

# California Legislature

April 8, 2026

Ms. Lauren Sanchez, Chair  
California Air Resources Board  
1001 I Street  
Sacramento, CA 95864

## Re: Proposed 2026 Amendments to the Cap-and-Invest Regulation

Dear Chair Sanchez and Board Members:

### INTRODUCTION: AFFORDABILITY THROUGH DESIGN

We write as a bipartisan-bicameral group of California legislators who believe that the state's climate program and its economy are most durable when they move together. Cap-and-Invest is a genuine achievement. California built something no other state has managed at comparable scale: a market-based program that has reduced emissions cost-effectively, raised significant public revenue, provided direct ratepayer relief, and maintained broad legislative support across multiple administrations. We do not take that accomplishment lightly, and we are not here to dismantle it.

What we are asking is something more specific, and achievable. The proposed 2026 amendments present California Air Resources Board (CARB) with an opportunity to embed strong affordability measures and robust leakage protection directly into program design. The statutes authorize exactly that approach. The evidence in front of the Board makes it necessary.

California's enabling legislation has been clear on these points from the beginning. AB 32 required that CARB adopt regulations that achieve cost-effective emissions reductions while accounting for economic impacts on California businesses and consumers.<sup>1</sup> SB 32 reinforced those objectives for the post-2020 period.<sup>2</sup> AB 398 directed CARB to minimize leakage, avoid or minimize ratepayer costs, and deliver a statutory leakage report to the Legislature by December 31, 2025.<sup>3</sup> AB 1207, enacted in 2025, made the

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<sup>1</sup> California Health and Safety Code § 38562(a)(1)-(2), as enacted by AB 32 (Nunez, Chapter 488, Statutes of 2006). CARB shall adopt regulations to achieve the maximum technologically feasible and cost-effective reductions and shall ensure that activities undertaken do not disproportionately impact low-income communities.

<sup>2</sup> SB 32 (Pavley, Chapter 249, Statutes of 2016). Established a 2030 greenhouse gas reduction target of 40 percent below 1990 levels and extended CARB's regulatory authority and cost-effectiveness obligations.

<sup>3</sup> California Health and Safety Code § 38562(c)(2)(I), as enacted by AB 398 (Garcia, Chapter 135, Statutes of 2017): "Report to the Legislature, by December 31, 2025, on the progress toward meeting the greenhouse gas emissions reduction targets established pursuant to Sections 38550 and 38566 and the leakage risk posed by the regulation. The state board shall include recommendations to the Legislature on necessary statutory changes to the program to

transition of Natural Gas Supplier (NGS) allocation to Electric Distribution Utilities (EDU) a design requirement and mandated that regulations not disproportionately impact low-income communities.<sup>4</sup> The weight of this statutory direction is cumulative. It points toward a program that uses its mechanisms, including free allocation, to solve today's affordability and leakage problems.

We want to be direct about the tradeoff our recommendations involve. Stronger free allocation and leakage protections mean less allowance revenue coming from auctions. Program revenue will be lower than under the CARB proposal. We accept that tradeoff because we believe the value, in the form of decreased costs, preserving in-state industries, and economic stability for households and businesses in California is reflective of what California needs.

California's climate and energy goals are significant, however with the documented affordability and leakage issues now facing the state, we believe Cap-and-Invest is being asked to do more than pure mathematical compliance. The program was designed to be durable, which requires calibration; climate and energy policies must be implemented in a way that can adjust to real economic conditions.

The regulatory decisions CARB is making are being made in an economic environment materially different from the first 10 years of Cap-and-Trade. California faces persistent affordability pressures across electricity, transportation fuels, groceries, and housing. Industrial facilities like refining, food processing, manufacturing, glass, and cement have reduced output, closed, or announced closures. Supply chains have grown more global, not less, resulting in increased global emissions, not less.

The proposed removal of approximately 118 million allowances from the 2027-2030 budgets is significant in its own right. CARB's ISOR is explicit on the near-term stringency this produces: the average annual cap decline under the proposed amendments is approximately 11 percent per year from 2027-2030, compared to roughly 4.6 percent under the current regulation. That is a near-doubling of the annual budget reduction rate.<sup>5</sup> Layered on top is a post-2031 step-down in the Cap Adjustment Factor that CARB's own analysis acknowledges could produce material volatility and leakage risk if not managed carefully. Our recommendations address that risk at the mechanism level before it becomes a consumer cost problem.

## SUMMARY OF RECOMMENDATIONS

Taken together, the recommendations in this letter would reduce costs by an estimated **\$10-\$15 billion from being passed through to California electricity ratepayers and broader economy** over 2027-2035, using CARB's own \$68 per tonne weighted average price assumption from ISOR Table 21. That value does not disappear from the program. It avoids becoming a cost that must be absorbed by electricity bills, gas bills, and fuel prices. Fuels and covered sectors will continue operating under the declining cap, providing

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reduce leakage, including the potential for a border carbon adjustment, while maintaining the state's ability to reach its targets."

<sup>4</sup> AB 1207 (Irwin, Chapter 117, Statutes of 2025). California Health and Safety Code § 38562(b)(1)(B)(i) (NGS-to-EDU transition design requirement); § 38562(b)(2) (disproportionate impact prohibition on low-income communities).

<sup>5</sup> CARB, Staff Report: Initial Statement of Reasons for Proposed Amendments to the California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms Regulation (January 20, 2026) [hereinafter ISOR], p. 33. The proposed amendments produce an average annual cap decline of 11 percent from 2027-2030, compared to approximately 4.6 percent under the current regulation (derived from ISOR Table 4).

ongoing auction revenue, even as free allocations are held at protective levels for sectors facing documented leakage. The Cap Adjustment Factor section of this letter provides the full breakdown by mechanism.

## SUMMARY OF RECOMMENDATIONS

### Utility Allocation and Ratepayer Protection

- **Rec. 1a:** Minimize negative impacts to ratepayers by designing a natural gas to electric utility allowance transition with a moderate, phased, transition pace while reserving 30% of these allowances exclusively to support low-income residential gas bills.
- **Rec. 1b:** Require CARB to publish a net annual bill impact analysis for dual-fuel residential households across the full transition window, prior to the Board Hearing.

### EDU Allowance Allocation

- **Rec. 2a:** Ensure EDU allowance allocation continues to reward voluntary decarbonization and protect electricity ratepayer affordability, consistent with the design intent of the existing 10-year framework.
- **Rec. 2b:** Adopt the Effective RPS approach (nominal RPS reduced 25 percent to reflect PCC 2/3 statutory flexibility) for all EDU allocation periods.
- **Rec. 2c:** Defer EDAM inclusion in the outstanding emissions calculation until the system has launched, data pathways are validated, and an error-correction mechanism is in place.

### Cap Adjustment Factor and Leakage Protection

- **Rec. 3a:** Reclassify petroleum refineries (NAICS 324110) and food processing (NAICS 311) from Medium to High leakage risk, consistent with documented facility closures and CEC's June 2025 formal findings.
- **Rec. 3b:** Lock the Cap Adjustment Factor at the 2024 Alt-CAF level of 0.858 for all current and newly reclassified high-leakage sectors for at least ten years (2026-2035 at minimum).
- **Rec. 3c:** Extend CAF and Assistance Factor values through at least 2045 to fill the post-2035 regulatory void and provide capital investment planning certainty.

### Issues for Continued Engagement

- **MDI Access:** All high-leakage sectors should have access to the Manufacturing Decarbonization Incentive.
- **Offsets:** The Legislature should revisit offset limits considering AB 1279's allowance for 15 percent indirect emission reductions toward carbon neutrality.
- **CCUS:** CARB should complete the SB 905 work and provide a clear compliance recognition pathway with provisional approval authority.

## UTILITY ALLOCATION AND RATEPAYER PROTECTION: HOUSEHOLD AFFORDABILITY

For most Californians, the Cap-and-Invest program is not experienced as an emissions trading market. It appears as a line on an energy bill, or more precisely, as a credit that reduces what that bill would otherwise be. The California Climate Credit, funded by allowances freely allocated to electric and gas utilities, is the program's most visible consumer-facing mechanism. It is also, by design, the primary

instrument through which CARB meets its statutory obligation to minimize ratepayer impacts. The Proposed Amendments make significant changes to both the level and the distribution of that value, and those changes deserve careful scrutiny before the Board finalizes the regulation.

**A. The NGS-to-EDU Transition: Pace, Value, and the 2031 Statutory Question**

AB 1207 directed CARB to design regulations that transition support from gas corporations to electrical distribution utilities, to minimize ratepayer impacts, on or before January 1, 2031.<sup>6</sup> The Proposed Amendments implement that direction through a phased transfer schedule beginning in vintage year 2029 at 20 percent and adding 10 percent per year, completing the full transition at 100 percent in 2037.<sup>7</sup>

The total value at stake is substantial. Using CARB's own projected allowance price trajectory from ISOR Table 21, the IOU NGS sector will receive approximately \$1.6 billion in annual allocation value in 2027, declining to roughly \$968 million in 2035 as the CAF falls and the transition advances.<sup>8</sup> Table 1 below shows the year-by-year distribution of that value between gas and electric customers across the transition window.

**Table 1: NGS Allocation Value and Transition to EDUs, 2027-2037**

Year	NGS CAF	Total NGS Alloc. Value (\$M)	% to EDU	Value to EDU (\$M)	Value to NGS (\$M)	Est. Gas Credit/Residential Customer
2027	0.613	\$1,636	0%	\$0	\$1,636	~\$152
2028	0.579	\$1,623	0%	\$0	\$1,623	~\$150
2029	0.545	\$1,576	20%	\$315	\$1,261	~\$117
2030	0.511	\$1,523	30%	\$457	\$1,066	~\$99
2031	0.494	\$1,494	40%	\$598	\$897	~\$83
<b>2032</b>	<b>0.348</b>	<b>\$1,084 (CAF cliff)</b>	<b>50%</b>	<b>\$542</b>	<b>\$542</b>	<b>~\$50</b>
2033	0.324	\$1,038	60%	\$623	\$415	~\$38
2034	0.301	\$1,004	70%	\$703	\$301	~\$28

<sup>6</sup> California Health and Safety Code § 38562(b)(1)(B)(i), as amended by AB 1207 (Chapter 117, Statutes of 2025).

<sup>7</sup> CARB, Proposed Regulation Order (Appendix A-1, January 2026) [hereinafter Proposed Regulation Order], Table 9-6A, p. 250. Percentages: 20 percent (2029), 30 percent (2030), 40 percent (2031), 50 percent (2032), 60 percent (2033), 70 percent (2034), 80 percent (2035), 90 percent (2036), 100 percent (2037 and beyond).

<sup>8</sup> Dollar values estimated from ISOR, Table 21 (allowance price trajectory, p. 320); see also Assemblymember Irwin et al., Letter to CARB Chair Lauren Sanchez (March 9, 2026) (citing approximately \$3 billion in total NGS allocation value 2027-2030 based on the November 2025 auction settlement price).

Year	NGS CAF	Total NGS Alloc. Value (\$M)	% to EDU	Value to EDU (\$M)	Value to NGS (\$M)	Est. Gas Credit/Residential Customer
2035	0.279	\$968	80%	\$774	\$194	~\$18
2036	0.279	\$993	90%	\$894	\$99	~\$9
2037+	0.279	\$1,030	100%	\$1,030	\$0	\$0

**Note:** Dollar values estimated using ISOR Table 21 allowance price trajectory (\$60-\$83/tonne, 2027-2037) and approximately 10.8 million residential IOU gas customers. The 2032 row reflects simultaneous CAF cliff and 50 percent transition. All figures are model estimates.

Two features of Table 1 warrant particular attention. First, the 2032 compound effect. The Standard CAF drops from 0.494 to 0.348 in a single year, a 29.6 percent reduction, at the same moment 50 percent of remaining NGS allocation is transitioning to EDUs. The combined effect reduces the value available for the gas Climate Credit from approximately \$897 million in 2031 to \$542 million in 2032, a drop of \$355 million in a single budget year. That is a 40 percent reduction in the value protecting gas customers, driven by two simultaneous mechanisms that CARB has not analyzed together in the ISOR.

Second, the plain text of AB 1207 should be read carefully. Health and Safety Code section 38562(b)(1)(B)(i) directs CARB to "design the regulations ... in a manner that transitions support from gas corporations to electrical distribution utilities ... to minimize ratepayer impacts." The operative phrase is "design the regulations," not "complete the transition." The 2031 date is a regulatory design deadline. Critically, the same sentence embeds a balancing mandate: the regulations must minimize ratepayer impacts. A moderate, phased transition such as CARB's 2029-2037 proposal in the ISOR paired with reserving 30% of the NGS allowances specifically to continue to support low-income gas customers would help provide this balance. Approximately 30% of state-wide IOU NGS customers are in low-income programs and are most likely to remain on the natural gas system the longest; reserving a similar percentage of the IOU NGS allowances would ensure ongoing support for mitigating the compliance costs of Cap-and-Invest for the residential customers who need it the most.

### **B. The Equity Gap: Who Bears the Transition Cost**

The transition, as currently designed, appears regressive in its interim distributional effects. Households that have already electrified gain a larger electric Climate Credit as NGS allocation shifts to EDUs. Approximately 80 percent of California households remaining on natural gas, and more heavily concentrated among renters, lower-income residents, and multi-family housing occupants, receive a declining gas Climate Credit while their gas bills may not fall proportionally.<sup>9</sup>

<sup>9</sup> The approximately 80 percent figure for dual-fuel households is referenced in the Assemblymember Irwin letter (March 9, 2026) and is consistent with CEC household energy use surveys. Lower-income households and renters

Table 2 quantifies the estimated net annual credit change by household type across the transition window. A dual-fuel household that has not been electrified by 2035 stands to lose approximately \$134 per year in gas Climate Credit while gaining approximately \$57 per year in electric Climate Credit, a net annual loss of roughly \$77. A fully electrified household gains the full \$57 with no offsetting loss.

**Table 2: Estimated Annual Climate Credit Impact by Household Type, 2027-2035**

Household Type	2027 Credit (Baseline)	2031 Credit (40% Transitioned)	2035 Credit (80% Transitioned)	Net Change 2027-2035
Fully electrified (no gas service)	\$0 gas + \$0 elec add	\$0 gas + ~\$44/yr elec	\$0 gas + ~\$57/yr elec	+\$57/yr by 2035
Dual-fuel (gas + electric, not yet electrified) -- ~80% of CA households	~\$152/yr gas + base elec	~\$83/yr gas + ~\$44/yr elec	~\$18/yr gas + ~\$57/yr elec	-\$76/yr net (loses \$134 gas, gains \$57 elec)
Renter in multi-family -- most likely to remain dual-fuel	~\$152/yr gas credit	~\$83/yr gas credit	~\$18/yr gas credit	-\$134/yr gas loss. Electric credit may not offset if landlord receives it.

**Note:** Estimates based on Table 1 calculations. Multi-family renter row reflects additional risk that the electric Climate Credit may not flow directly to tenants if the EDU account holder is the building owner. All figures are model estimates.

The data in Table 2 support the conclusion that the transition as currently designed is regressive in its interim distributional effects. The households least able to absorb energy cost increases, those who cannot afford to electrify on short timelines, bear the largest net credit reduction during the transition window. This is not an argument against the transition. It is an argument for building explicit equity protections into the transition mechanics before the regulation is finalized.<sup>10</sup>

AB 1207's direction is unambiguous: CARB must ensure that activities undertaken to comply with the regulations do not disproportionately impact low-income communities.<sup>11</sup> CARB cannot make that finding without the kind of disaggregated analysis described in Recommendation 1b. No equivalent CPUC proceeding currently protects gas customers whose annual credit shrinks from approximately \$152 to near

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are represented among the majority remaining on gas, as electrification retrofit costs are generally borne by property owners rather than tenants.

<sup>10</sup> ISOR, pp. 52-53. CPUC initiated rulemaking R.25-07-013 in July 2025 to review and improve the residential electric California Climate Credit for IOU EDUs. No equivalent CPUC proceeding has been initiated for the gas Climate Credit, creating an asymmetric procedural protection gap.

<sup>11</sup> California Health and Safety Code § 38562(b)(2), as amended by AB 1207 (Chapter 117, Statutes of 2025).

zero over the transition window, while CPUC rulemaking R.25-07-013 actively addresses the electric credit side.

**Recommendation 1a:**

Design a phased, incremental NGS allowance transition while also retaining at least 30% of the allowances to moderate the impact on low-income residential gas customers who cannot electrify on short timelines.

**Recommendation 1b:**

Require CARB to publish, prior to the Board Hearing, a net annual bill impact analysis for dual-fuel residential households in each year of the transition window from 2029 through 2037. To the extent possible the analysis should be disaggregated by income level, tenure type (owner vs. renter), and housing type (single-family vs. multi-family), consistent with CARB's environmental justice obligations under AB 32 and AB 1207.

**EDU ALLOWANCE ALLOCATION: PRESERVE THE FRAMEWORK, CORRECT THE METHODOLOGY**

The allowances allocated to electrical distribution utilities are the primary mechanism through which the Cap-and-Invest program protects electricity ratepayers from compliance cost passthrough. The Proposed Amendments contain methodology choices that appear to undercut that objective in two distinct and compounding ways: abandoning the fixed 10-year allocation framework mid-cycle and applying an RPS percentage that does not align with the compliance flexibility provided in the RPS statute.

**A. The Allocation Design Intent: Incentivizing Decarbonization**

In 2017, CARB deliberately adopted a fixed 10-year allocation schedule for 2021-2030, to provide regulatory certainty, encourage voluntary GHG reductions, and protect ratepayers from compliance cost passthrough. CARB's own Final Statement of Reasons for that rulemaking stated explicitly that fixed allocations were chosen because voluntary reductions would reduce compliance costs without changing allocations, creating a net benefit and incentivizing early decarbonization.<sup>12</sup>

The proposed amendments penalize that success. Because EDUs have reduced emissions faster than the original forecast assumed, the updated data now shows they need fewer allowances. CARB proposes to respond by cutting the allocation to match. This inverts the program's logic: the fixed-allocation structure was designed so utilities would keep the benefit of their over-compliance. Recalibrating mid-cycle claws back that benefit and eliminates the incentive for the next round of voluntary action.

As the Joint Utility Group has documented, the proposed reduction amounts to an estimated loss of \$4.9 billion in allowance value over 2027-2030, based on a \$60 per allowance price assumption.<sup>13</sup> For 2027

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<sup>12</sup> CARB, Final Statement of Reasons for Rulemaking: California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms (2017), discussing the rationale for fixed 10-year EDU allocation schedules and the early-action incentive structure.

<sup>13</sup> Joint Utility Group comment letter filed March 9, 2026, pp. 1-6 (citing SRIA Appendix C, Table 50, \$60 assumed allowance price; comparing current Table 9-4 to proposed 2027-2030 allocation over four years).

alone, the proposed cut represents a 39 percent reduction in total EDU allowances, a \$1.6 billion reduction in a single year. At a moment when electricity rates are rising and customers are being asked to electrify their homes and vehicles, this reduction in the primary protective mechanism available to offset those pressures is particularly ill-timed.

## **B. The RPS Methodology Gap**

Separately, the Proposed Amendments apply an RPS percentage that does not align with the allowable use of PCC 2 and PCC 3 resources. CARB applies the statutory SB 100 RPS floor of 60 percent by 2030, minus 5 percent for firm-and-shape, leaving a 55 percent net zero-carbon share. The residual 45 percent is attributed to fossil fuel compliance costs. However, California's RPS statute explicitly permits up to 25 percent of RPS-compliant procurement to come from Portfolio Content Category 2 or 3 resources.<sup>14</sup> PCC 2 and PCC 3 products retain a Cap-and-Invest compliance obligation and are not zero-emitting for allocation purposes. The Joint Utility Group's proposed correction, reducing the nominal RPS percentage by 25 percent to derive an Effective RPS, is well-grounded in the methodology's own logic. For 2030, that calculation produces an Effective RPS of 45 percent rather than the current 55 percent net.

### **Recommendation 2a:**

Work with utilities and the CPUC to ensure that EDU allowance allocation methodology continues to incentivize voluntary decarbonization and protect electricity ratepayer affordability. Any revision to the existing allocation framework should preserve the design intent of the 2017 rulemaking: that utility customers retain the benefit of over-compliance, that ratepayers are protected from compliance cost passthrough, and that the program does not penalize early action. CARB should not finalize a methodology that reduces allocation relative to current Table 9-4 levels without demonstrating that the revised approach meets these objectives.

### **Recommendation 2b:**

Adopt the Effective RPS approach proposed by the Joint Utility Group for EDU allocation calculations, applying a 25 percent reduction to the nominal RPS target to reflect the statutory flexibility that permits up to 25 percent of RPS-compliant procurement from PCC 2/3 resources. For 2030, the Effective RPS is 45 percent.

### **Recommendation 2c:**

Defer incorporation of EDAM into the outstanding emissions framework until EDAM has launched, data pathways have been validated, and a formal error-correction mechanism has been established. Premature inclusion risks mis-accounting that would incorrectly reduce EDU allowance allocations, with no existing mechanism for correction, as occurred with WEIM during 2021-2022.

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<sup>14</sup> Public Utilities Code § 399.16(c)(1) permits up to 25 percent of RPS-eligible procurement from Portfolio Content Category 2 or 3 resources. PCC 2 and PCC 3 products retain a Cap-and-Invest compliance obligation under the Mandatory Reporting Regulation and are not zero-emitting for allocation purposes. SB 350 (Stats. 2015, ch. 547), § 21.

## THE CAP ADJUSTMENT FACTOR

Leakage is not a theoretical concern. When in-state production capacity declines and imports increase to meet unchanged demand, emissions shift and are likely to increase globally. Consumers face higher prices from supply constraints and transportation costs, workers, many of them members of trades and building unions with deep roots in refinery towns, cement communities, and food processing regions, lose not just jobs but career pathways, pension contributions, and the kind of stable employment that anchors working-class communities. California's manufacturing base will erode in ways that we are concerned cannot be reversed. When California transportation fuel production costs are higher than the cost to produce and import similar fuels, in-state facilities suffer, as they cannot compete with cheaper imports not subject to stationary source fees.

The result is not emissions reductions it is production displacement. Every covered facility that leaves California leaves manufacturing employment, adjacent business activity, local property and business tax revenue. A static CAF does not lower the cap; it preserves the industrial base that the program aims to decarbonize rather than displace. The CAF floor provides interim protection while California works toward the more durable solution: ensuring that goods and fuels entering California from jurisdictions without equivalent carbon pricing face a corresponding adjustment at the border, so that the competitive disadvantage created by in-state carbon costs does not simply export production, and emissions, elsewhere.

California's ratio of industrial free allowance allocation to industrial covered emissions stands at approximately 62 percent, the lowest of any major comparable program. Washington State's Cap-and-Invest program provides EITE industries with no-cost allowances equal to 94 percent or more of baseline emissions through 2034. Quebec sits at 99 percent, the EU at 84 percent, and the United Kingdom at 72 percent.<sup>15</sup> In the context of a budget removal that accelerates 2027-2030 compliance pressure and a post-2031 CAF step-down of approximately 30 percent, California's comparative disadvantage is not hypothetical; it is a quantifiable structural risk.

### A. Reclassifying Leakage Risk

Table 8-1 of the Proposed Regulation Order classifies petroleum refineries (NAICS 324110) as medium leakage risk, placing them on the Standard CAF trajectory. That classification predates two major refinery closures, an unprecedented gasoline import surge, and a formal determination by the Governor's own energy agency that the sector is in crisis. Phillips 66 permanently ceased conventional crude oil processing at its Wilmington refinery by the end of 2025. Valero has announced plans to idle or cease operations at its Benicia refinery by April 2026.<sup>16</sup>

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<sup>15</sup> ISOR, Table 6, p. 60: California 62 percent; Washington approximately 100 percent; Quebec 99 percent; European Union 84 percent; United Kingdom 72 percent. See also CARB Cap-and-Invest Program Workshop, October 29, 2025 (slide 38).

<sup>16</sup> OPIS. (2025). As reliance on imported gasoline rises, California adapts to a new world. Phillips 66 permanently ceased conventional crude oil processing at its Wilmington refinery by the end of 2025. Valero announced plans to idle or cease refining operations at its Benicia refinery by April 2026.

In June 2025, California Energy Commission Vice Chair Siva Gunda formally warned Governor Newsom that gasoline imports statewide could reach 25 to 35 percent of demand by the summer of 2026, and up to 50 percent in northern California after the anticipated refinery closures.<sup>17</sup> His letter stated that if the cost of refining fuel in state exceeds the cost of importing fuel, it could further accelerate additional petroleum refinery exits.<sup>18</sup> The proposed CAF schedule for refineries does precisely the opposite of what that finding recommends.

The AB 398 leakage report that the Legislature required CARB to deliver by December 31, 2025 has not been published as a formal report to the Legislature.<sup>19</sup> Health and Safety Code section 38562(c)(2)(I) required CARB to report on the leakage risk posed by the regulation, including recommendations on necessary statutory changes and the potential for a border carbon adjustment, in the reports place CARB substituted a workshop . The Board is being asked to approve a CAF schedule for sectors experiencing documented, accelerating leakage without the statutory leakage analysis the Legislature required. That is a significant procedural gap, and we ask CARB to address it directly.

Food processing, glass manufacturing, cement, steel, and other sectors are similarly experiencing documented production decline and should be added to the high-leakage classification. For each of these industries, the leakage risk is concrete: reduced in-state output means reduced local employment, including union-represented positions in facilities that have operated under collective bargaining agreements for decades, diminished property and sales tax revenues for host communities, and increased dependence on imports produced without California’s environmental standards. All EITE sectors with evidence of reduced in-state output should be reviewed for reclassification before this regulation is finalized.

### **B. A 0.858 Floor for High-Leakage Sectors**

The current Standard CAF reaches 0.348 by 2032. The Alternate CAF for designated high-leakage sectors declines at half the annual rate, reaching 0.610 by 2032. We believe that trajectory, for all sectors experiencing documented leakage, should be replaced with a floor anchored at 0.858, the 2024 Alt-CAF level in CARB's own Table 9-2.

This recommendation is grounded in CARB's own methodology. It represents the protection level currently available to CARB's highest-risk industrial sectors. Functionally, it extends that protection to all EITE sectors facing documented leakage conditions and holds it there while the leakage analysis the Legislature actually required gets completed.

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<sup>17</sup> California Energy Commission, Letter from Vice Chair Siva Gunda to Governor Gavin Newsom (June 27, 2025), p. 7 [https://www.energy.ca.gov/sites/default/files/2025-07/CEC's\\_Response\\_to\\_Governor\\_Newsom's\\_Letter\\_June-27-2025\\_ada.pdf](https://www.energy.ca.gov/sites/default/files/2025-07/CEC's_Response_to_Governor_Newsom's_Letter_June-27-2025_ada.pdf)

<sup>18</sup> *ibid*, p. 10

<sup>19</sup> California Health and Safety Code § 38562(c)(2)(I), as enacted by AB 398 (Chapter 135, Statutes of 2017). CARB substituted an October 2025 workshop presentation (ISOR citation CARB 2025j) rather than delivering the formal statutory report to the Legislature. The workshop presentation is not a report to the Legislature under § 38562(c)(2)(I).

The 2031-to-2032 step-down is particularly severe because several pressures converge simultaneously. First, the Standard CAF drops 29.6 percent in a single year. CARB's own ISOR projects a weighted average allowance price of \$68 per tonne under the Proposed Amendments,<sup>20</sup> meaning each reduction in free allocation costs more to replace at auction in 2032 than it would have in 2027. Second, the California refinery sector would see an additional \$67 million in costs from the 2031-to-2032 CAF drop.

Table 3 shows the proposed CAF schedule alongside the recommended 0.858 floor. Table 4 shows the per-unit value retained for each affected sector at the 2032 cliff year.

**Table 3: Cap Adjustment Factor Schedule, 2027-2045 — Standard CAF, Alt-CAF, and 0.858 Floor**

Year	Standard CAF (CARB)	Alt-CAF (CARB)	0.858 Floor	Std. CAF Year-on-Year Change	Alt-CAF Year-on-Year Change
2027	0.613	0.807	0.858	-5.3%	-2.1%
2028	0.579	0.790	0.858	-5.5%	-2.1%
2029	0.545	0.773	0.858	-5.9%	-2.2%
2030	0.511	0.756	0.858	-6.2%	-2.2%
2031	0.494	0.747	0.858	-3.3%	-1.2%
<b>2032</b>	<b>0.348 (-29.6%)</b>	<b>0.610 (-18.3%)</b>	<b>0.858</b>	<b>-29.6%</b>	<b>-18.3%</b>
2033	0.324	0.588	0.858	-6.9%	-3.6%
2034	0.301	0.567	0.858	-7.1%	-3.6%
2035	0.279	0.547	0.858	-7.3%	-3.5%
2036-2045	Not established	Not established	0.858	N/A (CARB void)	N/A (CARB void)

**Note:** Source: CARB Proposed Regulation Order (Appendix A-1, January 2026), Table 9-2, pp. 218-219. CARB has established no CAF or Assistance Factor values beyond 2035. PSC 0.858 floor shown for 2036-2045 to illustrate the planning signal that would result from adoption of Recommendation 3b. 2032 row highlighted: year of maximum CAF cliff.

<sup>20</sup> ISOR, Table 21, p. 320. Proposed Amendments scenario: projected weighted average allowance price of \$68 per tonne (2027-2046).

**Table 4: Per-Unit Impact of PSC 0.858 Floor by Sector, 2032 (Year of Maximum Cliff)**

Sector (NAICS)	Current Risk Class.	CAF Type	CARB 2032 CAF	Floor	Value Retained Per Unit (at \$70/tonne)
<b>Petroleum Refining (324110) [reclassify]</b>	<b>Medium</b>	<b>Standard</b>	<b>0.348</b>	<b>0.858</b>	<b>+\$1.12/barrel (+\$0.027/gallon)</b>
Cement Mfg. (327310)	High	Alt-CAF	0.610	0.858	+\$12.47/short ton
Flat Glass Mfg. (327211)	High	Alt-CAF	0.610	0.858	+\$8.32/short ton
Container Glass (327213)	High	Alt-CAF	0.610	0.858	+\$4.54/short ton
Steel EAF (331111)	High	Alt-CAF	0.610	0.858	+\$2.86/short ton

**Note:** Source: CARB Proposed Regulation Order, Tables 8-1, 9-1, and 9-2. Dollar values at \$70/tonne (near ISOR Table 21 weighted average). "Value retained per unit" represents additional free allocation value per unit of production under the floor vs. CARB proposed CAF. Petroleum row currently Medium classified; this letter recommends reclassification to High.

The cumulative additional allocation value retained by the California refinery sector under a 0.858 floor versus CARB's proposed Standard CAF trajectory totals approximately \$1.72 billion over 2027-2035, at CARB's own projected allowance price levels. That is \$1.72 billion in compliance cost exposure that erodes refinery margins toward closure. The CEC's June 2025 findings document what happens when refinery margins compress below import parity: facilities close, imports surge, and fuel prices spike.

### **C. The Post-2035 Void**

Perhaps the most consequential design gap in the entire proposal is what CARB has left undefined. The Proposed Regulation Order establishes CAF and Assistance Factor values only through 2035. Beyond that date, no values exist. For a covered facility evaluating whether to invest in a decarbonization project that would not be operational until 2037 or 2038, there is literally no regulatory signal to base that decision on. Capital investment committees at major industrial facilities routinely require a 10-year cost-of-compliance horizon to approve major projects. CARB's proposed structure provides seven years of values, then silence. That silence is itself a leakage driver: it makes the case for relocating rather than staying. When a facility relocates, collective bargaining agreements, apprenticeship programs, and wage standards that took decades to build do not transfer. The workers do not follow the capital.

**Recommendation 3a:**

Reclassify petroleum refineries (NAICS 324110) and food processing (NAICS 311) from Medium to High leakage risk in Table 8-1, consistent with documented evidence of active leakage: two refinery closures since 2024, a sustained gasoline import surge, and the CEC's formal June 2025 findings. All EITE sectors with documented production decline should be reviewed for reclassification.

**Recommendation 3b:**

Establish a minimum CAF floor of 0.858 for all current and newly reclassified high-leakage sectors, effective for budget years 2026 through at least 2035. Where CARB's proposed CAF falls below 0.858 in any year, the floor applies instead. CARB retains authority to revisit the floor value after 2035 based on updated leakage risk findings but must make affirmative findings justifying any reduction before it takes effect.

**Recommendation 3c:**

Establish CAF and Assistance Factor values through at least 2045, not 2035, to provide the long-horizon planning certainty that industrial capital investment decisions require. A facility evaluating a decarbonization project coming online in 2038 cannot plan against a blank regulatory page.

**ISSUES FOR CONTINUED ENGAGEMENT**

The following topics are not fully resolved in the 45-day package and warrant continued engagement between CARB, the Legislature, and stakeholders. We raise them to signal that the Legislature intends to remain active on these questions.

**Manufacturing Decarbonization Incentive**

All high-leakage sectors should have access to the Manufacturing Decarbonization Incentive. Beyond access, the MDI's administrative structure may need adjustment to be practically deployable. Industrial modernization rarely occurs through a single capital project. A cement facility may need to combine clinker substitution, alternative fuels, waste heat recovery, electrified grinding systems, and eventual carbon capture. Requiring separate approval for each component slows modernization and increases administrative friction. A portfolio-based approach, allowing a facility-level decarbonization strategy encompassing multiple coordinated projects, would better reflect engineering and financial realities.

We also encourage CARB to allow structured extensions of MDI application deadlines and milestone schedules where delays are caused by factors outside the applicant's control: CEQA permitting timelines, grid interconnection queues, equipment lead times, or financing dependencies. Rigid deadline structures that cannot account for these realities risk converting MDI from an investment catalyst into a compliance trap. If executives cannot rely on regulatory timing flexibility in the face of permitting and infrastructure constraints, the incentive will be discounted internally and capital will flow elsewhere.

### **Offsets and Carbon Neutrality Alignment**

AB 1279 established California's framework for achieving carbon neutrality no later than 2045, providing that at least 85 percent of greenhouse gas reductions should come from direct emission reductions and up to 15 percent may be achieved through net reductions such as carbon removal and sequestration.<sup>21</sup> The current offset limits in Cap-and-Invest, 4 percent for the 2025 data year and 6 percent beginning in 2026, appear inconsistent with that statutory architecture, which contemplates a meaningful role for indirect reductions in the state's overall climate strategy.

We encourage CARB to articulate how offsets within Cap-and-Invest will integrate with the 85/15 carbon neutrality construct. The Legislature will also need to revisit statutory offset limits to align them with AB 1279's framing. In a tightening cap environment, well-verified offset availability moderates compliance cost exposure within the allowed percentage limit, which supports affordability without weakening the cap's environmental trajectory. Offsets should not be treated as a marginal tool.

### **Carbon Capture, Utilization, and Sequestration**

SB 905 directed CARB and other state agencies to develop standards and guidance for carbon capture, utilization, and sequestration as a climate strategy.<sup>22</sup> That work remains incomplete and we acknowledge delays in budgetary funding. The proposed amendments consolidate CCUS compliance obligations in new section 95852.3 but leave the practical compliance recognition pathway dependent on future rulemaking with uncertain timelines. For capital-intensive projects, regulatory recognition timing is not a minor detail. Facilities considering capture investments must assess the certainty of compliance treatment before committing capital.

CARB should complete the SB 905 work and consider a provisional compliance recognition pathway, with full permanence, verification, and public notice requirements intact, that allows projects to proceed while the formal methodology is incorporated into the regulation. A well-sequenced CCUS framework is part of a durable carbon market architecture.

### **Carbon Cost Parity for Imported Goods and Fuels**

As long as California's carbon price applies only to in-state production, every ton reduced domestically risks being replaced by an unpriced ton embedded in an import. The Legislature wants to work with CARB and relevant state agencies to assess mechanisms that would apply an equivalent carbon cost adjustment to imported fuels and covered goods from jurisdictions without comparable programs. Such a mechanism would make leakage protection structural rather than perpetual, allowing CAF floors to be phased down over time as competitive parity is achieved.

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<sup>21</sup> AB 1279 (Muratsuchi, Chapter 337, Statutes of 2022). Established California's statutory framework for achieving carbon neutrality no later than 2045, providing that at least 85 percent of greenhouse gas reductions should come from direct emission reductions and up to 15 percent may be achieved through net reductions, including carbon removal and sequestration.

<sup>22</sup> SB 905 (Caballero, Chapter 359, Statutes of 2022). Directed CARB, in consultation with other state agencies, to develop standards and guidance for carbon capture, utilization, and storage as a greenhouse gas emissions reduction strategy.

## CONCLUSION

We are asking Cap-and-Invest to solve broader problems than was originally designed around. We believe it is capable of doing so. The program has demonstrated that a carbon market can be durable, that it can generate revenue, protect consumers, reduce emissions, and maintain political support across administrations with different priorities. That durability is worth protecting by making the design choices that allow it to continue.

The U.S. Acid Rain Program achieved SO<sub>2</sub> reductions exceeding 50 percent of baseline levels ahead of schedule and below projected costs. Its allocation structure gave industry the planning certainty to invest in pollution controls rather than simply absorb compliance costs.<sup>23</sup> The environmental outcome was not compromised by that structure. It was enabled by it. California's program can work the same way.

**The recommendations in this letter prevent an estimated \$10-\$15 billion in costs from being assessed on consumers and businesses in California.** For a typical dual-fuel IOU household, this translates to a combined electricity and gas Climate Credit that remains above \$110 per year through 2035 — compared to approximately \$74 per year under CARB's proposed design. The CAF floor prevents an estimated \$0.01 to \$0.03 per gallon in additional fuel cost passthrough at the 2032 cliff, modest per gallon but material across California's annual fuel consumption. These figures use CARB's own \$68 per tonne weighted average price assumption. The breakdown: significant electricity ratepayer protection through the EDU allocation framework (the Joint Utility Group estimates at least \$4.9 billion at risk over 2027–2030 alone), approximately \$1.6 billion in gas ratepayer protection directed to low-income customers, and \$1.7 to \$3.5 billion in avoided industrial cost passthrough to fuel and product prices through the CAF floor.

We want to be honest about what these protections are. They are a bridge, not a destination. The CAF floor, a moderated NGU transition, and the EDU allocation preservation buy time for California's hardest-to-abate industries to navigate a transition that cannot happen at the pace the carbon price alone would force. That time only has value if the transition infrastructure gets built: CCUS pipelines and storage, industrial electrification, hydrogen supply chains, and a workable compliance recognition framework for carbon removal. The Legislature's role does not end with this rulemaking. The case for these protections rests on a commitment to accelerate the work that makes them temporary rather than permanent.

Affordability as a primary design criterion is not a retreat from environmental ambition. It is the condition under which environmental ambition remains politically and economically viable. Cap-and-Invest should use the full range of those tools, including free allocation, leakage protection, and ratepayer support mechanisms, to deliver what the statutes require: cost-effective emissions reductions that do not disproportionately burden the Californians least able to absorb those costs.


We respectfully urge CARB to adopt the recommendations in this letter, to complete the outstanding statutory leakage analysis the Legislature required, and to ensure that the affordability implications of the transition design are quantified and publicly available before the Board takes final action.


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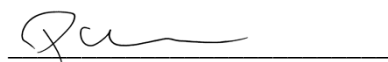
<sup>23</sup> U.S. Environmental Protection Agency, Acid Rain Program: 2007 Progress Report (2008); Schmalensee, R., et al. (1998). An interim evaluation of sulfur dioxide emissions trading. *Journal of Economic Perspectives*, 12(3), 53-68.

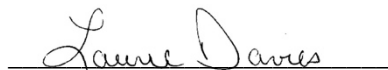
We look forward to continued engagement on these issues and welcome the opportunity to discuss any of the recommendations in greater detail. For additional information, please contact Travis Knowles, Chief of Staff to Assemblymember David Alvarez (Travis.Knowles@asm.ca.gov).

Respectfully submitted,

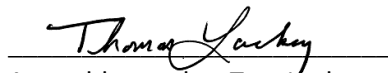
  
Assemblymember Juan Alanis

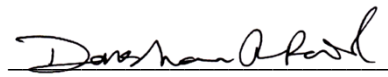
  
Assemblymember Anamarie Avila Farias

  
Assemblymember Patrick Ahrens


  
Assemblymember Laurie Davies

  
Senator Tim Grayson

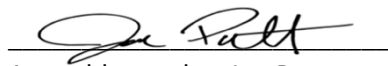
  
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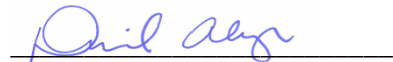
  
Assemblymember Darshana Patel

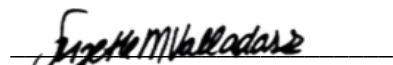
  
Assemblymember Esmeralda Soria

  
Senator Megan Dahle


  
Senator Brian Jones


  
Assemblymember Joe Patterson


  
Assemblymember David Alvarez

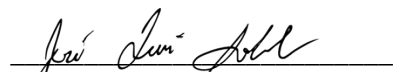
  
Senator Suzette Valladares


  
Assemblymember Juan Carrillo

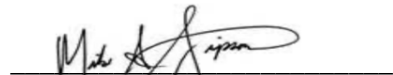
  
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Assemblymember Josh Hoover

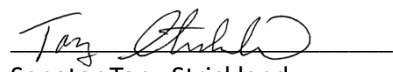
  
Assemblymember Blanca Pacheco

  
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Senator Bob Archuleta

  
Assemblymember Mike Gipson

  
Assemblymember Stephanie Nguyen

  
Senator Tony Strickland