

BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

IN THE MATTER OF)	
)	Docket No. UT-003013
)	PART A
THE CONTINUED COSTING AND PRICING)	
OF UNBUNDLED NETWORK ELEMENTS)	OPENING BRIEF OF TRACER
AND TRANSPORT AND TERMINATION)	
_____)	

I. INTRODUCTION

1. Section 706 of the Telecommunications Act of 1996 states Congress' intent "to encourage the deployment on a reasonable and timely basis of advanced telecommunications capability to all Americans... ." Of all of the emerging communications technologies, DSL holds the most promise for meeting the need for these advanced services. And if this promise is to be kept, new entrants to the telecommunications market must be allowed access to DSL customers on terms and conditions that place them on an even competitive footing with the incumbent carriers. Most importantly, new entrants must be allowed access to the high-frequency portion of the loop ("HUNE") on a nondiscriminatory basis.

2. It is undisputed that the incumbent local exchange carriers ("ILECs" or "incumbents") incur no additional costs for the loop in

providing their own DSL services. Nor do the incumbents allocate any cost to the loop in the cost studies they have filed in support of their DSL services. Similarly, they do not incur any additional loop costs in making the high-frequency portion of the loop available to the competitive local exchange carriers (“CLECs”) for use in providing competitive DSL services. Despite these facts, Qwest is proposing to charge the CLECs half of the total cost of the loop — \$9.08 — for the use of the HUNE. This proposal, if accepted, will unfairly discriminate against the CLECs by imposing costs upon them that the ILECs do not face; it will artificially raise the cost of DSL services to consumers; and it will thereby severely hamper competition and impede the delivery of DSL services to the citizens of Washington. TRACER, therefore, urges this Commission to reject Qwest’s discriminatory and anticompetitive proposal, and instead set a zero price for the HUNE.

II. DISCUSSION

A. The FCC’s Requirements for Pricing the HUNE.

3. In its *Line Sharing Order*, released late last year,¹ the Federal Communications Commission (“FCC”) ordered the ILECs to make the high frequency portion of the loop available to CLECs as an unbundled network element (“UNE”) when the loop is already used by the ILEC to deliver voice grade service. The FCC based its order on its finding that a lack of access to the HUNE would materially raise the CLECs’ costs of providing DSL services, and would delay and limit the scope of advanced services to residential and small business users.²

4. In ordering the ILECs to provide line sharing, the FCC specifically addressed the appropriate methodology for pricing the HUNE. Noting that virtually all states had already adopted and implemented a TELRIC methodology,³ the FCC directed that the price of line sharing UNEs “should be set by states in the same manner as they set the price for other unbundled network elements.”⁴

¹*In the matter of Deployment of Wireless Services Offering Advanced Telecommunications Capability and Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, Third Report and Order in CC Docket No. 98-147, Fourth Report and Order in Docket No. 96-98 (Rel. Dec. 9, 1999) (“*FCC Line Sharing Order*”).

²*FCC Line Sharing Order* ¶ 13.

³*FCC Line Order* ¶ 132

⁴*FCC Line Sharing Order* ¶ 135.

Specifically with regard to the establishment of the price for the HUNE, the FCC required that TELRIC principles be used to adopt a reasonable method for determining the shared loop cost. In extending the TELRIC methodology to the HUNE, the FCC concluded:

*In arbitrations and in setting interim prices, states may require that incumbent LECs charge no more to competitive LECs for access to shared local loops than the amount of loop costs the incumbent LEC allocated to ADSL services when it established its interstate retail rates for those services. This is a straightforward and practical approach for establishing rates consistent with the general pro-competitive purpose underlying the TELRIC principles. We find that establishing the TELRIC of the shared line in this manner does not violate the prohibition in section 51.505(d)(1) of our rules against considering embedded cost in the calculation of the forward looking economic cost of an unbundled network element.*⁵

5. The FCC went on to explain that:

We find it reasonable to presume that the costs attributed by LECs in the interstate tariff filings to the high-frequency portion of the loop cover the incremental costs of providing xDSL on a loop already in use for voice services. Under price cap rules for new access services, the recurring charges for such services may not be set below the direct costs of providing the service, which are comparable to incremental costs. The rates the incumbent LECs set for their special access xDSL services should cover those costs. The incumbent LECs filed their cost support for their own special access DSL services before we issued the notice giving rise to this Order compelling line sharing, and they have defended their cost support when challenged in petitions to reject or suspend their tariff filings. *Since the incremental loop cost of the high-frequency portion of the loop should be similar to the*

⁵FCC Line Sharing Order ¶ 139 (emphasis added).

*incremental loop cost of the incumbent LEC's xDSL special access service, this approach should result in the recovery of the incremental loop cost of the high-frequency portion of the loop.*⁶

6. The FCC emphasized its intentions on this point in a later

Order in which it stated:

The Line Sharing Order concluded that states should not permit incumbent LECs to charge more to competitive LECs for access to shared local loops than the amount of loop costs the incumbent LEC allocated to ADSL services when it established its interstate retail rates for those services.⁷

7. Also of significance in the pricing of the HUNE is the FCC's directive for the application of TELRIC principles contained in its *Local Competition Order*⁸:

Only those costs that are incurred in the provision of the network element in the long run shall be directly attributable to those elements. Costs must be attributed on a cost-causative basis. Costs are causally-related to the network element being provided if the costs are incurred as a direct result of providing the network elements, or can be avoided, in the long run, when the company ceases to provide them.⁹

⁶*FCC Line Sharing Order* ¶ 140 (emphasis added).

⁷FCC 00-193, Sixth Report and Order in CC Docket Nos. 96-262 and 94-1, Report and Order in CC Docket No. 99-249, Eleventh Report and Order in CC Docket No. 96-45 (rel. May 31, 2000), at ¶ 98.

⁸*Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, CC Docket No. 96-98, First Report and Order, 11 FCC RCD. 15,499 ¶1, (1996) (“*Local Competition Order*”).

⁹*Local Competition Order* ¶ 691.

8. As will be shown below, application of the FCC's principles and policies for the pricing of the HUNE mandates that this Commission set a zero price for the HUNE.

B. The ILECs Incur No Incremental Loop Cost Associated with the Provision of the HUNE.

9. It is undisputed that there is no incremental cost to Qwest when a CLEC (or Qwest) uses the HUNE to provide DSL service. As explained above, a CLEC is allowed to order a HUNE from the ILEC only where the ILEC already provides the customer with voice service on the lower frequency portion of the loop. Once a loop is connected to an end-user, no changes to the physical loop are required to create a HUNE. Thus, when the ILEC does provide a HUNE to a CLEC, it will incur no additional costs associated with that loop. This fact was readily agreed to by Qwest witness Fitzsimmons at the time of the hearing:

Q: Now, focusing again on what we have described as the loop, the piece of copper between the network interface device and the central office, isn't it correct that there are no additional costs to the loop itself when a CLEC provides DSL services using the HUNE?

A: That's correct. When you provide a shared line, all of the direct costs become common costs but there are not any additional costs.¹⁰

10. Moreover Qwest's proposal to allocate half of the cost of the loop to the HUNE as a "common cost" is inconsistent with its current practice wherein Qwest allocates 100 percent of the loop costs to its basic service, thus recovering 100 percent of its loop costs through its rates. As explained by Qwest in response to a data request:

In the retail service environment for MegaBit service, the cost of the loop is attributed to the basic service, and therefore there is no incremental cost of the loop attributed to MegaBit.¹¹

11. Consistent with its allocation of 100 percent of loop costs to its voice services, Qwest does not allocate any amount for the cost of the loop to its xDSL products in its MegaBit tariff.¹² Indeed, Dr. Fitzsimmons admitted at hearing that application of the FCC rule regarding cost allocation would result in a zero dollar price for the loop.¹³

¹⁰Transcript of Hearing (Fitzsimmons) 181:3-11.

¹¹Qwest Response to COVAD Data Request 01-201.

¹²Exhibit 41.

¹³Hearing Transcript (Fitzsimmons), 186:13-21.

12. Despite these facts, Qwest maintains that it should be allowed to charge the CLECs half the costs associated with the loop when they request to use the HUNE. Qwest reasons that once the HUNE has been ordered, all of the direct costs associated with the loop become “joint and common costs of the loop.” Relying on the FCC’s statement that UNE prices include a “reasonable share of joint and common costs”,¹⁴ Qwest recommends that the Commission set a price for the HUNE equal to one-half of the Commission-approved unbundled loop rate. This recommendation has no basis in law or policy and should be rejected.

13. A careful analysis of the characteristics of the HUNE, as unbundled by the FCC, shows that the ILECs’ costs associated with the loop are *not* joint and common to it. As explained by Dr. Cabe:

The FCC’s determination that a line sharing arrangement is only available as an adjunct to a loop that is also in use for the provision of analog service implies that one cannot cause an ILEC to incur loop costs by requesting line sharing, nor can loop costs be avoided in the long run by discontinuing a line sharing arrangement. Therefore, the two portions of the loop are not joint products in the traditional sense. Instead, unlike the case of traditional joint products, the cost of the loop can only be caused by the voice portion of the loop, and the cost of the loop is in no sense incremental to a line-sharing arrangement.¹⁵

¹⁴Direct Testimony of William L. Fitzsimmons, pp.7-10.

¹⁵Rebuttal Testimony of Richard Cabe, 6:5-12.

14. Moreover, even if the Commission were to find that the cost of the loop is joint and common to voice and DSL services, the evidence shows that Qwest's allocation of 50 percent of the cost of the loop to the HUNE is completely arbitrary and should be rejected. Dr. Fitzsimmons' testimony at the hearing suggests that Qwest's price proposal for the HUNE represents nothing more than a guess:

If we set a price for this UNE as the initial price at 50 percent of the loop cost that's going to be \$9.08, I believe. If it turns out that the market price, if we were to let this market roll forward, and I'm sure we're going to get into maybe what it means to let this market roll forward . . . and the market driven price would be \$10.00, we will never know that, because we put a ceiling on what the price is.¹⁶

15. Indeed, when pressed, Dr. Fitzsimmons had to agree that Qwest had presented no meaningful evidence whatsoever as to what the correct allocation of joint and common cost should be for the HUNE:

Q: . . . [Y]ou would agree with me, wouldn't you, that there is no meaningful evidence to show that one percent of the loop cost would not be a reasonable price for the HUNE?

A: Presented in this proceeding, there really hasn't been evidence on what the market would drive us to, which is actually what we would say is the reasonable cost.¹⁷

¹⁶Hearing Transcript (Fitzsimmons), 207:7-18.

¹⁷Transcript of Hearing (Fitzsimmons), 208:11-20.

16. Thus, absent any meaningful evidence to support Qwest's proposal — indeed, to support any positive price for the HUNE — the Commission should adhere to sound economic principles and public policy analysis and set the price for the HUNE at zero.

C. Economic Principles and Public Policy Concerns Require that this Commission Set a Zero Price for the HUNE.

1. Setting a Non-Zero Price for the HUNE Would Subject CLECs to a Price Squeeze.

17. The FCC's primary goal in ordering line sharing was to "to expedite the deployment of xDSL-based advanced services while simultaneously fostering meaningful competition in the provision of those services."¹⁸ Setting any price for the HUNE other than zero would be discriminatory and anti-competitive, thus frustrating the goals of the Telecommunications Act of 1996.

18. As discussed above, Qwest does not allocate any cost of the loop to its DSL products. Thus, any competitor who is required to pay a positive cost for the use of the HUNE would be subject to a price squeeze. The testimony of Qwest's own witness, Thompson, illustrates this point. On cross-examination, Thompson explains that Qwest's MegaBit product retails at \$29.95 and that the direct costs of providing MegaBit are \$17.32. That leaves Qwest with a margin of \$12.63 with which to cover common costs and earn a profit. Assuming that a competing CLEC prices its comparable DSL product at \$29.95, and further assuming that the CLEC incurs the same direct

¹⁸*Line Sharing Order* ¶ 133.

costs as Qwest, if that CLEC is required to pay an additional \$9.08 for the HUNE, it will be left with \$3.55 to cover common costs before profit.¹⁹ Even if the CLEC could remain in business at this level of margin, it would not be for long. Qwest's significantly greater margin would allow it to drop its price to a level which would force the CLEC out of the market.

2. Imposition of a Non-Zero Price for the HUNE Would Artificially Raise the Price of DSL Services.

19. Imposition of any non-zero charge for the HUNE would serve to establish an artificial floor on DSL prices in the state of Washington. This is true because any charge for the use of the HUNE will constitute a direct cost to the CLEC providers, and they will be forced to pass that cost on to their customers. Thus, the retail price of DSL-based services will increase. Similarly, assessing a non-zero price for the HUNE would allow Qwest to "double recover" the costs of the loop. As the testimony of Staff witness Thomas L. Spinks suggests, Qwest not only allocates, but also recovers 100 percent of the costs of the loop through its voice revenues. Indeed, it appears that Qwest's current earnings already exceed the

¹⁹Transcript of Hearing (Thompson), 417:21 - 419:14.

authorized rate of return.²⁰ Moreover, contrary to Qwest's suggestions, there is no indication that the advent of DSL technologies will cause Qwest's loop take level to decline. In fact, the rate of second-line take in the state of Washington is rising.²¹ Thus, assessing a positive charge for the HUNE would serve only to preserve a significant portion of the margin which Qwest would enjoy if it provided the DSL service to the end-user itself.²² As such, Qwest's proposal seeks to price the HUNE in order to recover its "opportunity costs" — a pricing method which was specifically rejected by the FCC in its Local Competition Order.²³

D. Qwest's Proposal to Impute the HUNE Price will not Serve to Protect Competitors or Consumers.

20. Qwest argues that it can prevent a price squeeze by agreeing to price its MegaBit services at some price higher than its direct costs plus the imputed price of the HUNE. Consumers as well as competitors would suffer under such a proposal.

²⁰Direct Testimony of Thomas A. Spinks, 10:7-18.

²¹Transcript of Hearing, 227:2 - 228:11.

²² Rebuttal Testimony of Richard Cabe, 3:9-16.

²³*First Report and Order In the Matter of Implementation of Local Competition Provisions in the Telecommunications Act of 1996*, CC Docket No. 96-98 (Rel. Aug. 8, 1996), ¶¶ 708-09.

21. As explained by Dr. Cabe in his Rebuttal Testimony, a price squeeze can occur wherever UNE prices are discriminatory. Moreover, this concern can never be addressed entirely by the imposition of an imputation test.²⁴ Witness Thompson's testimony on cross-examination illustrates the problem with Qwest's imputation "solution."²⁵ Dr. Thompson agrees that Qwest has agreed to impute to the cost of the loop whatever price it charges to its competitors for the HUNE. Again assuming \$17.32 in direct costs and a HUNE price of \$9.08, this would produce a price floor for Qwest's MegaBit service of \$26.40. Qwest could therefore price its MegaBit service at \$26.45 and still meet the imputation test. If the CLEC were to drop its prices to meet a \$26.45 price by Qwest, after accounting for \$26.40 in direct costs it would be left with \$.05 with which to cover its joint and common costs, and would thus be soon forced out of the market. Meanwhile, Qwest has been allowed to pocket \$9.08 for every HUNE purchased by the CLECs — a service with no incremental cost to Qwest.

22. The price squeeze would prove significantly greater if a CLEC attempted to compete with Qwest's MegaBit Lite DSL product.

²⁴Rebuttal Testimony of Richard Cabe, 11:5-8.

²⁵Hearing Transcript (Thompson), 424:1 - 426:4.

Qwest markets MegaBit Lite for \$19.95, and represents the direct cost for this service as \$9.43. If Qwest imputes \$9.43 for the cost of the loop, it can still continue to charge the current price of \$19.95 and make \$10.52 on each sale. The CLEC's prospects are dismal by comparison. Again assume that the CLEC experiences similar costs for its comparable service in the amount of \$9.43, and purchases a loop from Qwest over which to provide the service at a price of \$9.08. A CLEC charging \$19.95 for its comparable service in order to compete with Qwest would end up with a margin of \$1.44 with which to cover its joint and common costs. If Qwest drops its price to the permissible floor, in this case \$19.43, and the CLEC is forced to follow, then the CLEC will be left with less than a dollar to cover its joint and common costs, and will eventually be forced out of the market.²⁶

23. Moreover, Qwest's offer to impute the CLECs' costs for the HUNE would do nothing to prevent the windfall profits Qwest will enjoy as it "double recovers" both for every loop on which it provides DSL services, and for every HUNE ordered by a competitor. Thus, unless Qwest adopts an offsetting decrease in the monthly recurring

²⁶Hearing Transcript (Thompson), 427:16 - 431:23.

charge for voice-grade services, any line-sharing charge that exceeds any incremental loop costs will provide windfall profits to the ILEC with no corresponding benefit to its voice-service customers. Ultimately, Qwest's proposal could increase the price that basic exchange service customers pay for any DSL-based service provided over the same line, whether they buy that service from the incumbent, its data affiliate or an unaffiliated competitor.²⁷ Such a result would directly contravene Congress' intent as expressed in § 706 of the Telecommunications Act to encourage the deployment of advanced services.

E. The Harm to Consumers Caused by a Non-Zero Price for the HUNE Cannot Easily be Addressed with an Offset.

24. If the Commission allows Qwest to charge a positive price for the HUNE, it must also order Qwest to offset that price against basic local services. To do otherwise would result in a windfall to Qwest. However, calculating and applying an appropriate offset would be highly problematic for two reasons. *First*, the Settlement between Staff and U S WEST in the Qwest/U S WEST merger case includes a three-year moratorium on rate changes, either up or down.²⁸

²⁷Direct Testimony of Richard Cabe, 15:2-14.

²⁸*In Re Application of US West, Inc. and Qwest Communications International, Inc., for an Order Disclaiming Jurisdiction, or in the Alternative, Approving the US West, Inc.–Qwest Communi-*

Second, Qwest's DSL services are interstate, and the costs for those services are recovered through interstate jurisdiction.²⁹ Therefore, any cost for the HUNE imputed to Qwest's MegaBit services would technically be a part of the interstate access service. Absent an actual "payment" from Qwest to its intrastate operations, there would be no money available for the offset.³⁰

III. CONCLUSION

25. Through its own filing and admissions in this case, Qwest has demonstrated to the Commission that it will incur no incremental loop costs in providing the HUNE to its competitors as an unbundled network element. Similarly, it incurs no incremental cost when it uses the high frequency portion of the loop to provide customers with its own DSL services. Moreover, the evidence at hearing shows that Qwest is already recovering and will continue to recover 100 percent of its loop costs through its revenues from its voice services. All of

cations International, Inc. Merger, Ninth Supplemental Order Approving and Adopting Settlement Agreements and Granting Application in Docket No. UT-991358 (June 19, 2000).

²⁹Transcript of Hearing (Fitzsimmons), 223:2-23.

³⁰The interstate nature of Qwest's DSL services also point out the flaw in Qwest's argument that the HUNE price should be half of the costs of the local loop. Because the jurisdictional separations process allocates 25% of loop costs to the federal jurisdiction, any allocation of loop costs to the HUNE would necessarily be based on some fraction of 25% of the loop, and not based on a fraction of the entire loop. *See* Transcript of Hearing (Fitzsimmons), 223:2-23.

these facts point to one inescapable conclusion — that costs associated with the loop are caused by voice services and are properly recovered through revenues flowing from those voice services. Moreover, improperly imposing the costs of the loop upon the HUNE will unfairly burden those CLECs using the HUNE to deliver their DSL services, and ultimately, it will unnecessarily burden the consumers of those services. For these reasons TRACER urges the Commission to set the price for the HUNE at zero.

DATED this 9th day of October, 2000.

ATER WYNNE LLP

BY _____
Lisa F. Rackner
Of Attorneys for TRACER

CERTIFICATE OF SERVICE

***IN THE MATTER OF THE CONTINUED COSTING AND PRICE OF UNBUNDLED
NETWORK ELEMENTS, TRANSPORT AND TERMINATION***

WUTC DOCKET NO. UT-003013

PART A

I hereby certify that I have this day served the **OPENING BRIEF OF TRACER** upon all the parties of record in this proceeding, by first-class mail, except where otherwise noted. Please see attached list.

DATED at Portland, Oregon this 9th day of October 2000.

Donna L. Locke, Paralegal

VIA FEDEX PRIORITY OVERNIGHT

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