



**SENATE ENVIRONMENTAL QUALITY COMMITTEE AND
SENATE BUDGET AND FISCAL REVIEW SUBCOMMITTEE NO. 2 ON
RESOURCES, ENVIRONMENTAL PROTECTION, AND ENERGY**

**SENATOR BLAKESPEAR
SENATOR GÓMEZ REYES
CHAIRS**

May 6, 2026, 9:00 a.m.
1021 O Street, Room 1200

JOINT INFORMATIONAL HEARING

Proposed Amendments to the Cap-and-Invest Regulation

BACKGROUND

On May 4, 2026, the chairs of the Senate Environmental Quality Committee and Budget and Fiscal Review Subcommittee No. 2 on Resources, Environmental Protection, and Energy shared with the California Air Resources Board (CARB) the following concerns with the proposed amendments to the Cap-and-Invest regulation:

- 1. The Legislature's clear intent and direction seem to not be consistently and faithfully executed.**
- 2. The proposed amendments confound our ability to achieve our climate goals and preserve the integrity of the cap.**
- 3. The proposed amendments make significant changes to the investments funded by the program without any legislative direction.**

FAQ

What is Cap-and-Invest?

- Cap-and-Invest (formerly Cap-and-Trade) is California’s flagship greenhouse gas (GHG) emission reduction program. Cap-and-trade establishes a declining limit on roughly 80% of the sources of GHG emissions throughout California (called “covered entities”), and it creates a powerful economic incentive for significant investment in cleaner, more efficient technologies. Cap-and-Invest was first authorized in 2006 under AB 32’s authority to create a “market-based compliance mechanism” and reauthorized with reforms via AB 398 (E. Garcia, Chapter 135, Statutes of 2017), AB 1207 (Irwin, Chapter 117, Statutes of 2025), and SB 840 (Limón, Chapter 121, Statutes of 2025).

What is the “cap”?

- The CARB creates allowances equal to the total amount of permissible annual emissions (i.e., the “cap”). Each year, fewer allowances are created and the annual cap declines.

What are allowances?

- One allowance equals one metric ton of carbon dioxide equivalent emissions (using the 100-year global warming potential). Allowances enter Cap-and-Invest in one of three ways: 1. free allocations to industry, 2. allocations to utilities to be consigned to auction to benefit ratepayers, or 3. for sale at auction to fund the Greenhouse Gas Reduction Fund (GGRF). In 2026, the auction price for an allowance was approximately \$30 per ton of CO₂ equivalent.

What are our climate goals?

- Under current law (i.e. SB 32 and AB 1279), California is required to reduce the state’s GHG emissions to 40% below the 1990 level by 2030 and to 85% below the 1990 level by 2045. AB 1279 set an additional goal of carbon neutrality by 2045.

Are we on track to reach our climate goals?

- In the 2022 Scoping Plan Update, CARB determined that in order to be on track for carbon neutrality in 2045, California should further strive for a 48% reduction by 2030. However, the Cap-and-Invest Draft Regulations released in January 2026, aimed instead for the statutory goal of a 40% reduction by 2030 by removing 118 million allowances, as seen below in Table 3 from the Initial Statement of Reasons (ISOR) for the Proposed Amendments to Cap-and-Invest (CARB, January 2026).

Table 3: Cumulative allowance budget scenarios reflecting GHG inventory adjustments and specified 2030 GHG emissions reduction targets.

2030 GHG Reduction Scenario	Removals Needed to Reflect GHG Inventory Updates and GHG Reduction Scenario	Cumulative 2021-2045 Budget
40%	118	4,125
48%	264	3,793
55%	392	3,503

The ISOR states that “the Proposed Amendments remove approximately 118 million allowances from the 2027-2030 annual budgets and establish post-2030 declining allowance budgets consistent

with the AB 1279 target to reduce statewide anthropogenic GHG emissions by 85% by 2045.” (ISOR, CARB 2026, p. 30)

- Removing fewer than 118 million allowances by 2030 could put California in jeopardy of not reaching its statutory climate goal.
- The April revisions to the Proposed Amendments create the Build Up California Reserve Account, which was to be populated with roughly 118 million allowances *above the cap* that can be used for projects eligible for the Manufacturing Decarbonization Incentive (MDI).

What is leakage?

- Emissions leakage is when emission reductions in California are counterbalanced by emission increases out of the state, such as a manufacturer moving to another state with laxer policies. When tasked by AB 32 to develop a market-based compliance mechanism, CARB was directed in statute to minimize leakage.
- Covered entities are evaluated as low, medium, or high risk for leakage depending on how emissions-intensive the industry is and the industry’s exposure to trade. Regardless of their determined leakage risk, the 2017 reauthorization of the program designated all industrial recipients as having high risk of leakage.

What are free industrial allowances?

- Free industrial allowances are a tool to minimize leakage. In 2026, 22% of free allowances went to industrial entities. The other free allowances are allocated to electricity utilities and natural gas providers. Entities who emit more than their free allowances must purchase additional allowances at auction.
- Free industrial allowances represent over \$1 billion in assets from the state’s primary GHG emission reduction program given freely to major sources of pollution in the state. Every industry covered by Cap-and-Invest receives free allowances, regardless of leakage risk.

What is the Greenhouse Gas Reduction Fund (GGRF)?

- GGRF is funded from the sale of allowances at auction. GGRF funding is divided into three tiers.
 - Tier 1 includes a manufacturing tax exemption (largely for electricity utilities and agriculture) and the Legislative Counsel Climate Bureau.
 - Tier 2 includes \$1 billion for High-Speed Rail Authority and \$1 billion for legislative discretionary spending.
 - Tier 3 includes the Affordable Housing and Sustainable Communities Program, the Community Air Protection Program, the Law Carbon Transit Operations Program, Wildfire and forest resilience, and the Safe and Affordable Drinking Water Program.
- Tier 1 is funded before Tier 2, and Tier 2 is funded before Tier 3. Therefore, decreases in GGRF jeopardize clean air, affordable water, and wildfire programs before other appropriations.

What is compliance cost and how does it impact affordability?

- Compliance cost is the cost for an entity to comply with the Cap-and-Invest program, either through the purchase of allowances at auction, direct emissions reductions, or purchase of offsets.

Compliance cost is impacted by the amount of free allowances, the allowance price, and the cost to decarbonize. Therefore, more free allowances or a lower allowance price can decrease compliance costs.

- Since some, if not all, compliance costs are passed onto consumers by goods purchased from covered entities, lower compliance costs can translate to more affordable goods.
- GGRF funds several public health, safety, and affordability programs. Therefore, while increasing free allowances can decrease compliance cost pass-through to consumers, it can also defund necessary affordability programs.
- The April revisions to the Proposed Amendments to Cap-and-Invest decrease GGRF revenues by 40% without the guarantee that commensurate, compliance cost savings will be passed onto consumers.

What is the Manufacturing Decarbonization Incentive (MDI)?

- First proposed in the January 2026 Proposed Amendments and amended in the April 2026 revisions to the Proposed Amendments, the MDI is an additional tool to minimize leakage. MDI provides additional free allowances to specific industries which engage in decarbonization projects, such as renewable energy generation and storage.
- Initially, MDI was allotted 40 million allowances (estimated at \$2 billion) for a 12-year period (2027 to 2038) and excluded fossil fuel extraction, refining, and manufacturing. The 40 million allowances were borrowed from future allocations, meaning additional allowances would be retired after the MDI program ended.
- Presently, MDI has been allotted 118 million allowances (estimated at \$4 billion) *above the cap* through the Build Up California Reserve Account for an 8-year period (2028 to 2035). The Build Up California Reserve Account was newly created in the more recent amendments to the Cap-and-Invest regulations. Additionally, the eligibility was expanded to fossil fuel refining and manufacturing.
- **The creation of new allowances above the cap of a cap-and-trade program undermines the integrity of the cap. The magnitude of allowances introduced by MDI jeopardizes California's climate goals.**

What else changed in the Draft Regulations between January and April?

- Free allowances to industry were increased by \$800 million.
- The 2027 to 2030 revenues to the GGRF are estimated to decrease by 40%.
- Industrial allocations are only estimated through 2030, leaving *substantial uncertainty* in free allocations, MDI allocations, and GGRF revenues beyond 2030. Without industrial allocations beyond 2030, it is impossible to understand how much MDI has expanded at the expense of other portions of Cap-and-Invest.
- In summary, from January to April, **MDI was increased by nearly 3 times as many allowances, 2 times the budget, over 4 fewer years to a wider array of polluting industries alongside a 40% decrease in GGRF revenues.**