

FEBRUARY 23, 2026

Overview of New Updates to the Cap-and-Invest Program

PRESENTED TO:

Joint Legislative Committee on Climate Change
Policies
Hon. Jacqui Irwin, Chair



LEGISLATIVE ANALYST'S OFFICE

Introduction

Legislature Adopted Cap-and-Invest Legislation at the End of the 2025 Session. In September 2025, the Legislature adopted Chapter 117 of 2025 (AB 1207, Irwin) and Chapter 121 of 2025 (SB 840, Limón), which extended and made various changes to the cap-and-invest program. These changes:

- Modified the program’s design features and allowance allocations.
- Added reporting, evaluation, and oversight provisions.
- Changed the allocation of Greenhouse Gas Reduction Fund (GGRF) revenues.

Overview of Handout. This handout summarizes (1) key components of AB 1207 and SB 840 and (2) some notable implications of these two pieces of legislation.



Key Components of Legislation

Key Changes in Cap-and-Invest Design Features and Allowance Allocations	
Prior Law and/or Regulation	AB 1207 and SB 840 ^a
Program Sunset and Name	
<ul style="list-style-type: none"> Sunset date of January 1, 2031. Program named “cap-and-trade.” 	<ul style="list-style-type: none"> Sunset date of January 1, 2046. Expresses intent to rename the program “cap-and-invest.”
Linkage to State Climate Goals	
<ul style="list-style-type: none"> General guidance to CARB to set emission limits to meet the state’s GHG reduction goals. 	<ul style="list-style-type: none"> Explicit requirement that CARB set emission limits to ensure the state meets, at a minimum, its 2030 and 2045 goals.
Use of Offsets	
<ul style="list-style-type: none"> Use of offsets does not affect allowance budget. Covered entities can meet 6 percent of compliance obligations with offsets in 2026 through 2030. No requirement that CARB update its offset protocols. No requirement for CARB to prepare a study on offsets. 	<ul style="list-style-type: none"> Reduces the subsequent year’s allowance budget for each offset used. CARB to determine the degree to which covered entities can meet compliance obligations with offsets (no more than 6 percent). 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. CARB must prepare a study on offsets by December 31, 2026.
Allowances Provided to Utilities	
<ul style="list-style-type: none"> Electric and natural gas utilities allocated free allowances (roughly one-quarter and one-eighth of total allowances, respectively) to benefit ratepayers. 15 percent of electric IOU allowances may be provided for clean energy and energy efficiency. Electric IOU rebates must be provided to residential, small business, and emissions-intensive trade-exposed retail customers. Electric IOU rebates provided twice annually (in April and October) and natural gas rebates provided once annually (in April). Electric IOUs required to adopt and implement customer outreach plans to inform the public about utility rebates. POUs can use allowances for various purposes that benefit ratepayers. 	<ul style="list-style-type: none"> CARB must develop regulations to transition gas utilities’ free allowances to electric utilities by January 1, 2031. 5 percent of electric IOU allowances must be provided to support a California Transmission Accelerator Revolving Fund through July 1, 2031. Electric IOU rebates must be provided to residential customers. Small business and certain retail customers may also be provided rebates, as determined by CPUC. Residential electric IOU rebates must be provided in up to the four highest-billed months. Electric IOUs required to update their customer outreach plans. POUs 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.)
Allowances Provided to Industry	
<ul style="list-style-type: none"> CARB must assume the highest leakage risk for all industries. 	<ul style="list-style-type: none"> Starting in 2031, CARB must distribute allowances to minimize leakage risk to cost-effectively meeting the state’s climate goals.
Price Ceiling	
<ul style="list-style-type: none"> Proceeds from permits sold at the price ceiling must be used to purchase offsets. General direction for CARB to consider avoiding adverse impacts on households, businesses, and the economy (among various other factors) when establishing the price ceiling. 	<ul style="list-style-type: none"> 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. 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.
<p>^a 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).</p> <p>CARB = California Air Resources Board; GHG = greenhouse gas; IOUs = investor-owned utilities; CPUC = California Public Utilities Commission; and POU’s = publicly owned utilities.</p>	



Key Components of Legislation

(Continued)

Some Key Changes to Program’s Design Features and Allowance Allocations

Extends Program Through 2045 and Renames It Cap-and-Invest.

Extends the California Air Resources Board’s (CARB’s) explicit authority to operate the program—which had been set to expire at the end of 2030—through the end of 2045.

Makes Some Changes to Program’s Design Features. For example, AB 1207 specifies that for each offset that is used to meet a compliance obligation, an allowance is removed from the subsequent year’s allowance budget. (This approach is often referred to as placing offsets “under the cap.”)

Modifies Utility and Industry Allowances. Assembly Bill 1207 makes various modifications to the way free allowances are provided to utilities and industry, including:

- ***Reallocates Allowances Across Different Types of Utilities.*** Requires (1) CARB to design regulations that, by January 1, 2031, shift the free allowances that natural gas utilities currently receive to instead be allocated to electric utilities; and (2) the California Climate Credit be provided to residential electric customers of investor-owned utilities up to four times a year during the highest billed months or to address unforeseen circumstances (rather than twice annually in April and October, as currently is the case).
- ***Reduces Required Allowances for Certain Industries.*** Starting January 1, 2031, replaces a requirement that CARB assume the highest leakage risk for all industries with a requirement that CARB distribute allowances in a way that reduces leakage risk to cost-effectively meeting the state’s greenhouse gas (GHG) reduction goals.



Key Components of Legislation

(Continued)

Makes Changes Related to the Price Ceiling. Assembly Bill 1207 specifies that the proceeds from the sale of permits sold at the price ceiling must be deposited into a newly established Climate Mitigation Fund to be available, upon legislative appropriation, for direct rebates and other purposes. This contrasts with prior law, which specified the proceeds must be used to pay for mitigation outside of the capped sectors (i.e. the purchase of offsets). Assembly Bill 1207 also adds new direction to CARB to consider actions to ensure consumers are protected—such as modifying the price ceiling—if it finds that the program’s structure does not adequately protect consumers.



Key Components of Legislation

(Continued)

Adds New Reporting, Evaluation, and Oversight Requirements

Expresses Intent to Create a New Oversight Entity. New entity would be housed within the Office of Legislative Counsel, with roles responsibilities to be determined through subsequent legislation.

Extends Responsibilities of Existing Oversight Entities. Extends the sunset dates for the existing Compliance Offset Protocol Task Force and Independent Emissions Market Advisory Committee from 2030 to 2045. Also, extends a requirement that the Legislative Analyst’s Office provide an annual report through January 1, 2046.

Requires CARB to Conduct Additional Reporting and Evaluation Activities. For example, AB 1207 requires CARB to evaluate the cost impacts of the cap-and-invest program when it revises regulations for the program. The legislation also includes a requirement that CARB transmit any major regulations pertaining to the cap-and-invest program—as well as related board hearing agendas—to relevant committees of the Legislature.



Key Components of Legislation

(Continued)

Modifications to Statutorily Required GGRF Appropriations Pursuant to SB 840^a

Program	Department	Prior Statutory Allocations	Starting in 2026-27 ^b
Starting in 2026-27, funding will be allocated first to the following programs:			
Manufacturing tax exemption	N/A	<ul style="list-style-type: none"> • Roughly \$160 million. • Sunsets on July 1, 2030. 	<ul style="list-style-type: none"> • No changes (maintains sunset).
State Responsibility Area fee backfill	CalFire	<ul style="list-style-type: none"> • Roughly \$90 million. • Sunsets on January 1, 2031. 	<ul style="list-style-type: none"> • No changes (maintains sunset).
Legislative Counsel Climate Bureau	Legislative Counsel	<ul style="list-style-type: none"> • None. 	<ul style="list-style-type: none"> • \$3 million annually.
Then second to the following programs:			
High-speed rail project	HSRA	<ul style="list-style-type: none"> • 25 percent of annual revenues. • No sunset. 	<ul style="list-style-type: none"> • \$1 billion annually.
Unspecified programs subject to appropriation	Various	<ul style="list-style-type: none"> • None. 	<ul style="list-style-type: none"> • \$1 billion annually.
Then third, if funding is available, to the following programs:^c			
Affordable Housing and Sustainable Communities Program	SGC	<ul style="list-style-type: none"> • 20 percent of annual revenues. • No sunset. 	<ul style="list-style-type: none"> • \$800 million annually.
TIRCP	CalSTA	<ul style="list-style-type: none"> • 10 percent of annual revenues. • No sunset. 	<ul style="list-style-type: none"> • \$400 million annually.
Community Air Protection Program—AB 617 ^d	CARB	<ul style="list-style-type: none"> • None.^e 	<ul style="list-style-type: none"> • \$250 million annually.
Low Carbon Transit Operations Program	Caltrans	<ul style="list-style-type: none"> • 5 percent of annual revenues. • No sunset. 	<ul style="list-style-type: none"> • \$200 million annually.
Wildfire and forest resilience—SB 901 ^f	CalFire	<ul style="list-style-type: none"> • \$200 million annually. • Sunsets on June 30, 2029. 	<ul style="list-style-type: none"> • \$200 million annually.
Safe and Affordable Drinking Water Program	SWRCB	<ul style="list-style-type: none"> • 5 percent of annual revenues (up to \$130 million). • Sunsets on June 30, 2030. 	<ul style="list-style-type: none"> • \$130 million annually.
Then fourth, remaining funding is subject to legislative appropriation for discretionary purposes.			

^a Chapter 121 of 2025 (SB 840, Limón).

^b No sunset date unless otherwise noted.

^c 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.

^d Chapter 136 of 2017 (AB 617, C. Garcia).

^e AB 617 did not have a prior statutory allocation, but the program historically has received roughly \$250 million annually on a discretionary basis.

^f Chapter 626 of 2018 (SB 901, Dodd).

GGRF = Greenhouse Gas Reduction Fund; CalFire = California Department of Forestry and Fire Protection; 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.



Issues for Legislative Consideration and Oversight

Cap-and-Invest Program: Issues for Legislative Consideration and Oversight

- ✓ Extension helps ensure key climate strategy can continue and provides important program certainty.
- ✓ While the legislation maintains most aspects of the program—including significant discretion for CARB—changes reflect legislative goals.
- ✓ Changes in GGRF allocations will affect funding for particular programs.
- ✓ Certain effects of the legislation will become clearer over time and will depend on CARB decisions.
- ✓ Some important legislative decisions remain.
- ✓ Legislative oversight of program continues to be important.
- ✓ Oversight provisions could potentially help the Legislature ensure the program is meeting intended goals but effectiveness will depend upon implementation.

CARB = California Air Resources Board and GGRF = Greenhouse Gas Reduction Fund.

While Legislation Maintains Most Aspects of Program—Including Significant Discretion for CARB—Changes Reflect Legislative Goals.

Some provisions—such as putting offsets under the cap—are likely to have implications for GHG reduction. Other provisions—such as redirecting the proceeds of the sale of permits sold at the price ceiling to reduce consumer costs—could help address affordability.

Certain Effects of Legislation Will Become Clearer Over Time and Will Depend on CARB Decisions. The program’s impacts on GHG reductions and consumer costs will be heavily dependent on CARB’s forthcoming decisions, such as on the following:

- ***Number of Allowances Issued.*** The aggregate number of allowances CARB decides to issue will affect not only emissions levels but also the scarcity of allowances. This will, in turn, impact allowance prices and costs paid by households and businesses.



Issues for Legislative Consideration and Oversight

(Continued)

- **Allocation of Allowances Among Purposes.** How CARB decides to allocate allowances across various broad purposes—such as selling them to benefit GGRF or providing them for free to industry and/or utilities—ultimately will determine where the revenue from the charges paid by emitters will go. If, for example, CARB allocates a relatively smaller share of allowances to utilities (and a larger share to GGRF and/or industry), utility customers would receive smaller rebates—and therefore experience higher costs—than would otherwise be the case.

Legislative Oversight of Program Continues to Be Important.

- **Stakes Are High.** The program has the potential to have significant implications for some of the state’s key priorities, such as GHG reduction and affordability, but the specifics of how the program operates will determine how effective it is at achieving those priorities.
- **Meeting All of the Legislature’s Goals Will Be Difficult.** The Legislature’s climate goals are ambitious and are likely to come with trade-offs, such as related to costs to households and businesses. Monitoring the program’s implementation will be an important way for the Legislature to help ensure that the state is striking its intended balance between key goals and priorities.
- **CARB’s Regulations Could Have Important Implications for the Program.** In January 2026, CARB released proposed regulations that incorporate some changes in response to AB 1207, as well as some other modifications. Closely monitoring this and other future rulemaking efforts—and providing input on them, as appropriate—can help ensure the board’s decisions are in line with the Legislature’s vision.

