



**JOINT LEGISLATIVE COMMITTEE ON CLIMATE CHANGE POLICIES**  
**ASSEMBLYMEMBER JACQUI IRWIN, CHAIR**  
**SENATOR HENRY STERN, VICE CHAIR**

**Monday, February 23, 2026**

**Upon Adjournment of Assembly and Senate Floor Sessions**  
**State Capitol, Room 126**

***Reauthorized and Renamed:***  
***California's Cap-and-Invest Program***

- In September 2025, the Legislature and Governor Newsom reauthorized California's Cap-and-Invest program through 2045.
- In January 2026, the California Air Resources Board released a set of Proposed Amendments to the Cap-and-Invest Regulation.
- The Proposed Amendments would:
  - 1) Align Cap-and-Invest allowance budgets with California's climate targets of 40% GHG emissions reduction from 1990 levels by 2030 and 85% reduction by 2045.
  - 2) Change the number of allowances allocated to electric utilities, which may affect electricity affordability.
  - 3) Gradually transition allowances from natural gas suppliers to electric utilities from 2029–2037, rather than transitioning of those allowances by 2031.
  - 4) Largely continue status quo allowance allocation of industrial facilities by maintaining existing Industry Assistance Factors and Cap Adjustment Factors.
  - 5) Make numerous technical changes to the Cap-and-Invest program.

**What is Cap-and-Invest?**

California is a national and global leader in environmental policy with a particular focus on economy-wide emissions reduction and decarbonization. Following the passage of AB 32 (Nuñez & Pavley, 2006), California has adopted a series of increasingly ambitious greenhouse gas (GHG) emissions reduction targets. AB 1279 (Muratsuchi, 2022), the most recent bill to update these targets, committed to reaching statewide carbon neutrality and an 85% emissions reduction from 1990 levels by no later than 2045.

California's Cap-and-Invest Program is one of a suite of programs implemented following the passage of AB 32 that are designed to reduce GHG in the state. The Cap-and-Invest program covers approximately 350 total facilities<sup>1</sup> (including refineries, electricity generators, and manufacturing facilities), each of which emit 25,000 metric tons or more<sup>2</sup> of CO<sub>2</sub>e<sup>3</sup> per year and in total comprise approximately 80% of California's GHG emissions.<sup>4</sup> The California Air Resources Board (CARB) establishes an annual cap for the total emissions permitted across all entities covered by the Cap-and-Invest program and issues a number of allowances proportional to the cap, with each allowance representing one metric ton of CO<sub>2</sub>e.<sup>5</sup> Covered entities can acquire allowances by receive free allocation of allowances from CARB,<sup>6</sup> buying allowances at quarterly auctions,<sup>7</sup> or by trading with other market participants. Covered entities must surrender a number of allowances corresponding to their emissions for the year to be in compliance with the program. Offset credits generated from emissions-reduction or sequestration projects, using protocols developed by CARB,<sup>8</sup> are also eligible to fulfill up to 6% of a covered entity's compliance obligation. This framework gives compliance entities three options for program compliance: 1) reduce their GHG emissions, 2) acquire (through allocation or purchase at auction) and surrender allowances to cover their emissions, or 3) purchase offset credits to cover a specified portion of their emissions.

The Cap-and-Invest program drives emissions reductions by shrinking the cap over time, which corresponds to fewer allowances being available. The price of allowances is expected to increase as the supply declines, which incentivizes covered entities to make investments to reduce their emissions, rather than paying for increasingly scarce and expensive allowances. California's cap-and-trade program favors compliance flexibility and cost-effectiveness of emissions reductions over control of where, how, or by which compliance entity those emissions reductions are achieved. This level of flexibility has drawn criticism over the years for insufficiently mitigating local air pollution from sources covered by the program<sup>9,10</sup> but has also been lauded as the most cost-effective method for reducing GHG emissions.<sup>11</sup>

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<sup>1</sup> California Air Resources Board (CARB); "Regulation for the California Cap on Greenhouse Gas Emissions and Market- Based Compliance Mechanisms 2024 Amendments Standardized Regulatory Impact Assessment (SRIA)"; April 2024; p52; [https://ww2.arb.ca.gov/sites/default/files/2024-04/nc-Cap-and-Trade\\_SRIA2024.pdf](https://ww2.arb.ca.gov/sites/default/files/2024-04/nc-Cap-and-Trade_SRIA2024.pdf)

<sup>2</sup> CARB; "Cap-and-Trade Regulation (Unofficial Electronic Version)"; April 2019; p66; [https://ww2.arb.ca.gov/sites/default/files/2021-02/ct\\_reg\\_unofficial.pdf](https://ww2.arb.ca.gov/sites/default/files/2021-02/ct_reg_unofficial.pdf)

<sup>3</sup> One metric ton of carbon dioxide emissions or the corresponding amount of a different GHG required to produce a comparable global warming potential.

<sup>4</sup> CARB; "Cap-and-Invest Program"; <https://ww2.arb.ca.gov/our-work/programs/cap-and-invest-program/about>

<sup>5</sup> CARB; "FAQ Cap-and-Trade Program"; <https://ww2.arb.ca.gov/resources/documents/faq-cap-and-trade-program>

<sup>6</sup> CARB; "Allowance Allocation"; <https://ww2.arb.ca.gov/our-work/programs/cap-and-trade-program/allowance-allocation>

<sup>7</sup> Congressional Research Service (CRS); "The California Cap-and-Trade Program: Overview and Considerations for Congress"; December 2024; p10; <https://crsreports.congress.gov/product/pdf/R/R48314/2>

<sup>8</sup> CARB; "Compliance Offset Program"; <https://ww2.arb.ca.gov/our-work/programs/compliance-offset-program>

<sup>9</sup> Office of Environmental Health Hazard Assessment (OEHHA); "Impacts of Greenhouse Gas Emission Limits Within Disadvantaged Communities: Progress toward Reducing Inequities"; February 2022; <https://oehha.ca.gov/media/downloads/environmental-justice/impactsofghgpoliciesreport020322.pdf>

<sup>10</sup> Environmental Justice Advisory Committee; "2022 Scoping Plan Recommendations"; September 2022; p26; [https://ww2.arb.ca.gov/sites/default/files/2024-02/EJAC%20FINAL%20Recommendations%20September%202022\\_1.pdf](https://ww2.arb.ca.gov/sites/default/files/2024-02/EJAC%20FINAL%20Recommendations%20September%202022_1.pdf)

<sup>11</sup> Döbbling-Hildebrandt, *et al.*; "Systematic review and meta-analysis of ex-post evaluations on the effectiveness of carbon pricing."; May 2024; <https://www.nature.com/articles/s41467-024-48512-w.pdf>

The Legislature and Governor Newsom reauthorized the Cap-and-Invest program in September 2025 through the passage and signing of AB 1207 (Irwin, 2025) and SB 840 (Limón, 2025). AB 1207 contained provisions related to reauthorization through 2045, program design changes, and the Electric California Climate Credit. SB 840 focused on the role of compliance offsets in Cap-and-Invest and established a new framework for the distribution of Cap-and-Invest program revenues through the Greenhouse Gas Reduction Fund (GGRF). The key provisions of both reauthorization bills are outlined in the following tables, compiled by the Legislative Analyst’s Office: *Key Changes in Cap-and-Invest Design Features and Allowance Allocations and Modifications to Statutorily Required GGRF Appropriations Pursuant to SB 840*.

CARB has started a Rulemaking process to align the program with the requirements of the reauthorization bills and update the program which, after being amended eight times between 2012 and 2018, has not been updated since the most recent amendments took effect in April 2019.<sup>12</sup> CARB’s opening update proposal, generally referred to as the Initial Statement of Reasons (ISOR) or Proposed Amendments, for the Cap-and-Invest regulation was released in January 2026. The Proposed Amendments would affect the distribution of allowances in the Cap-and-Invest program, include specific design changes required by AB 1207 as well as new program features, and contain numerous technical updates to Cap-and-Invest.<sup>13</sup> The Public Comment period for the Proposed Amendments is currently open and concludes on March 9<sup>th</sup>.<sup>14</sup>

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<sup>12</sup> CARB; “Staff Report: Initial Statement of Reasons”; January 2026; p20-21; [https://ww2.arb.ca.gov/sites/default/files/barcu/regact/2026/cap\\_invest/nc\\_isor.pdf](https://ww2.arb.ca.gov/sites/default/files/barcu/regact/2026/cap_invest/nc_isor.pdf)

<sup>13</sup> CARB; “Staff Report: Initial Statement of Reasons”; January 2026; p26-28.

<sup>14</sup> CARB; “Notice of Public Hearing”; January 2026; [https://ww2.arb.ca.gov/sites/default/files/barcu/regact/2026/cap\\_invest/nc\\_notice.pdf](https://ww2.arb.ca.gov/sites/default/files/barcu/regact/2026/cap_invest/nc_notice.pdf)

## Key Changes in Cap-and-Invest Design Features and Allowance Allocations

Prior Law and/or Regulation	AB 1207 and SB 840 <sup>a</sup>
<b>Program Sunset and Name</b>	
<ul style="list-style-type: none"> <li>• Sunset date of January 1, 2031.</li> <li>• Program named "cap-and-trade."</li> </ul>	<ul style="list-style-type: none"> <li>• Sunset date of January 1, 2046.</li> <li>• Expresses intent to rename the program "cap-and-invest."</li> </ul>
<b>Linkage to State Climate Goals</b>	
<ul style="list-style-type: none"> <li>• General guidance to CARB to set emission limits to meet the state's GHG reduction goals.</li> </ul>	<ul style="list-style-type: none"> <li>• Explicit requirement that CARB set emission limits to ensure the state meets, at a minimum, its 2030 and 2045 goals.</li> </ul>
<b>Use of Offsets</b>	
<ul style="list-style-type: none"> <li>• Use of offsets does not affect allowance budget.</li> </ul>	<ul style="list-style-type: none"> <li>• Reduces the subsequent year's allowance budget for each offset used.</li> </ul>
<ul style="list-style-type: none"> <li>• Covered entities can meet 6 percent of compliance obligations with offsets in 2026 through 2030.</li> </ul>	<ul style="list-style-type: none"> <li>• CARB to determine the degree to which covered entities can meet compliance obligations with offsets (no more than 6 percent).</li> </ul>
<ul style="list-style-type: none"> <li>• No requirement that CARB update its offset protocols.</li> </ul>	<ul style="list-style-type: none"> <li>• CARB must update its offset compliance protocols by January 1, 2029, evaluate them for potential update every five years thereafter, and consider expanding protocols to new sectors.</li> </ul>
<ul style="list-style-type: none"> <li>• No requirement for CARB to prepare a study on offsets.</li> </ul>	<ul style="list-style-type: none"> <li>• CARB must prepare a study on offsets by December 31, 2026.</li> </ul>
<b>Allowances Provided to Utilities</b>	
<ul style="list-style-type: none"> <li>• Electric and natural gas utilities allocated free allowances (roughly one-quarter and one-eighth of total allowances, respectively) to benefit ratepayers.</li> </ul>	<ul style="list-style-type: none"> <li>• CARB must develop regulations to transition gas utilities' free allowances to electric utilities by January 1, 2031.</li> </ul>
<ul style="list-style-type: none"> <li>• 15 percent of electric IOU allowances may be provided for clean energy and energy efficiency.</li> </ul>	<ul style="list-style-type: none"> <li>• 5 percent of electric IOU allowances must be provided to support a California Transmission Accelerator Revolving Fund through July 1, 2031.</li> </ul>
<ul style="list-style-type: none"> <li>• Electric IOU rebates must be provided to residential, small business, and emissions-intensive trade-exposed retail customers.</li> </ul>	<ul style="list-style-type: none"> <li>• Electric IOU rebates must be provided to residential customers. Small business and certain retail customers may also be provided rebates, as determined by CPUC.</li> </ul>
<ul style="list-style-type: none"> <li>• Electric IOU rebates provided twice annually (in April and October) and natural gas rebates provided once annually (in April).</li> </ul>	<ul style="list-style-type: none"> <li>• Residential electric IOU rebates must be provided in up to the four highest-billed months.</li> </ul>
<ul style="list-style-type: none"> <li>• Electric IOUs required to adopt and implement customer outreach plans to inform the public about utility rebates.</li> </ul>	<ul style="list-style-type: none"> <li>• Electric IOUs required to update their customer outreach plans.</li> </ul>
<ul style="list-style-type: none"> <li>• POU's can use allowances for various purposes that benefit ratepayers.</li> </ul>	<ul style="list-style-type: none"> <li>• POU's must use the incremental allowances they receive from the transition away from natural gas allowances for customer rebates. (No changes to requirements for POU's' other allowances.)</li> </ul>
<b>Allowances Provided to Industry</b>	
<ul style="list-style-type: none"> <li>• CARB must assume the highest leakage risk for all industries.</li> </ul>	<ul style="list-style-type: none"> <li>• Starting in 2031, CARB must distribute allowances to minimize leakage risk to cost-effectively meeting the state's climate goals.</li> </ul>
<b>Price Ceiling</b>	
<ul style="list-style-type: none"> <li>• Proceeds from permits sold at the price ceiling must be used to purchase offsets.</li> </ul>	<ul style="list-style-type: none"> <li>• Proceeds from permits sold at the price ceiling must be deposited into Climate Mitigation Fund to be appropriated by the Legislature to reduce energy costs and for other purposes.</li> </ul>
<ul style="list-style-type: none"> <li>• General direction for CARB to consider avoiding adverse impacts on households, businesses, and the economy (among various other factors) when establishing the price ceiling.</li> </ul>	<ul style="list-style-type: none"> <li>• CARB also directed to consider actions to ensure consumers are protected if it finds that the price ceiling and/or price containment reserve do not adequately protect consumers.</li> </ul>

<sup>a</sup> Most changes in the program design and allowance allocations are pursuant to Chapter 117 of 2025 (AB 1207, Irwin). However, some offset-related provisions are also included in Chapter 121 of 2025 (SB 840, Limón).

CARB = California Air Resources Board; GHG = greenhouse gas; IOUs = investor-owned utilities; CPUC = California Public Utilities Commission; and POU's = publicly owned utilities.

## Modifications to Statutorily Required GGRF Appropriations Pursuant to SB 840<sup>a</sup>

Program	Department	Existing Statutory Allocations	Starting in 2026-27 <sup>b</sup>
<b>Starting in 2026-27, funding will be allocated first to the following programs:</b>			
Manufacturing tax exemption	N/A	<ul style="list-style-type: none"> <li>• Roughly \$100-\$140 million.</li> <li>• Sunsets on July 1, 2030.</li> </ul>	<ul style="list-style-type: none"> <li>• No changes (maintains sunset).</li> </ul>
State Responsibility Area fee backfill	CalFire	<ul style="list-style-type: none"> <li>• Roughly \$70-\$90 million.</li> <li>• Sunsets on January 1, 2031.</li> </ul>	<ul style="list-style-type: none"> <li>• No changes (maintains sunset).</li> </ul>
Legislative Counsel Climate Bureau	Legislative Counsel	<ul style="list-style-type: none"> <li>• None.</li> </ul>	<ul style="list-style-type: none"> <li>• \$3 million annually.</li> </ul>
<b>Then second to the following programs:</b>			
High-speed rail project	HSRA	<ul style="list-style-type: none"> <li>• 25 percent of annual revenues.</li> <li>• No sunset.</li> </ul>	<ul style="list-style-type: none"> <li>• \$1 billion annually.</li> </ul>
Unspecified programs subject to appropriation	Various	<ul style="list-style-type: none"> <li>• None.</li> </ul>	<ul style="list-style-type: none"> <li>• \$1 billion annually.</li> </ul>
<b>Then third, if funding is available, to the following programs:<sup>c</sup></b>			
Affordable Housing and Sustainable Communities Program	SGC	<ul style="list-style-type: none"> <li>• 20 percent of annual revenues.</li> <li>• No sunset.</li> </ul>	<ul style="list-style-type: none"> <li>• \$800 million annually.</li> </ul>
TIRCP	CalSTA	<ul style="list-style-type: none"> <li>• 10 percent of annual revenues.</li> <li>• No sunset.</li> </ul>	<ul style="list-style-type: none"> <li>• \$400 million annually.</li> </ul>
Community Air Protection Program—AB 617 <sup>d</sup>	CARB	<ul style="list-style-type: none"> <li>• None.<sup>e</sup></li> </ul>	<ul style="list-style-type: none"> <li>• \$250 million annually.</li> </ul>
Low Carbon Transit Operations Program	Caltrans	<ul style="list-style-type: none"> <li>• 5 percent of annual revenues.</li> <li>• No sunset.</li> </ul>	<ul style="list-style-type: none"> <li>• \$200 million annually.</li> </ul>
Wildfire and forest resilience—SB 901 <sup>f</sup>	CalFire	<ul style="list-style-type: none"> <li>• \$200 million annually.</li> <li>• Sunsets on June 30, 2029.</li> </ul>	<ul style="list-style-type: none"> <li>• \$200 million annually.</li> </ul>
Safe and Affordable Drinking Water Program	SWRCB	<ul style="list-style-type: none"> <li>• 5 percent of annual revenues (up to \$130 million).</li> <li>• Sunsets on June 30, 2030.</li> </ul>	<ul style="list-style-type: none"> <li>• \$130 million annually.</li> </ul>
<b>Then fourth, remaining funding is subject to legislative appropriation for discretionary purposes.</b>			
<p><sup>a</sup> Chapter 121 of 2025 (SB 840, Limón).</p> <p><sup>b</sup> No sunset date unless otherwise noted.</p> <p><sup>c</sup> Senate Bill 840 requires the Department of Finance to proportionately reduce the amounts for these programs if funding is not sufficient to fully support them and pay for state administrative costs.</p> <p><sup>d</sup> Chapter 136 of 2017 (AB 617, C. Garcia).</p> <p><sup>e</sup> AB 617 did not have a prior statutory allocation, but the program historically has received roughly \$250 million annually on a discretionary basis.</p> <p><sup>f</sup> Chapter 626 of 2018 (SB 901, Dodd).</p> <p>GGRF = Greenhouse Gas Reduction Fund; CalFire = California Department of Forestry and Fire Prevention; HSRA = High Speed Rail Authority; SGC = Strategic Growth Council; TIRCP = Transit and Intercity Rail Capital Program; CalSTA = California State Transportation Agency; Caltrans = California Department of Transportation; and SWRCB = State Water Resources Control Board.</p>			

<sup>15</sup> LAO; “Overview of New Updates to The Cap-and-Invest Program”; December 2025; p4; <https://lao.ca.gov/reports/2025/5097/New-Updates-Cap-and-Invest-Program-120925.pdf>

<sup>16</sup> LAO; “Overview of New Updates to The Cap-and-Invest Program”; December 2025; p7.

### **Allowance Budget Adjustments**

CARB is proposing to align the Cap-and-Invest program with the 40% GHG reduction by 2030 requirement in SB 32 (Pavley, 2016) by removing 118 million allowances from 2027-2030 allowance budgets rather than pursuing the more ambitious emissions reduction pathways outlined in the 2022 Scoping Plan Update of 48% or 55% reduction by 2030. The 48% or 55% pathways would have necessitated the removal of 264 million or 392 million allowances from 2027-2030 allowance budgets, respectively.<sup>17</sup> The Proposed Amendments also include allowance budgets from 2032-2045, which align with the emissions reduction target of 85% below 1990 levels by 2045 (AB 1279 (Muratsuchi, 2022), as required by AB 1207 (Irwin, 2025)).<sup>18</sup>

### **Allowance Allocation**

CARB maintains significant discretion to allocate allowances in the Cap-and-Invest program. Because allowances have a monetary value, how allowances are divided across different uses significantly affects the financial benefits, impacts, and implications of the program.<sup>19</sup> The major categories for allowance allocation are electric distribution utilities, natural gas suppliers, and industrial facilities. The remaining allowances are reserved for auction to supply the Greenhouse Gas Reduction Fund (GGRF). Of the allowances allocated by CARB for 2026 (i.e., not including auctioned allowances), 54% were allocated to electric distribution utilities, 23% to natural gas suppliers, and 22% were allocated to industrial facilities.<sup>20</sup>

### **Allowance Allocation to Electric Distribution Utilities**

CARB allocates allowances to electric distribution utilities (EDUs), which include both investor-owned utilities (IOUs) and publicly owned utilities (POUs), to cover the passthrough costs of the Cap-and-Invest program to electric utility ratepayers through the electric California Climate Credit (largely IOUs) and programs that reduce GHG emissions or ratepayer costs (largely POUs).<sup>21</sup> As such, the number of allowances allocated to each EDU is based on its anticipated Cap-and-Invest program compliance costs, which reflect the electrical load of each utility and how clean the actual generation mix of that EDU is in a given year. The current Cap-and-Invest regulation includes a table of projected annual allowance allocations to each EDU for 2021–2030,<sup>22</sup> which were calculated based on projections of Cap-and-Invest compliance costs for each EDU. The Proposed Amendments revise EDU allocations for 2027–2030 to account for cleaner electricity generation and updated information from the California Energy Commission on the actual load served by each EDU.<sup>23</sup>

The proposed changes in allowance allocation to IOUs would significantly reduce the total funds distributed to ratepayers through the electric Climate Credit through 2030 relative to projections from the previous cap-and-trade regulation.<sup>24</sup> For example, under the existing regulation, Pacific Gas & Electric (PG&E) would be allocated 85.8 million allowances for 2027–

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<sup>17</sup> CARB; “Staff Report: Initial Statement of Reasons”; January 2026; p32.

<sup>18</sup> CARB; “Appendix A-1: Proposed Regulation Order”; January 2026; p109;

[https://ww2.arb.ca.gov/sites/default/files/barcu/regact/2026/cap\\_invest/nc\\_app%20a-1.pdf](https://ww2.arb.ca.gov/sites/default/files/barcu/regact/2026/cap_invest/nc_app%20a-1.pdf)

<sup>19</sup> LAO; “Overview of New Updates to The Cap-and-Invest Program”; December 2025; p12.

<sup>20</sup> CARB; “Allowance Allocation”.

<sup>21</sup> CARB; “Summary of 2013-2023 Electrical Distribution Utility Use of Allocated Allowance Value”; March 2025;

<https://ww2.arb.ca.gov/sites/default/files/cap-and-trade/allowanceallocation/2023%20EDU%20Use%20of%20Allowance%20Value%20Report.pdf>

<sup>22</sup> CARB; “Cap-and-Trade Regulation (Unofficial Electronic Version)”; April 2019; p212-216.

<sup>23</sup> CARB; “Staff Report: Initial Statement of Reasons”; January 2026; p50.

<sup>24</sup> CARB; “Appendix A-1: Proposed Regulation Order”; January 2026; p235.

2030.<sup>25</sup> Under the Proposed Amendments, the number of allowances allocated to fund the electric Climate Credit distributed to PG&E ratepayers would be reduced to 34.3 million allowances,<sup>26</sup> a 60% reduction compared to the existing regulation. Allowance allocation to POU through 2030 would also be reduced. Sacramento Municipal Utility District (SMUD) would be allocated 7.2 million allowances for 2027–2030 under the proposal,<sup>27</sup> a 24% reduction compared to their projected allocation of 9.5 million allowances under the current regulation.<sup>28</sup> The reduction in allowances to POU is generally smaller in magnitude than the reduction to IOU allowances. However, many of the POU have incorporated the previous allowance projections into their long-term planning processes, including investments in renewable generation resources, anticipating financial support from the allocated allowances and may be challenged to account for the change in allowance allocation.<sup>29</sup>

### **Allowance Allocation to Natural Gas Suppliers**

CARB allocates allowances to both EDUs and natural gas suppliers (NGS). However, electricity and natural gas are significantly different in how they relate to California’s climate goals: electrification is the most efficient way to reduce emissions across much of California’s economy while natural gas is primarily composed of methane, a potent GHG.<sup>30</sup> AB 1207 (Irwin, 2025) requires CARB to develop regulations to transition allocated allowances from natural gas utilities to electric utilities by 2031.<sup>31</sup> In the Proposed Amendments, CARB appears to be interpreting this requirement to mean that CARB must *develop regulations by 2031* outlining the eventual transition of allowances, rather than a requirement that CARB complete the transition of allowances from NGS to EDUs by 2031. CARB’s Proposed Amendments outline a slow transition of allowances from natural gas to electric utilities, starting in 2029 and eventually completing the transition in 2037.<sup>32</sup> The total value of allowances allocated to natural gas utilities for 2027–2030, using the allowance price from the November 2025 auction,<sup>33</sup> is about \$3 billion.<sup>34</sup> Under CARB’s proposal to slowly transition allowances, only \$350 million would be transferred from natural gas to electrical utilities by 2031, maintaining more than \$2.6 billion in funds from the Cap-and-Invest program in the natural gas sector rather than directing those funds to immediately reduce electricity bills.

The transition of allowances from NGS to EDUs, required by AB 1207 (Irwin, 2025), will eventually eliminate the Natural Gas Climate Credit. The Natural Gas Climate Credit, which is distributed as an annual credit on customer bills in April, has averaged \$36 per year since 2020.<sup>35</sup> To put the value of the Natural Gas Climate Credit in context, the total revenue requirement of California’s three largest natural gas utilities has increased by 72% over the past

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<sup>25</sup> CARB; “Cap-and-Trade Regulation (Unofficial Electronic Version)”; April 2019; p215.

<sup>26</sup> CARB; “Appendix A-1: Proposed Regulation Order”; January 2026; p237.

<sup>27</sup> CARB; “Appendix A-1: Proposed Regulation Order”; January 2026; p237.

<sup>28</sup> CARB; “Cap-and-Trade Regulation (Unofficial Electronic Version)”; April 2019; p215.

<sup>29</sup> SCPPA; “Comments on Potential Amendments to the Cap-and-Trade Regulation, May 31, 2024, Workshop”; June 2024;

[https://ww2.arb.ca.gov/system/files/webform/public\\_comments/15251/SCPPAComments\\_CapandTrade\\_June2024.pdf](https://ww2.arb.ca.gov/system/files/webform/public_comments/15251/SCPPAComments_CapandTrade_June2024.pdf)

<sup>30</sup> CARB; “GHGs Descriptions & Sources in California”; <https://ww2.arb.ca.gov/ghg-descriptions-sources>

<sup>31</sup> HSC § 38562(B)(i)

<sup>32</sup> CARB; “Appendix A-1: Proposed Regulation Order”; January 2026; p250.

<sup>33</sup> CARB; “Summary of Auction Settlement Prices and Results”; November 2025;

[https://ww2.arb.ca.gov/sites/default/files/2020-08/results\\_summary.pdf](https://ww2.arb.ca.gov/sites/default/files/2020-08/results_summary.pdf)

<sup>34</sup> CARB; “2021-2030 Allowance Allocation to NG Suppliers”; [https://ww2.arb.ca.gov/sites/default/files/cap-and-trade/allowanceallocation/NGS\\_Allocation.xlsx](https://ww2.arb.ca.gov/sites/default/files/cap-and-trade/allowanceallocation/NGS_Allocation.xlsx)

<sup>35</sup> CPUC; “California Climate Credit”; <https://www.cpuc.ca.gov/climatecredit>

decade to \$14.43 billion in 2025.<sup>36</sup> This increased revenue being collected through natural gas rates has largely been driven by increased spending on the natural gas distribution network,<sup>37</sup> even as California residential natural gas demand has declined over the past decade and is currently forecasted to continue to decline through 2040.<sup>38</sup> Opportunities may be available to address spending on natural gas infrastructure that could equal or exceed the ratepayer savings historically provided by the Natural Gas Climate Credit.<sup>39,40,41</sup>

### **Allowance Allocation to Industrial Facilities**

Allowance allocation to industrial facilities is a method of reducing the amount that industrial emitters are required to pay for Cap-and-Invest program compliance and reducing the chance that industries would leave the state, which is known as leakage.<sup>42</sup> In 2023, GHG emissions from industrial sources in California was approximately 56 million metric tons of CO<sub>2</sub>e. Allowance allocation to industrial facilities totaled approximately 35 million allowances, which covered 62% of the overall program compliance for industrial covered entities for the year. As a result, industrial industries in California were responsible for covering 38% of their actual emissions in 2023 through the purchase of allowances and offset credits.<sup>43</sup> For 2026, the Refining & Hydrogen Production sector was allocated over 17 million allowances, Cement, Lime, Clay, & Gypsum received 5.5 million allowances, and Oil & Gas Production received nearly 3 million allowances, with the remaining 4.2 million allowances allocated to industrial facilities across all other sectors.<sup>44</sup>

Allowance allocation to industrial facilities is determined by a four-variable formula. Allocating allowances based on this formula is meant to minimize the risk of emissions leakage by providing an incentive for GHG emissions efficient manufacturing in California.<sup>45</sup> Three of the variables in the formula are meant to ensure that allocation to an industrial facility reflects the emissions associated with the industrial production method being used, the quantity of product produced, and the leakage risk assessment for the facility's industrial sector (e.g., fruit and vegetable canning, poultry processing, or petroleum refining). The fourth variable, the Cap Adjustment Factor, adjusts the number of allowances allocated to align with the overall emissions cap as allowance budgets in the Cap-and-Invest program decline over time.<sup>46</sup> Each variable in the formula affects the number of allowances allocated to an industrial facility.

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<sup>36</sup> CPUC; "2025 Senate Bill 695 Report"; September 2025; p4; [https://www.cpuc.ca.gov/-/media/cpuc-website/divisions/office-of-governmental-affairs-division/reports/2025/2025-sb-695-report\\_093025.pdf](https://www.cpuc.ca.gov/-/media/cpuc-website/divisions/office-of-governmental-affairs-division/reports/2025/2025-sb-695-report_093025.pdf)

<sup>37</sup> CPUC; "2025 Senate Bill 695 Report"; September 2025; p63.

<sup>38</sup> CPUC; "2024 Joint Agency Staff Paper: Progress Towards a Gas Transition A White Paper"; February 2024; p9; <https://docs.cpuc.ca.gov/PublishedDocs/Efile/G000/M525/K660/525660391.PDF>

<sup>39</sup> Rocky Mountain Institute; "Non-Pipeline Alternatives: Emerging Opportunities in Planning for U.S. Gas System Decarbonization"; May 2024; [https://www.nationalgridus.com/media/pdfs/other/CM9904-RMI\\_NG-May-2024.pdf](https://www.nationalgridus.com/media/pdfs/other/CM9904-RMI_NG-May-2024.pdf)

<sup>40</sup> E3 - Energy and Environmental Economics; "Benefit-Cost Analysis of Targeted Electrification and Gas Decommissioning in California"; December 2023; [https://www.ethree.com/wp-content/uploads/2023/12/E3\\_Benefit-Cost-Analysis-of-Targeted-Electrification-and-Gas-Decommissioning-in-California.pdf](https://www.ethree.com/wp-content/uploads/2023/12/E3_Benefit-Cost-Analysis-of-Targeted-Electrification-and-Gas-Decommissioning-in-California.pdf)

<sup>41</sup> UCLA Law; "Go Big, Save Big: Approaches to Fund Building Electrification in California"; December 2025; <https://law.ucla.edu/news/go-big-save-big-approaches-fund-building-electrification-california>

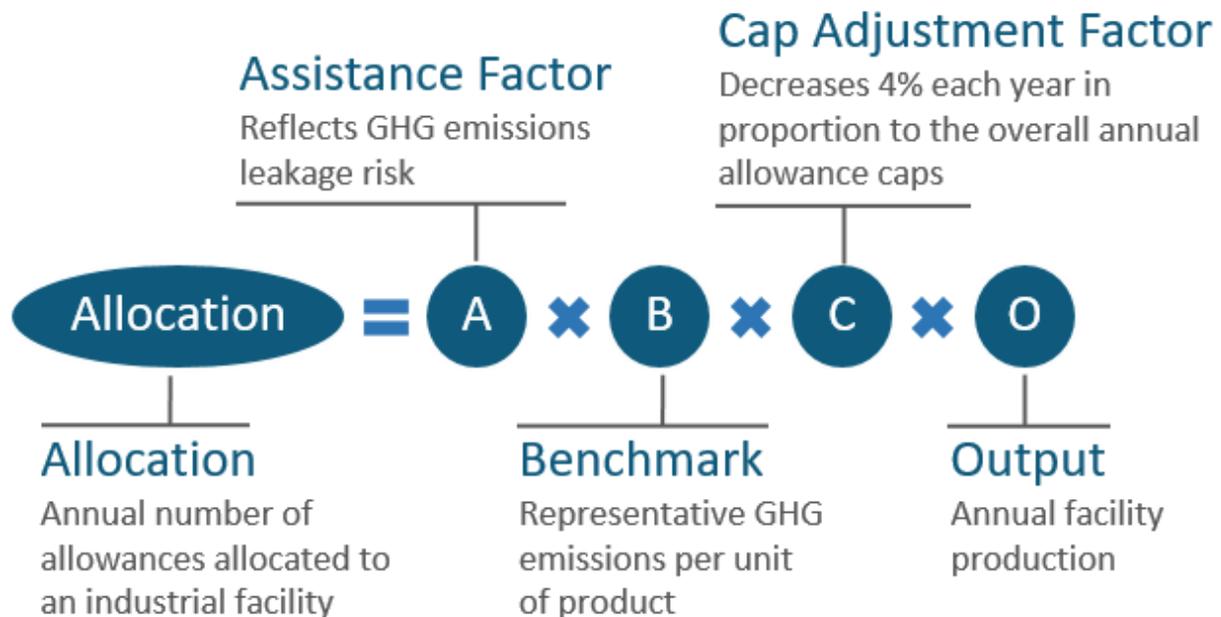
<sup>42</sup> CARB; "Allowance Allocation to Industrial Facilities"; <https://ww2.arb.ca.gov/our-work/programs/cap-and-trade-program/allowance-allocation/allowance-allocation-industrial>

<sup>43</sup> CARB; "Staff Report: Initial Statement of Reasons"; January 2026; p60.

<sup>44</sup> CARB; "Allowance Allocation".

<sup>45</sup> CARB; "Staff Report: Initial Statement of Reasons"; January 2026; p61.

<sup>46</sup> CARB; "Staff Report: Initial Statement of Reasons"; January 2026; p318.



**(A)** is the Industry Assistance Factor, the only variable in the formula that specifically reflects the leakage risk of industrial industries. AB 398 (E. Garcia, 2017) required CARB to set industry assistance factors at 100% leakage risk for all industries, while AB 1207 (Irwin, 2025) removed the requirement that industry assistance factors be set to 100% after 2030, enabling CARB to adjust industry assistance factors to ensure that industries with the greater leakage risk are allocated more allowances than industries with lower leakage risk.<sup>47</sup> The Proposed Amendments maintain 100% industry assistance factors for all industries through 2035<sup>48</sup> to minimize the risk of emissions leakage across the industrial sector.<sup>49</sup> According to CARB, “the Proposed Amendments are informed by the technical work to support the AB 398 report to the Legislature on leakage risk as presented in the October 2025 workshop”.<sup>50</sup> The Industrial Leakage Assessment presented in the October 2025 workshop was limited in scope and contained no specific information on individual industrial sectors.<sup>51</sup>

**(B)** is the Product Benchmark, which represents the GHG emissions associated with producing one unit of a specific product.<sup>52</sup> CARB sets benchmarks for types of products to ensure that facilities producing comparable goods with similar emissions would receive similar levels of allowance allocation, all other variables being equal.<sup>53</sup> The Proposed Amendments include changes to a variety of product benchmarks including those for cement manufacturing, crude oil extraction, and transportation fuel production, which consolidates gasoline, diesel, jet fuel, renewable diesel, and sustainable aviation fuel under a single liquid hydrocarbon fuel benchmark.<sup>54</sup>

<sup>47</sup> LAO; “Overview of New Updates to The Cap-and-Invest Program”; December 2025; p5.

<sup>48</sup> CARB; “Appendix A-1: Proposed Regulation Order”; January 2026; p158-166.

<sup>49</sup> CARB; “Staff Report: Initial Statement of Reasons”; January 2026; p161.

<sup>50</sup> CARB; “Staff Report: Initial Statement of Reasons”; January 2026; p161.

<sup>51</sup> CARB; “Cap-and-Invest Program Workshop”; October 2025; p35-36;

[https://ww2.arb.ca.gov/sites/default/files/cap-and-trade/meetings/nc\\_CapInvestWorkshop\\_October2925.pdf](https://ww2.arb.ca.gov/sites/default/files/cap-and-trade/meetings/nc_CapInvestWorkshop_October2925.pdf)

<sup>52</sup> CARB; “Staff Report: Initial Statement of Reasons”; January 2026; p61.

<sup>53</sup> CARB; “Appendix A-1: Proposed Regulation Order”; January 2026; p177-195.

<sup>54</sup> CARB; “Staff Report: Initial Statement of Reasons”; January 2026; p62-63.

**(C)** is the Cap Adjustment Factor. In the current Regulation, the Cap Adjustment Factor for “Standard Activities”, which includes most industries covered under Cap-and-Invest, is reduced each year at the same rate as the overall allowance budgets as the program-wide cap gradually declines.<sup>55</sup> The Proposed Amendments maintain the existing Cap Adjustment Factors through 2031. Because the overall allowance budgets are being reduced for 2027–2030 to align with the 40% emissions reduction target, maintaining the existing Cap Adjustment Factors results in allocation to industrial facilities accounting for a larger percentage of the total allowances for 2027–2030 than under the status quo.<sup>56</sup> The Proposed Amendments set Cap Adjustment Factors for 2032–2035 that decline at the same rate as the annual allowance budgets for those years, using the same methods used to determine the Cap Adjustment Factors for 2013–2031.<sup>57</sup>

The Cap-and-Invest program contains two sets of Cap Adjustment Factors: one for standard activities, which includes approximately 93% of industrial activities covered under Cap-and-Invest,<sup>58</sup> and an alternate Cap Adjustment Factor, which is applied to facilities utilizing an exclusive and clearly defined set of industrial processes. To be eligible for the alternate Cap Adjustment Factor, a facility must have more than 50% of the total emissions produced from process emissions (e.g., approximately 60% of total GHG emissions associated with cement production in California are a result of the chemical process of limestone calcination, which is necessary to manufacture conventional cement),<sup>59</sup> operate in a sector with high emissions intensity, and be classified as having high leakage risk.<sup>60</sup> The only activities which meet these criteria are coke calcining and specified industrial processes associated with nitrogenous fertilizer manufacturing, cement manufacturing, and lime manufacturing.<sup>61</sup>

The alternate Cap Adjustment Factor declines at half the rate at which the Cap Adjustment Factor for standard activities declines, meaning that significantly more allowances are allocated to industrial facilities with the alternate Cap Adjustment Factor.<sup>62</sup> The Proposed Amendments would add the industrial activities “Mining (except oil and gas) for Supplementary Cementitious Materials” and “Nonmetallic Mineral Product Manufacturing for Supplementary Cementitious Materials” to the “Cement Manufacturing” industrial sector definition, as those materials may be used to produce an overall lower-carbon cement.<sup>63</sup> However, the Proposed Amendments do not appear to make the newly added processes eligible for the alternate Cap Adjustment Factor. The potential inclusion of any additional industrial activities under the alternate Cap Adjustment Factor would substantially increase the number of allowances allocated to the industrial facilities engaged in those activities. As the Cap-and-Invest program has finite allowance budgets aligned with California’s statutory emission reduction targets, a significant increase in allocation to industrial facilities would inevitably reduce the number of

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<sup>55</sup> CARB; “Staff Report: Initial Statement of Reasons”; January 2026; p318.

<sup>56</sup> CARB; “Cap-and-Invest Program Workshop”; October 2025; p45.

<sup>57</sup> CARB; “Staff Report: Initial Statement of Reasons”; January 2026; p60.

<sup>58</sup> CARB; “Appendix A-1: Proposed Regulation Order”; January 2026; p158-166.

<sup>59</sup> CARB; “Draft SB 596 Cement Strategy”; March 2025; p14; <https://ww2.arb.ca.gov/sites/default/files/2025-03/Draft%20Net-Zero%20GHG%20Emissions%20Strategy%20for%20the%20Cement%20Sector.pdf>

<sup>60</sup> CARB; “Staff Report: Initial Statement of Reasons”; January 2026; p59.

<sup>61</sup> CARB; “Appendix A-1: Proposed Regulation Order”; January 2026; p159-160.

<sup>62</sup> CARB; “Staff Report: Initial Statement of Reasons”; January 2026; p71.

<sup>63</sup> CARB; “Staff Report: Initial Statement of Reasons”; January 2026; p63.

allowances allocated to EDUs for ratepayer benefit and the allowances available to be auctioned for GGRF.<sup>64</sup>

**(O)** is Output, the overall production of an individual facility.

### **Change to the Electric California Climate Credit**

The Proposed Amendments would remove the prohibition on distributing the Electric California Climate Credit volumetrically.<sup>65</sup> The climate credit has historically been distributed as a lump sum on customer bills,<sup>66</sup> whereas distributing the credit volumetrically would directly reduce the price of electricity for ratepayers.<sup>67</sup> The California Public Utilities Commission (CPUC) has an ongoing proceeding to update the mechanics of the Electric California Climate Credit and recently issued a Proposed Decision to pause the distribution of the Credit, pending the CPUC considering a broader set of changes to the residential Electric California Climate Credit.<sup>68</sup>

### **Allowance Removals for Offsets Usage**

In the first two years of a three-year compliance period, covered entities are required to retire allowances or offset credits for 30% of the previous year's covered emissions. At the end of each compliance period, covered entities must surrender allowances or offset credits for both the previous year's covered emissions and the remaining 70% of covered emissions from prior years. AB 1207 requires that allowances be removed from the next year's allowance budget for the number of offsets used for compliance in the previous year. Pairing the requirement to remove allowances for the number of offsets used with the three-year compliance pattern would lead to a significant reduction in the allowance budget every three years.<sup>69</sup> The Proposed Amendments include a mechanism to limit the year-to-year variability in allowance supply by transferring allowances each year to a newly created account. The allowances in the account would then be available in reserve, to be drawn upon during years in which a high number of allowances are removed due to offset credit usage, to provide greater year-to-year stability for GGRF revenues.<sup>70</sup>

### **Manufacturing Decarbonization Incentive Allocation**

To minimize leakage risk, the Proposed Amendments include a mechanism to allocate additional allowances for covered manufacturing facilities to incentivize on-site decarbonization actions. By incentivizing projects that reduce GHG emissions from manufacturing facilities, the proposed mechanism may reduce the compliance costs of eligible facilities and thereby reduce leakage risk.<sup>71</sup> In-state manufacturers producing cement, food products, glass, metals, and other goods would be eligible for this decarbonization incentive.

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<sup>64</sup> CARB; "Staff Report: Initial Statement of Reasons"; p187;  
[https://ww2.arb.ca.gov/sites/default/files/barcu/regact/2026/cap\\_invest/nc\\_isor.pdf](https://ww2.arb.ca.gov/sites/default/files/barcu/regact/2026/cap_invest/nc_isor.pdf)

<sup>65</sup> CARB; "Appendix A-1: Proposed Regulation Order"; p225;  
[https://ww2.arb.ca.gov/sites/default/files/barcu/regact/2026/cap\\_invest/nc\\_app%20a-1.pdf](https://ww2.arb.ca.gov/sites/default/files/barcu/regact/2026/cap_invest/nc_app%20a-1.pdf)

<sup>66</sup> CPUC; "Response to Executive Order N-5-24"; February 2025; <https://www.cpuc.ca.gov/-/media/cpuc-website/industries-and-topics/reports/cpuc-response-to-executive-order-n-5-24.pdf>

<sup>67</sup> Meng & Prasad; "Using California's Cap-and-Trade Revenue to Lower Electricity Prices"; May 2025;  
<https://emlab.ucsb.edu/sites/default/files/documents/emlab-policy-brief-ca-cap-and-trade-energy-affordability.pdf>

<sup>68</sup> CPUC; "Decision Pausing The Distribution of the Large Electric Utilities' 2026 Residential Climate Credit"; February 2026; <https://docs.cpuc.ca.gov/PublishedDocs/Efile/G000/M598/K101/598101732.PDF>

<sup>69</sup> CARB; "Cap-and-Invest Program Workshop"; October 2025; p21-24.

<sup>70</sup> CARB; "Staff Report: Initial Statement of Reasons"; January 2026; p36.

<sup>71</sup> CARB; "Staff Report: Initial Statement of Reasons"; January 2026; p70.

For a full accounting of the changes in the Proposed Amendments, which also include updates to rules for market participants and changes in compliance period schedule to align with state climate targets, see the table on pages 26–28 of CARB’s Initial Statement of Reasons.

Finally, the Proposed Amendments to Cap-and-Invest are part of the next chapter of California’s international climate leadership and role within the Western Climate Initiative alongside the Province of Quebec. The linkage of California’s Cap-and-Invest market with Quebec’s carbon market, which has withstood numerous legal challenges, creates a larger, more liquid market, stabilizing allowance prices<sup>72</sup> and lowering compliance costs for California businesses.<sup>73</sup> At a time when California is strengthening international climate action to ensure consistent investments in decarbonization, it is important to acknowledge that the governments of Quebec and Washington State, which recently established a Cap-and-Invest program, are intently watching the Rulemaking process at CARB.

There is a short timeframe to reaffirm and pursue linkage with Quebec and Washington State, respectively. Key dates for linkage agreements are Quebec’s legislative session, which ends in June 2026, and Washington State’s first Cap-and-Invest compliance event in November 2027. Overall, at a time where the federal government has rescinded the Endangerment Finding<sup>74</sup> and starkly backtracked on reducing pollution, subnational partnerships provide a pathway for continued, sustained climate action.

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<sup>72</sup> Doda and Taschini; "Carbon dating: When is it beneficial to link ETSs?"; September 2017; <https://www.journals.uchicago.edu/doi/10.1086/691975>

<sup>73</sup> Resources for the Future; "Linking by Degrees: Incremental Alignment of Cap-and-Trade Markets"; April 2013; <https://www.rff.org/documents/1576/RFF-DP-13-04.pdf>

<sup>74</sup> The New York Times; "Trump Administration Erases the Government’s Power to Fight Climate Change"; February 2026; <https://www.nytimes.com/2026/02/12/climate/trump-epa-greenhouse-gases-climate-change.html>