

STATEMENT FOR THE HEARING RECORD

**MODIFICATION OF SECTION 25C IS NEEDED TO ADEQUATELY PROTECT
AMERICAN MANUFACTURING JOBS AND ADVANCE THE MOST ENERGY
EFFICIENT TECHNOLOGIES IN THE MARKETPLACE**

By

A.O. SMITH CORPORATION

Before the

COMMITTEE ON WAYS AND MEANS

U.S. HOUSE OF REPRESENTATIVES

April 14, 2010

The A.O. Smith Corporation is the largest manufacturer of residential and commercial water heating equipment in North America, employing 15,350 employees worldwide. The Corporation is a global leader in applying innovative technology and energy-efficient solutions to products marketed in more than 60 countries around the world, including solar, heat pump, and gas hybrid water heaters, along with the highest efficiency natural-draft residential gas storage water heaters on the market.

A.O. Smith applauds the Committee for its thoughtful consideration of existing and potential energy efficiency tax incentives and appreciates the opportunity to comment specifically on I.R.C. § 25C (non-business energy property credit), which provides a tax credit against the purchase of various energy-efficient appliances, including water heaters. A.O. Smith urges the Committee to amend the eligibility standards for gas-fired water heaters in Section 25C to ensure that they promote the purchase of the most energy-efficient water heaters on the market and do not inadvertently support foreign manufacturing jobs at the expense of U.S. manufacturing jobs. The current structure of Section 25C creates an unlevel playing field in the water heating industry by providing an incentive for consumers to purchase less energy-efficient imports instead of more energy-efficient domestically-manufactured water heaters.

Section 25C is without question an important market driver in the water heating industry, and indeed the credit has been steadily increased and expanded since its original authorization in the Energy Policy Act (EPACT) of 2005 (PL 109-58, Section 1333). EPACT provided a credit of \$300 toward the purchase of water heaters placed in service after December 31, 2005, and before January 1, 2008. However, eligible water heaters were only those that had an energy factor of 0.80 or greater – excluding all energy-efficient water heaters that, by law, can only be rated in thermal efficiency, not energy factor (see below), as well as certain domestically manufactured EF-rated water heaters. This error, related to the water heaters rated in thermal efficiency, was corrected in the Energy Improvement and Extension Act (EIEA) of 2008 (PL 110-343, Division B, Section 302), which extended the credit to apply to property placed in service during calendar year 2008 and provided that water heaters with a thermal efficiency of at least 90 percent would also be eligible for the credit. Finally, the American Recovery and Reinvestment Act of 2009 (PL 111-5, Section 1121)

amended Section 25C further by increasing the credit to a maximum of \$1,500 and providing that eligible water heaters included water heaters rated at 0.82 EF or 90 percent TE. The credit expires on December 31, 2010.

We believe the purpose of Section 25C is best served by promoting through the tax credit the most energy efficient, domestically-produced technologies on the market. As such, we suggest amending Section 25C to reflect the important energy efficiency distinctions between water heating products and to denote energy efficiency standards for each class (including separate standards for gas tankless and gas storage water heaters). These modifications will also ensure that foreign manufacturers compete on a level playing field and are not given a leg up over domestic manufacturers through the tax credit.

There are several classes of water heaters: electric heat pump storage (tank), electric resistance-element storage (tank), electric tankless (instantaneous), condensing gas storage (tank), non-condensing gas storage (tank), condensing gas tankless (instantaneous), and non-condensing gas tankless (instantaneous). As referenced above, current law does not uniformly rate the energy efficiency of all of these classes of water heaters. Depending on a water heater's gallon capacity and energy input rating, it may be covered under the National Appliance Energy Conservation Act (NAECA) or EPACT. If covered under NAECA, the water heater must be rated in energy factor (EF). If covered under EPACT, it must be rated in thermal efficiency (TE).

In the case of water heaters covered under NAECA, as Section 25C is currently structured, more foreign products than domestic products qualify for the tax credit. Specifically, Section 25C favors foreign-made gas tankless water heaters as a result of two flaws in the current structure of the law. First, the eligibility criteria allow foreign-manufactured, non-condensing gas tankless water heaters rated at 0.82 EF to receive a Section 25C tax credit. However, as the Department of Energy recently recognized in the Final Rule for residential water heaters published in the Federal Register on April 16, 2010¹ (as well as the previously published Notice of Proposed Rulemaking), the current DOE test method for NAECA-covered water heaters overstates the EF ratings for tankless heaters by more than 8 percent. As such, non-condensing gas tankless water heaters are more accurately rated at 0.74 EF, far below the current eligibility standard of Section 25C. We do not believe it furthers our nation's energy efficiency goals to equally promote through our tax code an imported 0.82 (actually performing at 0.74) EF gas water heater and a much more efficient, domestically-produced gas water heater rated at 90 percent TE. Further, since the authorization of the water heater credit in 25C, there have been advances in the industry regarding gas tankless heater efficiency, and there are now highly efficient condensing gas tankless heaters on the market. As such, we recommend that the eligibility standard for gas tankless water heaters be increased to 0.90 EF (or greater) and 90 percent TE (or greater) such that only the most energy-efficient products on the market receive the incentive.

Second, there is no manufacturer – foreign or domestic – that produces a gas storage water heater rated at 0.82 or greater. Thus, in actuality the only relevant standard under the current eligibility structure of Section 25C is 90 percent TE. To ensure that more domestically-manufactured storage water heaters can qualify for the tax incentive in Section 25C, the EF standard for storage water

¹ See Energy Conservation Program: Energy Conservation Standards for Residential Water Heaters, Direct Heating Equipment, and Pool Heaters, 10 CFR § 430 (2010).

heaters should be 0.77. Indeed, the Department of Energy has recognized that the correct EF criterion for condensing gas storage heaters is 0.77 EF, because it is the maximum efficiency level that can be achieved in this class of water heaters.² Both of the above flaws in the structure of 25C must be corrected to ensure that the tax credit maximizes energy savings and levels the playing field for foreign and domestic products.

In summary, A.O. Smith urges the Committee to amend Section 25C as follows:

- Revise the eligibility standard for gas tankless (instantaneous) water heaters to 0.90 EF (or greater) or 90 percent TE (or greater).
- Revise the eligibility standard for gas storage water heaters to 0.77 EF (or greater) or 90 percent TE (or greater).

Additionally, we support the existing inclusion of the following water heaters in Section 25C:

- Electric heat pumps at 2.0 EF (or greater)
- Geothermal heat pumps
- Solar hot water heaters

The Committee is now presented with an important opportunity to amend Section 25C to ensure equal treatment of foreign and domestic water heater manufacturers and make the credit more meaningful in its promotion of energy-efficient water heaters. We urge the Committee to make the above modifications to further job growth in the U.S. domestic heating industry and maximize the energy savings from incentivized retrofits promoted through Section 25C.

Thank you for your consideration.

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² *Id.*