

# ClimateBuild

March 9, 2026

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

Ms. Sahota:

### INTRODUCTION — AFFORDABILITY THROUGH DESIGN

ClimateBuild CA appreciates the opportunity to comment on CARB's proposed amendments to the Cap-and-Invest Regulation and Mandatory Reporting Regulation. Our organization represents businesses operating in California's energy, fuels, manufacturing, and infrastructure sectors. Our members are covered entities under the Cap-and-Invest program and downstream consumers of fuels, natural gas, electricity, cement, steel, and other emissions-intensive materials whose prices are directly influenced by allowance costs and regulatory design choices.

We supported the continuation of California's carbon market. Cap-and-Invest remains a central pillar of the state's climate framework. However, we submit these comments with a specific and urgent lens: ***affordability must be embedded in program design, not treated as a secondary downstream consideration.***

The statute directs CARB to achieve cost-effective reductions and to minimize leakage. Those objectives are not in tension with environmental ambition; they are essential to its durability. A carbon market that drives emissions reductions while preserving in-state production, protecting jobs, and moderating consumer cost impacts will endure. A carbon market that inadvertently accelerates industrial exit or compounds cost-of-living pressures will face increasing political and economic strain.

These comments aim to strengthen the program's durability by refining its design.

### ECONOMIC AND POLITICAL CONTEXT — LEAKAGE RISK AND COST SENSITIVITY

The regulatory decisions under consideration are being made in an economic environment materially different from the early years of Cap-and-Trade. California faces persistent affordability challenges in electricity, fuels, groceries, and housing, driven by intersecting cost pressures that now rank as the single most important concern for Californians across all demographic groups. Industrial facilities in refining, food processing, manufacturing, glass and cement sectors have reduced output, closed, or announced closures in recent years. Supply chains have become more global, not less, putting pressure on reducing costs for businesses to stay solvent.

The data are unambiguous. In its November 2025 statewide survey, PPIC found that the 36% of Californians (largest share of respondents to that question), identified cost of living, the economy, and

inflation as the most important issue facing the state.<sup>1</sup> A PPIC survey conducted in October 2025 found that 69% of Californians expected bad economic times in the next twelve months, and that one in five adults reported it would be very difficult or nearly impossible to cover a \$1,000 emergency expense.<sup>2</sup> A March 2025 PPIC economic assessment found that energy prices have risen 28% compared to pre-pandemic levels, and that California already carries the second-highest electricity rates in the nation.<sup>3</sup> These conditions are not abstractions. They are the operating environment into which this rulemaking will land.

Support for California's climate leadership remains strong in principle. According to PPIC's July 2025 environment survey, approximately six in ten Californians favor the state making its own policies on climate change, and nearly three in four support U.S. participation in international climate efforts.<sup>4</sup> But that same survey found that fewer than half of Californians are willing to pay more for electricity from renewable sources, and over half identified prices at the pump and energy bills as major problems.<sup>5</sup> As PPIC survey director Mark Baldassare has noted, heightened concerns around the cost of living have dampened enthusiasm for policies perceived as raising energy costs, even among those who support the underlying climate objectives.<sup>6</sup>

The implication is not that public support for climate action has collapsed. It has not. Rather, these data confirm that the program's political durability is directly contingent on demonstrable cost discipline in its design. That is the message CARB's own public engagement reflects, and it is the appropriate lens through which the specific mechanisms at issue in this rulemaking, the Cap Adjustment Factor, free allowance allocation, the NGS-to-EDU transition, and offset usability, should be evaluated.

The proposed removal of approximately 118 million allowances from the 2027-2030 budgets, a correction necessitated by updates to the GHG Emissions Inventory, is significant in its own right. But its interaction with the post-2031 program design creates a compounding effect that CARB should address directly. The ISOR is explicit on the near-term stringency this produces: the average annual cap decline under the proposed amendments is 11% per year from 2027-2030, compared to approximately 4.6% under the current regulation over 2025–2026, representing roughly a doubling of the annual budget

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<sup>1</sup> PPIC Statewide Survey: Californians and Their Government, November 13–19, 2025 (n=1,676). Cost of living/economy/inflation ranked as the top issue by 36% of respondents.

<sup>2</sup> PPIC Statewide Survey: Californians and Their Economic Well-Being, October 16–30, 2025 (n=2,306). 69% expected bad economic times in the next twelve months; one in five (19%) reported it would be very difficult or nearly impossible to cover a \$1,000 emergency expense.

<sup>3</sup> PIC, *Testimony: Cost Pressures and Affordability for Californians in Today's Economy*, Sarah Bohn, PPIC Economic Policy Center (March 24, 2025). Food and beverage prices up 28% and energy prices up 28% compared to pre-pandemic levels; California holds the second-highest electricity rates in the nation after Hawaii.

<sup>4</sup> PPIC Statewide Survey: Californians and the Environment, July 1–7, 2025 (n=1,736 adults). Approximately six in ten adults favor state climate policies; nearly three in four support international climate participation.

<sup>5</sup> *Ibid.* Fewer than half of adults (and likely voters) were willing to pay more for electricity from renewable sources; over half identified energy bills and gas prices as major problems.

<sup>6</sup> PPIC, *The Balancing Act Behind Meeting California's Climate Goals* (Sept. 2025), quoting PPIC Survey Director Mark Baldassare: "A majority are saying they are not willing to pay more for renewable energy ... it's because of their utility bills."

reduction rate.<sup>7</sup> The ISOR acknowledges this directly, noting that implementing the full removal of allowances within the 2027–2030 window rather than across a longer horizon "would steepen the near-term annual cap decline, which could exacerbate the post-2030 discontinuity in annual budgets, holding limits, and may result in unacceptable risks of price volatility, high consumer impacts, and emissions leakage."<sup>8</sup> CARB has attempted to moderate that risk by phasing the removals, 15 million in 2027, rising to 41.7 million in 2030, but the cumulative effect remains a materially accelerated compliance environment relative to anything covered entities have previously navigated under this program.

Layered on top of this is the market circulation dynamic. As the ISOR separately notes, the annual release of allowances from entity accounts due to the accelerated holding limit decline is expected to roughly double during 2027–2030, rising from an average of approximately 14 million allowances per year under the current regulation to approximately 22 million per year under the proposed amendments.<sup>9</sup> While this increases market liquidity in the near term, it also signals that entities holding allowances as a compliance buffer will be forced to release them into the market on a compressed timeline, a dynamic that interacts unpredictably with rising compliance demand.

The post-2031 steepening is substantial. Under the proposed Regulation (Table 9-2 of Appendix A-1 to the Proposed Regulation Order), the Standard Cap Adjustment Factor holds at 0.494 in 2031 then falls to 0.348 in 2032. That is a reduction of approximately 30% in a single budget year. The Alternate CAF for high-leakage sectors follows a parallel step: from 0.747 in 2031 to 0.610 in 2032. These values then continue declining to 0.279 (Standard) and 0.547 (Alt-CAF) by 2035.<sup>10</sup> For covered industrial facilities, this trajectory represents not a gradual glide path but an abrupt recalibration.

CARB's Initial Statement of Reasons acknowledges that Cap Adjustment Factors and other assistance mechanisms must be evaluated considering decreasing allowance budgets, leakage risk, and consumer affordability. That acknowledgment is correct. What is needed is a regulatory framework that converts that acknowledgment into structural design choices, not merely qualitative balance.

Comparative leakage data reinforces this urgency. As shown in Table 6 of the ISOR and slide 38 of CARB's October 2025 workshop presentation, California's ratio of industrial free allowance allocation to industrial covered emissions stands at approximately 60–62%. This compares to approximately 100% in Washington, 99% in Québec, 84% in the European Union, and 72% in the United Kingdom.<sup>11</sup> California is

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<sup>7</sup> CARB, Initial Statement of Reasons (Jan. 20, 2026), at 33: "The resulting average annual cap decline is 11% from 2027–2030." The current regulation produces an annual budget decline of approximately 4.6% (derived from ISOR Table 4: California-only budget of 317.71M in 2025 declining to 303.08M in 2026). The proposed amendments therefore roughly double the annual cap decline rate.

<sup>8</sup> *Ibid.* at 33–34.

<sup>9</sup> *Ibid.* at 43–44: "staff estimate that an additional 8 million allowances on average would be annually released into market circulation due to the accelerated annual decline in holding limits ... a total of 22 million allowances each year are expected for market release."

<sup>10</sup> Appendix A-1, Proposed Regulation Order, Table 9-2: Cap Adjustment Factor (CAF and Alt-CAF schedule, 2027–2035). Standard CAF: 0.613 (2027), 0.511 (2030), 0.494 (2031), 0.348 (2032), 0.279 (2035). Alternate CAF: 0.807 (2027), 0.756 (2030), 0.747 (2031), 0.610 (2032), 0.547 (2035).

<sup>11</sup> CARB, Initial Statement of Reasons (Jan. 20, 2026), Table 6 (Ratio of Industrial Allocation to Covered Emissions in Various Jurisdictions, 2023): California 62%; Washington ~100%; Québec 99%; European Union

already the most stringent of all major comparable emissions trading systems in its treatment of industrial allocation. In the context of a budget removal that accelerates 2027–2030 compliance pressure, and a post-2031 CAF step-down of approximately 30%, that comparative disadvantage is not a theoretical concern. It is a quantifiable and documented structural risk factor that should anchor CARB's leakage analysis.

Leakage is no longer theoretical. When in-state production capacity declines and imports increase to meet unchanged demand, emissions will only shift and potentially increase globally. Consumers will face higher prices from supply constraints, transportation costs, and market volatility. Workers face the risk of losing high-quality industrial jobs, and California's manufacturing base, the in-state supply chain that keeps costs lower and emissions accountable, erodes in ways that are difficult to reverse.

In this environment, it is not sufficient to focus solely on the mathematical trajectory of allowance budgets. The distribution of compliance costs and the structure of transitional mechanisms matter at minimum equally, and in the near-term political environment, perhaps more decisively for the program's durability.

The amendments under consideration provide an opportunity to recalibrate the program's internal mechanisms so that environmental ambition and economic durability move together.

#### **UTILITY ALLOCATION AND RATEPAYER PROTECTION — AFFORDABILITY AT THE FRONT DOOR**

For most Californians, the Cap-and-Invest program is experienced through utility bills and fuel prices. The California Climate Credit and the flow of allowance value through Electrical Distribution Utilities (EDUs) and Natural Gas Suppliers (NGS) represent the most visible consumer-facing component of the program. The purpose of providing EDUs and NGS allowances is to reduce or avoid customers from having to feel the costs of the Cap-and-Invest program. EDUs and NGS sell allowances in the auction and use those revenues to provide direct energy bill relief to residential customers through the climate credit. Historically NGS have also be allowed to use some portion of the allowances for compliance, which automatically reduces the pass-through costs of the program to all non-covered users of natural gas.

The proposed amendments establish a post-2030 methodology for EDU allocations that reflect SB 100 and SB 1020 clean electricity targets. The Initial Statement of Reasons (ISOR) describes assumptions about reaching 90 percent zero-carbon electricity by 2035, deducting five percent for firm and shape, and attributing the remainder to natural gas generation for emissions-factor purposes.

Aligning allocation methodology with statutory clean energy targets is logical. However, the public impact of that methodology must be considered carefully. If allowance value flowing to EDUs declines sharply while allowance prices rise under a tightening cap, consumers may perceive the program as increasing costs while reducing visible ratepayer protection.

That perception is avoidable.

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84%; United Kingdom 72%. See also CARB Cap-and-Invest Program Workshop, Oct. 29, 2025 (slide 38, "Industrial Allocation in Other Emissions Trading Systems").

The proposed regulation provides that additional allowances, where appropriate, transferred from investor-owned NGS to EDUs shall be placed in the utilities' limited use holding accounts.

The text is silent on when those transfers should occur, how many allowances should be transferred, and how the value of those allowances should be prioritized during periods of tightening cap stringency.

CARB's proposed regulatory changes begins the allowance transfer in 2029 and completely transfers all of the allowances by 2037. According to the 2022 Scoping Plan, residential and business will continue to rely on natural gas as an affordable energy source for many years after 2037. Moreover, those customers without the means to choose alternative energy sources will be left paying for the total cost of compliance of Cap-and-Invest for NGS, while those customers, typically wealthier customers, will be subsidized. This incentive program is similar to net energy metering, which over incentivized solar customers, while the non-solar customers were left paying for the services that solar customers still used, but didn't have to pay for.

AB 1207 (Irwin, Chapter 117, Statutes 2025) also requires CARB in designing the Cap-and-Invest regulations to "[e]nsure that activities undertaken to comply with the regulations do not disproportionately impact low-income communities."<sup>12</sup> The proposed amendments including the transfer of allowances from NGS to EDU would disproportionately impact low-income customers, because the overall NGS revenues would be spread out amongst more customers (about 80 percent of Californians rely on electricity and gas for their residential energy needs and 20 percent rely solely on electricity). Therefore those natural gas customers receiving a climate credit from their gas utility today, would receive a smaller climate credit from the electric utility instead. This has a greater impact on lower income customers because their annual bills tend to be lower.

We recommend clarifying that the value of transferred allowances should be prioritized for residential and small-business rate mitigation during the transition period.

The following amendment is therefore proposed:

"(4) Additional Allocation. ... For each electrical distribution utility, the Executive Officer will place all of its additional allowances in its limited use holding account and the electrical distribution utility shall prioritize the use of the value of these allowances to mitigate residential and small business rate impacts associated with Cap-and-Invest compliance costs through December 31, 2035."

This amendment does not alter the cap or reduce environmental integrity. It reinforces the program's consumer-facing stability during periods of increasing allowance scarcity.

Maintaining predictable ratepayer protection strengthens public trust and reduces the risk that Cap-and-Invest becomes politically associated with rising electricity costs.

#### **CAP ADJUSTMENT FACTOR — A LEAKAGE-RISK SAFEGUARD TRIGGERED BY OBJECTIVE METRICS**

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<sup>12</sup> Health and Safety Code Section 38562(b)(2)

California's Cap-and-Invest program has always attempted to balance declining allowance budgets with protection for emissions-intensive, trade-exposed sectors. The Cap Adjustment Factor (CAF) is the mechanism that determines annual free allowance allocation to covered industrial entities. The proposed amendments maintain current CAF values through 2031 and then align post-2031 values with the declining allowance budget, with the alternate CAF declining at half the annual rate to provide enhanced leakage protection.

Table 9-2 of Appendix A-1 illustrates the magnitude of the post-2031 shift. In 2025, the Standard CAF is 0.681 and the Alternate CAF for high leakage sectors is 0.841. By 2032, the Standard CAF drops to 0.348 and the Alternate CAF drops to 0.610. By 2035, the Standard CAF falls to 0.279.

That decline is mathematically consistent with a tightening cap. The question is whether it is economically consistent with California's present leakage conditions. ClimateBuild would say it is not.

The statute requires CARB to minimize leakage and ensure cost-effective reductions. The ISOR explicitly recognizes that CAF values must be considered "in the context of decreasing overall Program allowance budgets through 2045, the need to protect against emissions leakage risk and support affordability for California consumers."

The leakage risk environment California faces today is materially different from the one in which early CAF glide paths were conceived. The state has experienced refinery closures and cement capacity shutdowns. Industrial operators face higher electricity prices relative to competing jurisdictions. Imports of fuels and building materials continue to meet California demand. When domestic production declines while consumption remains steady, leakage is no longer hypothetical.

If the CAF declines mechanically at the same time the cap steepens, compliance costs for exposed sectors can increase sharply. Those costs may not appear immediately in allowance price charts. They appear instead as curtailed production, deferred investment, reduced workforce hours, or facility closure. The downstream impact is felt by consumers through higher prices and by workers through job loss.

For these reasons, ClimateBuild recommends that the Cap Adjustment Factor operate as a leakage-risk safeguard that is held constant rather than as an automatic function of budget decline.

This structure accomplishes several important objectives.

First, it preserves the integrity of the declining cap. The emissions limit remains binding. The safeguard does not relax environmental ambition. It simply moderates cost distribution during periods of elevated leakage risk.

Second, it aligns with CARB's own stated rationale in the ISOR that leakage protection and affordability must be evaluated in light of declining allowance budgets.

Third, it strengthens political durability. A program that adapts to measurable economic stress signals is more defensible to legislators, labor organizations, and the public than one that relies solely on formulaic declines.

Some may argue that aligning CAF directly with cap stringency ensures maximum incentive to decarbonize. That argument assumes that facilities respond to declining free allocation by investing in cleaner technology rather than exiting the jurisdiction. The evidence from recent industrial closures suggests that assumption may not always hold.

In short, the CAF should not be treated as a purely mathematical derivative of the allowance budget. It should function as a calibrated leakage-risk instrument embedded within the broader objective of cost-effective emissions reduction.

## **MANUFACTURING DECARBONIZATION INCENTIVE (MDI) — FROM THEORETICAL TOOL TO DEPLOYABLE CAPITAL MECHANISM**

The proposed Manufacturing Decarbonization Incentive reflects an important recognition by CARB: declining allowance budgets alone are not sufficient to drive deep decarbonization in hard-to-abate sectors. Capital-intensive industries require transitional mechanisms that lower risk and accelerate investment.

The ISOR describes MDI as a mechanism to support investments in emissions-reduction projects in covered industrial facilities and to reduce leakage risk during tightening phases of the cap.

That policy direction is sound. The question is whether the regulatory structure makes MDI practically deployable, or whether it risks becoming aspirational but administratively brittle.

MDI must satisfy three conditions if it is to serve as a genuine leakage-prevention instrument:

First, it must align with the real timeline of industrial capital development.

Second, it must allow portfolio-based modernization rather than forcing facilities into narrow project silos.

Third, it must operate predictably enough to influence investment committee decisions at corporate and institutional levels.

At present, the proposal partially satisfies the first condition and incompletely addresses the second.

### **A. Timing Alignment — Incorporating Defined but Flexible Milestone Standards**

The current proposed language establishes firm application deadlines tied to budget years and compliance periods.

Section 95891(g)(5) provides:

“To receive the manufacturing decarbonization incentive allocation the facility must apply to the Executive Officer by the following dates:

- (A) September 1, 2026 for budget years 2027 and 2028;
- (B) April 10, 2028 for budget years 2029 and 2030;
- (C) April 10, 2030 for budget years 2031 through 2033;

(D) April 10, 2033 for budget years 2034 and 2035;  
(E) April 10, 2035 for budget years 2036 through 2038.”

Section 95891(g)(6)(A) requires that applications include a project timeline with major milestones.

Section 95891(g)(7) requires post-compliance reporting.

The structure is orderly and predictable. What it does not explicitly account for is that large-scale industrial decarbonization projects often depend on variables outside the facility’s direct control.

Permitting under CEQA can take years. Interconnection queues for electrification projects can extend unpredictably. Equipment lead times for industrial boilers, electric arc furnace upgrades, hydrogen blending infrastructure, or carbon capture units routinely exceed 24 months. Financing commitments may hinge on federal tax-credit guidance that evolves after regulatory filing deadlines.

When incentive retention windows are rigid, these realities can transform MDI from a catalyst into a compliance trap.

To address this, ClimateBuild proposes the addition of defined, but flexible, milestone criteria within §95891(g). This is not a request for open-ended extensions. It is a request for structured flexibility grounded in documented progress.

We propose the insertion of the following language after §95891(g)(5)(E):

“The Executive Officer may grant reasonable extensions of application deadlines and/or project milestone schedules where an applicant demonstrates that delays are caused by factors outside the applicant’s reasonable control, including but not limited to permitting delays, interconnection delays, supply-chain disruptions, construction delays, or financing delays. Any extension shall require written findings by the Executive Officer and shall not exceed three years without additional Board approval.”

We further propose modifying §95891(g)(6)(A) to read:

“...including description of equipment or fuels purchased, project timeline with major milestones and defined, but flexible, criteria for schedule updates reflecting permitting, construction, and industrial process-change realities, cost estimates...”

And modifying §95891(g)(7) to clarify that reporting includes documentation of schedule variances and their causes rather than treating variance as presumptive noncompliance.

This structure accomplishes several objectives. It preserves accountability by requiring documentation and written findings. It prevents abuse by limiting extension duration.

Most importantly, it ensures that MDI can influence investment decisions. 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.

From an affordability perspective, this matters profoundly. If modernization projects fail to advance because the incentive window is too narrow, facilities will either absorb higher compliance costs or curtail operations. In both cases, consumer prices rise and leakage risk increases.

## **B. Expanding Eligible Project Types — Allowing Portfolio-Based Decarbonization**

The ISOR discussion of MDI indicates that eligible projects include defined categories of emissions-reduction investments.

While the current regulatory draft references eligible project descriptions and cost estimates, the structure reads as oriented toward discrete project approvals.

In practice, industrial decarbonization rarely occurs through a single measure. A cement facility may need to combine clinker substitution, alternative fuels, waste heat recovery, electrified grinding systems, and eventual carbon capture. A refinery may integrate hydrogen blending, heater electrification, efficiency retrofits, and CCUS across multiple units.

Requiring separate approval for each component can slow modernization and increase administrative friction.

We recommend amending §95891(g)(6) to allow submission and approval of a facility-level decarbonization strategy that encompasses multiple coordinated projects.

Proposed insertion:

“A facility may submit for approval a comprehensive decarbonization strategy encompassing multiple projects and measures. Upon approval by the Executive Officer, expenditures undertaken pursuant to the approved strategy shall be eligible for manufacturing decarbonization incentive allocation without requiring separate approval for each discrete project, provided that all expenditures are documented and meet the emissions-reduction criteria of this subsection.”

This amendment recognizes that industrial modernization is often iterative and integrated. It reduces administrative overhead and allows facilities to optimize investments holistically.

This is consistent with the program’s purpose. It does not expand emissions credit beyond real reductions. It simply allows facilities to organize their capital planning in a manner consistent with engineering and financial realities.

## **C. MDI as a Leakage-Risk Instrument**

MDI should not operate independently of CAF and leakage classification.

Where sectors experience measurable production decline or facility closure, MDI should function as an enhanced retention tool.

We recommend adding language linking MDI modifier values or prioritization to sectors classified as high leakage risk pursuant to the objective leakage metrics described earlier.

Suggested addition:

“Facilities within sectors classified as High Process Emissions/High Leakage Risk pursuant to Section [CAF safeguard subsection] shall receive priority review of manufacturing decarbonization incentive applications and may receive enhanced allocation modifiers consistent with maintaining in-state production capacity.”

This integrates MDI into the broader leakage-risk safeguard architecture rather than treating it as a standalone incentive.

#### **D. Why MDI Design Is a Consumer Affordability Issue**

It may be tempting to view MDI as purely an industrial policy instrument. It is not.

If industrial modernization succeeds, California retains production of fuels, cement, steel, glass, and refined products. That stabilizes supply chains and moderates price volatility.

If modernization fails and facilities close, imports fill the gap. Transportation costs rise. Import carbon intensity may be higher. Consumer prices increase.

Every compliance design decision that increases unnecessary friction in MDI increases the risk that consumers ultimately pay more.

Affordability through design therefore requires that MDI be structured as a practical capital-deployment mechanism, not as a theoretical offset to declining free allocation.

#### **OFFSETS — REDUCING FRICTION, PRESERVING INTEGRITY, AND ALIGNING WITH CALIFORNIA’S 85/15 CARBON NEUTRALITY FRAMEWORK**

Offsets have always played a defined role in California’s carbon market. They are not unlimited. They are subject to quantitative caps. They are subject to verification standards and permanence requirements. They are designed to complement, not replace, direct emissions reductions.

The proposed amendments clarify retirement ordering and confirm the quantitative usage limit schedule, including the four percent limit for the 2025 data year and six percent beginning in 2026 and continuing into subsequent compliance periods.

ClimateBuild does not seek to reopen the quantitative limit in this rulemaking. Instead, our comments focus on two structural concerns: administrative friction and statutory alignment with California’s carbon neutrality framework.

#### **Administrative Friction Can Function as a De Facto Tightening of the Cap**

**Offsets operate as a cost-containment mechanism.** They allow covered entities to meet a defined portion of their compliance obligation using verified reductions outside the capped sector. When offsets are liquid and usable within the defined percentage limits, they moderate compliance costs without altering the cap trajectory.

However, if administrative practices make offsets difficult to register, slow to verify, or unpredictable to retire, the practical availability of offsets shrinks below the regulatory limit. That dynamic functions as an implicit tightening of the cap, but without transparent Board action.

Section 95856(h) currently governs retirement ordering and references the quantitative usage limit.

The ISOR explains that these changes are intended to provide clarity and reflect the revised percentage limits adopted in prior legislative actions.

Clarity is welcome. What is needed now is a guardrail against incremental administrative tightening.

We therefore recommend inserting the following language into § 95856(h):

“...subject to the quantitative usage limit set forth in section 95854; provided that the Executive Officer shall not impose administrative or technical requirements that materially restrict offset credit availability or timely usability unless the Executive Officer makes written findings that such restrictions are necessary to prevent a material risk to environmental integrity.”

This amendment preserves CARB’s authority to protect environmental integrity. It simply requires that any usability restriction be justified transparently and tied to a demonstrable risk. In other words, if offsets are to be limited beyond the statutory cap, the record should explain why.

That transparency protects the program from unintended cost escalation.

## **B. Offsets and the 85/15 Carbon Neutrality Framework**

AB 1279 (Muratsuchi, Chapter 337, Statutes 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” such as carbon removal and sequestration.

While AB 1279 did not amend Cap-and-Invest directly, it is impossible to read the 85/15 framework without recognizing that offsets and carbon removal mechanisms occupy the policy space intended for that 15 percent indirect component.

California will not reach carbon neutrality solely through direct reductions. Certain industrial processes, aviation, maritime transport, and legacy emissions will require net reduction mechanisms. Offsets — broadly defined as rigorously verified carbon removal or avoided emission projects — are part of that long-term architecture.

If offsets are marginalized or administratively constrained in the near term, California risks increasing compliance costs in ways that do not accelerate the development of carbon removal infrastructure.

ClimateBuild therefore encourages CARB to articulate, either in this rulemaking or in subsequent guidance, how offsets within Cap-and-Invest will integrate with the 85/15 carbon neutrality construct. That articulation would provide market certainty and reduce the risk of misalignment between near-term compliance design and long-term neutrality strategy.

Offsets are not an evasion of direct reduction. They are a complement to it.

### **C. Offsets as an Affordability Mechanism**

In a tightening cap environment, allowance prices are expected to rise. When offset usability remains stable and administratively predictable, entities can moderate compliance cost exposure within the allowed percentage limit.

If offset usability becomes uncertain, compliance costs increase abruptly. Those costs flow through to electricity rates, fuel prices, and industrial product pricing.

A well-functioning offset market therefore supports affordability without weakening the cap.

This is entirely consistent with CARB's statutory mandate to achieve cost-effective reductions and minimize leakage.

Offsets should not be treated as a marginal policy tool. They are part of the economic balance that keeps the carbon market politically and economically durable.

### **CARBON CAPTURE, UTILIZATION, AND SEQUESTRATION (CCUS) — PROVIDING CLEAR AND WORKABLE COMPLIANCE RECOGNITION**

The proposed amendments reorganize and consolidate compliance obligations related to captured carbon dioxide in new § 95852.3. The draft language provides that an entity has a compliance obligation for every metric ton of CO<sub>2</sub> captured from a CO<sub>2</sub> stream, except where that CO<sub>2</sub> is verified to be sequestered or utilized pursuant to a Board-approved quantification methodology that ensures reductions are real, permanent to at least a 100-year permanence standard, quantifiable, verifiable, and enforceable, and consistent with Health and Safety Code section 39741.1. The proposed text further states that any Board-approved methodology must be incorporated into the Cap-and-Invest Regulation before it can be used to reduce a supplier's compliance obligation.

The ISOR explains that these changes are intended to consolidate CCUS recognition provisions, remove the exported CO<sub>2</sub> exemption, clarify that non-geologic sequestration methods may be considered if consistent with SB 905, and allow utilization pathways if they meet permanence and enforceability standards.

ClimateBuild supports the objective of strengthening integrity and aligning CCUS accounting with statutory requirements. However, clarity and timing are essential if CCUS is to function as a viable compliance pathway rather than an aspirational one.

The core issue is sequencing.

Under the proposed structure, a CCUS project cannot reduce a compliance obligation unless a Board-approved quantification methodology has been formally incorporated into the regulation. That requirement ensures rigor. At the same time, it may introduce multi-year delays between the development of technically viable capture projects and the availability of compliance recognition.

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. If recognition depends on future rulemaking cycles with uncertain timelines, the economic case for investment weakens substantially.

We therefore recommend adding a narrowly tailored provisional pathway that preserves all integrity standards but allows time-limited compliance recognition pending full regulatory incorporation.

Specifically, we propose modifying the final sentence of § 95852.3(a) as follows:

Current language provides:

“...The Board-approved quantification methodology must be incorporated into the Cap-and-Invest Regulation before it can be used to reduce a CO<sub>2</sub> supplier’s compliance obligation.”

We recommend revising this to read:

“...The Board-approved quantification methodology must be incorporated into the Cap-and-Invest Regulation before it can be used to reduce a CO<sub>2</sub> supplier’s compliance obligation, except that the Executive Officer may approve a provisional quantification approach for a limited pilot period where the approach meets the requirements of this subsection, is consistent with Section 39741.1 of the Health and Safety Code, and includes enforceable monitoring, reporting, and third-party verification sufficient to ensure reductions are real, quantifiable, verifiable, enforceable, and permanent to at least a 100-year permanence standard. Any provisional approval shall be subject to public notice and shall expire unless incorporated into the Regulation by the Board.”

This amendment does not relax environmental standards. The permanence threshold, verification requirements, and statutory consistency remain intact. What changes is the timing mechanism.

Such a structure aligns with the broader carbon neutrality framework established in AB 1279, which contemplates that a portion of reductions will occur through indirect mechanisms, including removal and sequestration. AB 1279’s 85 percent direct / 15 percent indirect architecture underscores that durable carbon removal pathways must be operationalized within compliance programs, not left as abstract future concepts.

Providing a provisional pathway also improves regulatory clarity. Rather than leaving project developers uncertain about whether and when recognition will occur, CARB would establish defined criteria and public documentation standards. That clarity reduces investment risk without sacrificing oversight.

From an affordability standpoint, the relevance is straightforward. If CCUS projects can proceed with predictable compliance treatment, industrial facilities are more likely to modernize rather than curtail operations. Modernization maintains in-state production and moderates downstream cost impacts. Conversely, if recognition lags, facilities may face escalating compliance costs without a feasible mitigation pathway.

The recommended amendment strengthens environmental integrity while enhancing regulatory workability. It treats compliance recognition not as a theoretical exercise but as a practical tool that must operate on real-world investment timelines.

### **CARBON BORDER ADJUSTMENT MECHANISM (CBAM) — LEAKAGE PROTECTION WITH BROAD AFFORDABILITY SAFEGUARDS**

California's carbon market currently addresses leakage risk primarily through free allocation, Cap Adjustment Factor adjustments, and transitional incentive mechanisms such as the proposed Manufacturing Decarbonization Incentive. These tools operate on the in-state production side of the equation. They are designed to moderate the compliance burden for facilities producing within California's regulatory jurisdiction.

They do not address the embedded emissions associated with imported products that enter the California market without facing an equivalent carbon cost.

As allowance budgets decline and compliance costs rise, this asymmetry becomes more consequential. A California cement facility, refinery, glass manufacturer, or fuel supplier internalizes the carbon cost through allowance purchases or reduced allocation. An out-of-state or foreign producer selling into California may not. The result is a widening differential in regulatory cost exposure.

This dynamic creates two distinct forms of pressure. The first is direct product competition between jurisdictions. The second, and in many respects more consequential, is internal capital allocation pressure within firms. Many covered entities operate in multiple states or countries. Investment committees allocate capital based on projected returns adjusted for regulatory risk. When carbon costs rise in California without comparable treatment of imported products, the internal case for investing in California production assets weakens.

A border carbon adjustment mechanism is therefore conceptually appropriate as a leakage-protection tool. By aligning the carbon cost of imported products with that of in-state production, a CBAM levels the playing field between producers competing in the California market.

However, a CBAM does not eliminate the need for free allocation or other leakage-protection measures. Nor does it insulate consumers from carbon price impacts. These distinctions are critical.

Free allocation and CAF-based assistance address internal capital allocation pressures. They influence whether a firm chooses to modernize an existing California facility or redirect capital elsewhere. A CBAM addresses competitive pressure at the product boundary. These mechanisms serve different functions and should not be treated as substitutes.

ClimateBuild therefore supports the initiation of a phased rulemaking to develop a CBAM, beginning with a mandatory reporting period. Under such a framework, importers of defined emissions-intensive, trade-exposed goods would report embedded emissions using standardized methodologies. CARB would analyze import penetration, emissions differentials, impacts on in-state production, and potential consumer cost effects over a defined period before considering the imposition of a compliance obligation.

A reporting-first structure reduces implementation risk and allows CARB to develop a credible evidentiary basis before imposing new compliance requirements. Other jurisdictions have adopted transitional reporting phases for similar reasons. Sequencing matters when designing instruments with trade and supply-chain implications.

At the same time, any future CBAM proposal must explicitly evaluate its interaction with existing leakage-protection mechanisms. A CBAM should not automatically displace or diminish free allocation absent clear, evidence-based findings that such changes will not increase leakage risk or undermine consumer affordability. Industrial facilities in California face competitive pressure not only from external producers but also from internal corporate capital allocation decisions. Removing free allocation prematurely, even in the presence of a CBAM, could exacerbate capital flight and reduce in-state production.

Accordingly, ClimateBuild recommends that any regulatory language authorizing a future CBAM include a non-preemption principle requiring the Board to evaluate interactions with existing leakage-protection tools and to make specific findings before reducing those tools.

Equally important is the treatment of revenues. A CBAM, if structured as a compliance obligation, will generate revenue. Carbon pricing impacts extend broadly across the economy, influencing electricity rates, fuel prices, transportation costs, and the price of emissions-intensive goods. If CBAM revenues are directed narrowly into programmatic expenditures rather than returned broadly to the public, the policy risks reinforcing cost-of-living pressures.

ClimateBuild therefore urges that any CBAM revenue be returned broadly and transparently to Californians through mechanisms such as ratepayer bill credits or tax relief, rather than through narrowly targeted spending programs. Broad-based recycling strengthens public confidence in the fairness of the system and preserves the affordability-through-design principle that underlies these comments.

In combination with a leakage-triggered CAF safeguard, a deployable MDI structure, continued free allocation calibrated to objective indicators, and administrative clarity on offsets and CCUS, a CBAM can form part of an integrated leakage-protection architecture. No single mechanism is sufficient. Together, they can maintain environmental ambition while preserving industrial competitiveness and consumer affordability.

California must continue to reduce emissions. It must also remain an attractive jurisdiction for industrial investment. A carefully sequenced CBAM, designed to complement rather than replace existing tools and coupled with broad revenue recycling, can contribute to that balance.

### **Conclusion: AN INTEGRATED LEAKAGE AND AFFORDABILITY FRAMEWORK**

Taken together, the recommendations form a coherent design strategy.

ClimateBuild recommends:

- A Cap Adjustment Factor that operates as an objective leakage-risk safeguard rather than a purely formulaic decline.

- A Manufacturing Decarbonization Incentive structured around real-world project timelines and portfolio-based modernization.
- Free allocation calibrated to measurable leakage conditions.
- A phased CBAM framework that complements, rather than displaces, existing leakage protections and returns revenues broadly to the public.
- Offset usability protections that reduce administrative friction while preserving integrity.
- CCUS recognition pathways that maintain rigor but allow practical investment sequencing.

These elements are not isolated technical adjustments. They are interdependent components of a durable carbon market architecture.

California's cap will continue to tighten. That trajectory is not in dispute. The design question is how compliance costs are distributed and how leakage risk is managed while maintaining public trust.

Industrial facilities are facing competitive pressure not only from external producers but from internal corporate capital allocation decisions. Consumers are facing cost-of-living pressures that influence their perception of climate policy. Labor organizations are concerned about job retention and industrial modernization.

A carbon market that recognizes these realities and calibrates its mechanisms accordingly will remain durable. One that relies solely on mathematical stringency without economic calibration risks undermining its own longevity.

ClimateBuild's recommendations aim to strengthen, not weaken, California's climate framework. By embedding affordability and leakage protection into program design, CARB can maintain environmental ambition while preserving economic stability.

Thank you for your consideration of our comments. We look forward to discussing them or answering any questions you may have at your convenience.

Sincerely,

/s/

Mikhael Skvarla