CONCLUSIONS

We have noted managerial weaknesses in GSA's actions in dealing with the effects of Computer II and AT&T divestiture on procurement of government telecommunications. Rather than formulating comprehensive plans that enable it to procure flexible, cost-effective systems within reasonable time frames, GSA has, in the short run, taken actions that have circumvented federal procurement requirements. For the next 5 years, GSA is embarking on an ambitious procurement program without adequately defining the requirements for such a program. The changing telecommunications environment demands careful planning by GSA to take advantage of the opportunities brought about by more competition.

RECOMMENDATIONS TO THE ADMINISTRATOR OF GENERAL SERVICES

We recommend that you take prompt action to

--issue an RFP to competitively procure the equipment that is currently leased under novation agreements with AT&TIS,

--identify and define basic requirements to be met in both developing RFPs and in awarding contracts for future ASP procurements, and

--delay the issuance of additional RFPs for ASPs until the requirements for them are developed.

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We have not included an evaluation of GSA's comments on our draft report because we did not receive them within 30 days, as required by 31 U.S.C. 718(b). To include comments would have delayed issuance of the report. We did, however, perform a preliminary analysis of GSA's comments and have incorporated the results of this analysis, as appropriate.

As you know, 31 U.S.C. 720 requires the head of a Federal agency to submit a written statement on actions taken on our recommendations. This written statement must be submitted to the House Committee on Government Operations and the Senate Committee on Governmental Affairs not later than 60 days after the date of the report. A written statement must also be submitted to the House and Senate Committees on Appropriations with an agency's

first request for appropriations made more than 60 days after the date of the report.

Sincerely yours,

Warren G. Reed
Director