BEFORE THE OFFICE OF THE UNITED STATES TRADE REPRESENTATIVE

USTR-2018-0018

HTSUS Subheadings 8501.32.20, 8501.52.40, and 8503.00.95

Testimony of Chris Rice, Product General Manager, Chillers

Daikin Applied Americas

Mr. Chairman and members of the committee, I am Chris Rice, Supply Chain Director, Chillers, Daikin Applied Americas (Daikin Applied). Daikin Applied is part of Daikin Industries, Ltd. (DIL). I am here today to discuss the reasons USTR should remove certain parts that Daikin Applied uses in the production of air conditioning equipment from the proposed list of products subject to additional tariffs. Those parts include fractional horsepower AC motors that are used to power fans on large air conditioning units (up to 30 per machine). The top of my written testimony contains the HTSUS subheadings at issue, which Daikin Applied discussed more fully in its written comments.

I want to provide you with a brief background on Daikin Applied and DIL. DIL, the parent company of Daikin Applied, is a global company with a diverse portfolio of heating, ventilation, and air conditioning ("HVAC"), chemical, air filtration, and oil hydraulics products. Daikin is the world's leading HVAC manufacturer. Daikin Applied (formerly McQuay International) designs, manufactures, and sells HVAC products, systems, parts and services for commercial applications. Daikin Applied is headquartered in Minneapolis, and, as shown at the end of the written testimony, has facilities in Faribault and Owatonna, Minnesota; Staunton, Virginia, Auburn, New York, Dayton, Ohio, and Phoenix, Arizona. In May 2018, Daikin Applied announced plans to open a new state of the art, built to order manufacturing facility in

Faribault, Minnesota.[1] This will expand the production capabilities of its products and complement the significant investments already in place in the United States. In total, Daikin Applied manufacturing plants in the US cover one million square feet and employ over 2,000 people.

Daikin Applied is not the only company in which DIL is making investments. In 2012, DIL acquired Goodman Manufacturing Company. After acquiring Goodman, DIL built a new, $500 million manufacturing facility outside of Houston, Texas. This facility, which began producing HVAC equipment a year ago, is known as the Daikin Texas Technology Park ("DTTP"). This is no ordinary plant. It is the third largest manufacturing plant in the United States with 4 million square feet and over 5,000 employees. DIL's significant investments in the United States, more than $7 billion in the last twenty-five years, demonstrates its commitment to making the United States a major manufacturing center for its HVAC products.

For its U.S. manufacturing facilities, Daikin Applied sources parts in the U.S. and globally, including China. One of DIL's corporate policies is to manufacture products where they are sold. Imposing a 25% tariff will negatively impact Daikin Applied and the American consumer by significantly increasing Daikin Applied's costs of operating in the United States. It is estimated that the tariffs will cause a negative financial impact of more than $1.5 million on Daikin Applied.

To make matters even worse, many of Daikin Applied's competitors have moved a significant portion of their production out of the United States. This means that, while Daikin Applied must pay the 25 percent tariff on the parts that it purchases from China, its U.S. and

[1] https://www.prnewswire.com/news-releases/daikin-applied-proposes-expanding-its-manufacturing-presence-in-minnesota-300649893.html.

non-U.S. competitors that produce outside of the United States will not incur the same 25 percent tariffs on the finished HVAC units that they manufacture outside of the United States and sell in the U.S. market. This will have an adverse impact on Daikin Applied, our customers, and our employees. Although Daikin Applied supports the administration's goal of moving as much manufacturing as possible back to the United States, the consequences of the tariffs will be to punish companies like Daikin Applied and other DIL affiliates that are trying to achieve the administration's goal by investing heavily in the United States.

The HVAC parts that Daikin Applied is importing are produced from mature technologies and are manufactured outside of the United States. The products, fan motors, consist of two parts; the stator and the rotor with shaft. The stator is made from stacked, stamped, and laminated steel plates. The plates are laced with coated copper wire then dipped in a varnish for protection. The rotor is a cast aluminum cylinder that is mounted to a shaft and transports the rotational power to the product. Next to the compressor, the fan motor is the most important operating component to an HVAC system.

Beginning around 2004, the motor industry experienced significant consolidation as leading component manufacturing companies acquired smaller competitors. After the acquisitions, production capacity was reduced and moved to low cost countries in order to optimize profitability. These products are not considered by China to be strategic or advanced because the technology associated with the production of motors is well established, having been developed throughout the first half of the 20th century, and provides little to no competetive advantage. In addition, the HVAC parts imported by Daikin Applied are not going to advance China up the value chain in any way.

These products are no longer produced in the United States. Alternative supply exists outside of China, however capacity outside China has been limited with the industry consolidations, and factories are operating near limits. A supplier who would acquire our business would need to increase their capacity, which could include expanding factories and equipment. This would be a significant investment of money and time, possibly taking more than 6 months.

Additionally, extensive expense and time is required to adapt a new supply base, which requires:

- Reviewing available materials and technologies in that supply base;
- Testing chemical compatability;
- Testing and analysis to receive the required U.S. regulatory agency or third-party certifications, such as the Department of Energy and Underwriters' Laboratory;
- Extensive laboratory demonstrations; and
- Recertifying every impacted product with the applicable U.S. regulatory agency or third-party agency.

This process alone costs tens of thousdands of dollars and requires more than 12 months to complete, which does not include the time it would take to increase the supplier's capacity to the levels required by Daikin Applied. The time and money Daikin Applied would be spending on simply identifying new suppliers and recertifying those parts is time and money that Daikin Applied will not be able to spend on developing and implementing advanced products in the United States. In other words, this process would negatively impact U.S. research and development, which will make Daikin Applied less competitive in the global industry, harm

Daikin Applied's employees, and, ultimately, harm U.S. consumers from benefitting from U.S.-developed advanced technology.

In conclusion, Daikin Applied believes that imposing tariffs on the mature parts in question that it imports from China will do nothing to influence the Chinese government's policies. Instead, it will simply harm Daikin Applied and DIL, which are investing heavily in U.S. manufacturing. Daikin Applied urges the USTR not to impose tariffs on the HVAC parts at issue that it uses to manufacture HVAC units at its U.S. facilities.

I appreciate the opportunity to testify today. I would be glad to answer any questions that you may have.

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