March 9, 2026

Lauren Sanchez
Chair
California Air Resources Board
1001 I Street
Sacramento, CA 95814

Re: Comments on Proposed Amendments to the California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms Regulation

Ms. Sanchez:

The California Chamber of Commerce (CalChamber)[1] appreciates the opportunity to comment on the California Air Resources Board's (CARB) proposed amendments to the California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms regulation (the Proposed Amendments).

For more than a decade, California's cap-and-invest program has delivered significant, cost-effective emissions reductions while providing covered entities compliance flexibility and helping protect economic competitiveness. The program's durability has depended on maintaining a careful balance between climate ambition and economic feasibility. The Proposed Amendments significantly increase the program's emissions reduction ambition but do not include sufficient enhancements to cost-containment and leakage protection to preserve that balance.

Without stronger cost-containment and leakage safeguards, the Proposed Amendments risk driving production out of state, imposing excessive and unpredictable compliance costs on covered entities, and contributing to rising costs for California households and businesses. At a time when the state faces an acute affordability crisis, policy design choices that contribute to job loss, tax base erosion, and cost-of-living pressures ultimately undermine the long-term durability of California's climate leadership.

CalChamber submits these comments in the hope that further revisions can preserve the program's historic balance between ambition, affordability, and economic competitiveness.

I. The Proposed Amendments Represent a Significant Shift from Design Principles That Made Cap-and-Invest Durable and Are Contrary to AB 1207's Directive to Minimize Leakage and Consider Affordability and Cost-Effectiveness.

California's cap-and-invest program has endured because it was designed as a market-based compliance system grounded in least-cost principles. From its inception, the program placed cost-effectiveness and affordability at the heart of program design. It established a declining emissions cap while allowing covered entities flexibility in how reductions were achieved. Drawing from the successful Acid Rain Program, it freely allocated a portion of the budgeted allowances to emissions-intensive, trade-exposed (EITE) sectors to help reduce compliance burden. The program also provided necessary flexibility through the ability to trade allowances and also use carbon offsets to satisfy compliance obligations. The program design was further strengthened in its 2017 reauthorization which established strong price-containment mechanisms to prevent destabilizing cost spikes. These features established a structure to maintain economic stability while reducing emissions.

AB 1207's reauthorization of the program reaffirmed that CARB must design its regulations in a manner that minimizes emissions leakage and considers affordability and cost-effectiveness.[2] The Legislature did not direct CARB to pursue emissions reductions at any cost; rather, it reaffirmed that California's climate

[1] CalChamber represents a broad and diverse cross-section of California employers, including many of the covered entities that would be directly affected by the proposed rule package.
[2] See Health and Safety Code § 38562(b) (directing CARB to minimize leakage, consider the effect of its regulations on affordability and cost-effectiveness).

ambition must be paired with economic safeguards that prevent the displacement of production, protect consumers, and ensure that emissions reductions are achieved cost-effectively.

These design principles, intended to minimize economic disruption and reduce the risk that emissions (and the correlated jobs) shift outside of California, underpin the program's political and economic durability. When the regulated community and consumers alike have confidence that the program contains meaningful protections against excessive cost escalation and leakage, the framework is more likely to endure and deliver long-term climate results while minimizing price increases on consumers.

The Proposed Amendments threaten to materially alter that balance. As shown in Table 2 from the Initial Statement of Reasons (ISOR), CARB proposes to remove approximately 118 million allowances from the 2027–2030 annual budgets and an additional 146 million allowances from post-2030 budgets, while further aligning the 2031–2045 trajectory with the 85 percent reduction target in AB 1279.[3] The ISOR explains that, relative to the existing regulation, the amendments would result in 753 million fewer allowances between 2031 and 2045, in addition to the earlier reductions.[4] Cumulatively, the proposed budgets through 2045 represent a materially more stringent allowance trajectory than under the current program design.

The pace of cap reductions necessarily constrains the pool of allowances available for auction, industrial allocation, and climate credit. As the cap declines, the volume of allowances available for industrial transition assistance and leakage mitigation declines as well. At the same time, the Proposed Amendments also make the industrial allocation methodology more stringent. Even where existing allocation formulas remain in place, the absolute quantity of freely allocated allowances significantly diminishes over time. The combined effect is increased market exposure for covered entities that rely on allocation to mitigate leakage risk and to reduce pressure to pass compliance costs through to consumers. Taken together, these changes shift the program's center of gravity from a least-cost compliance framework to one that ultimately drives cost increases on to businesses and consumers. This structural shift is difficult to reconcile with AB 1207's directives on leakage minimization, affordability, and cost-effectiveness.

Hard-to-decarbonize sectors operate under long capital cycles and face global competition. For many facilities, commercially viable decarbonization pathways remain constrained by technological readiness, permitting timelines, and infrastructure availability. A least-cost framework should recognize these realities and sequence reductions accordingly. A structure that tightens supply without proportionate cost-containment and leakage protection risks accelerating compliance costs beyond the pace of technological readiness. This increases the likelihood of production displacement with attendant global emissions increases rather than the net emissions reductions California seeks.

The affordability implications are equally significant. Compliance costs imposed upstream are passed through supply chains, affecting transportation, goods movement, agriculture, construction, and other essential services. California households are already facing elevated energy and living costs. Structural tightening without commensurate flexibility and cost-containment increases the risk that the program will exacerbate cost pressures on consumers and small businesses.

As the cap tightens post-2030, preserving structural balance becomes even more critical. A durable Cap-and-Invest program must ensure that increased stringency is matched by proportionate enhancements in flexibility, leakage protection, and cost-containment. Without those safeguards, the Proposed Amendments risk departing from the design principles that made the program effective and durable. The primary purpose of the program must remain achievement of cost-effective emissions reductions as opposed to increased revenue generation.

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[3] Initial Statement of Reasons, January 20, 2026, Table 2 at Page 31.

[4] *Ibid*.

II. Maintaining Robust Industrial Allocation Is Essential to Minimizing Emissions Leakage

As discussed above, the Proposed Amendments significantly tighten the allowance budget over time. While a declining cap is the primary mechanism through which the cap-and-invest program achieves emissions reductions, maintaining effective protection against emissions leakage becomes increasingly important as allowance supply declines.

Since the program's inception, industrial allocation has served as one of the principal mechanisms for mitigating emissions leakage risk within the cap-and-invest framework.[5] EITE sectors such as cement, oil refining, metals production, glass manufacturing, and other industrial activities often compete in national or global commodity markets where prices are largely determined outside California. In these sectors, facilities frequently have limited ability to pass compliance costs through to customers. If compliance costs rise faster than technological decarbonization options become available, production likely shifts to jurisdictions with less stringent climate policies. When this occurs, the result can be the displacement of economic activity without corresponding global emissions reductions.

The tightening allowance trajectory proposed in the rulemaking increases the importance of maintaining a robust industrial allocation framework. Even if the underlying allocation formulas remain unchanged, reductions in the overall allowance budget reduce the absolute number of allowances available for industrial allocation over time. As allocation declines relative to compliance obligations, the share of emissions that facilities must cover through purchased allowances increases. For sectors facing global competition and limited near-term decarbonization options, this dynamic can increase leakage risk and weaken the business case for maintaining or expanding production in California.

AB 1207 reaffirmed that the cap-and-invest program must be implemented in a manner that minimizes emissions leakage while considering affordability and cost-effectiveness. Maintaining an effective industrial allocation framework is one of the most direct ways to implement this statutory direction. Industrial allocation helps maintain production in California, which means the associated emissions remain within the capped system rather than shifting to regions with less stringent climate policies. To preserve the environmental integrity of the program, CARB should consider revising the Proposed Amendments to ensure that industrial allocation continues to function as an effective leakage-mitigation tool under the more stringent cap trajectory.

CARB should review the trajectory of the Cap Adjustment Factor (CAF) applied to industrial allocation formulas to ensure that allocation reductions do not outpace the availability of viable decarbonization technologies. CARB should also ensure that allocation methodologies continue to account for production variability and facility growth so that efficient California facilities are not penalized for maintaining or expanding in-state production. In addition, CARB should periodically evaluate sector-specific leakage exposure to ensure that EITE industries continue to receive sufficient allocation to remain economically competitive as the cap tightens.

A thorough understanding of leakage risk is essential to informing these decisions. CalChamber notes that the rulemaking record does not appear to include an updated analysis of emissions leakage exposure associated with the significantly tighter cap trajectory proposed in the rulemaking. In prior discussions surrounding the cap-and-invest reauthorization process, CARB indicated that it was preparing updated analyses examining leakage risks across covered sectors. Such analysis would provide important context for evaluating whether the proposed allowance budgets and allocation framework provide sufficient protection for EITE industries as the program becomes more stringent.

In light of AB 1207's explicit directive to minimize emissions leakage, the availability of an updated and transparent leakage assessment is particularly important for informing regulatory decisions in this rulemaking. CalChamber therefore encourages CARB to release any updated leakage analysis and incorporate it into the rulemaking record so that stakeholders and CARB's Board can fully evaluate

[5] Other program design features such as the Allowance Price Containment Reserve and the ability to use offsets to satisfy a portion of compliance obligation also serve to enhance leakage protection.

whether the proposed regulatory framework adequately protects against emissions leakage while the cap tightens.

Maintaining robust industrial allocation does not weaken the environmental integrity of the cap-and-invest program. The emissions cap continues to determine the overall quantity of emissions allowed within the program. Allocation simply determines how compliance costs are distributed among regulated entities. By maintaining sufficient leakage protections, CARB can ensure that emissions reductions occur through technological innovation and efficiency improvements rather than through the relocation of production outside California. Keeping industrial allocation strong and predictable as the cap tightens will help preserve the balance between environmental ambition and economic competitiveness that has historically defined California's cap-and-invest program.

III. Program Design Should Ensure That Allowance Value Does Not Undermine Affordability

As the emissions cap declines and allowance scarcity increases, the cap-and-invest program will generate increasing compliance costs that ultimately flow through California's economy. While the program is intended to drive cost-effective emissions reductions, it also generates substantial allowance value through auctions and compliance instrument trading transactions. How that value is managed becomes increasingly important to ensure that the program remains consistent with AB 1207's direction to consider affordability and cost-effectiveness.

Historically, California's cap-and-invest program incorporated multiple design features intended to prevent excessive allowance price escalation and to mitigate the downstream economic impacts of carbon pricing. These included robust price-containment mechanisms, predictable allowance supply responses, and the return of significant allowance value to consumers through utility climate credits. Together, these mechanisms helped ensure that the program's carbon price signal encouraged emissions reductions without producing abrupt or destabilizing cost increases for households and businesses.

As the cap becomes more stringent, preserving these affordability protections becomes even more important. Without adequate safeguards, tightening allowance supply can increase the likelihood that the program's revenue generating component acts as an inflationary force that imposes escalating costs across the economy. Because compliance costs are embedded in energy prices and supply chains, these impacts ultimately flow through to households, small businesses, and essential sectors such as transportation, construction, agriculture, and goods movement. Ensuring that program design features continue to moderate allowance price escalation is therefore an essential component of implementing AB 1207's directives on affordability and cost-effectiveness.

Several targeted adjustments to the program's price-containment and allowance-supply mechanisms could help maintain affordability while preserving the environmental integrity of the program.

First, CARB should preserve the current Allowance Price Containment Reserve (APCR) trigger that allows allowances contained in the APCR to be released when market prices reach 60 percent of the applicable price ceiling rather than the 80 percent threshold in the Proposed Amendments. This trigger acts as an additional safeguard to prevent excessive price escalation before the market reached the ceiling level. Preserving the current lower trigger threshold of 60 percent, given the tightened allowance supply, is necessary to help reduce the risk that allowance price spikes will negatively impact California cost of living.

Second, CARB should evaluate whether the volume of allowances available through the APCR remains sufficient given the significantly tighter allowance budgets in the Proposed Amendments. As the cap declines, the size and responsiveness of the reserve become increasingly important to maintaining market stability. Adjustments to the reserve volume or replenishment structure may therefore be necessary to ensure that the mechanism continues to function as an effective price-containment tool under the more stringent cap trajectory.

Third, CARB should evaluate whether the current price escalation structure remains appropriate given the significantly tighter allowance budgets contemplated in the Proposed Amendments. Under the existing program design, key price-containment parameters, including the auction reserve price, the APCR tier prices, and the price ceiling, are adjusted annually at a rate of five percent plus inflation. This structure

was originally adopted to ensure that the carbon price signal increased in real terms over time. However, when combined with a significantly tightening cap, this administrative escalator can contribute to rapid increases in allowance prices.

Limiting the annual escalation of these price-containment parameters to inflation, rather than five percent plus inflation, would help moderate the long-term trajectory of allowance prices while preserving the program's carbon pricing signal. Because allowance prices would continue to increase with inflation, the program would retain an increasing nominal price floor while reducing the risk that administrative escalators compound the effects of tightening allowance supply.

Finally, CARB should ensure that the design of the program does not create incentives for excessive revenue generation that are disconnected from emissions-reduction objectives. The emissions cap determines the environmental outcome of the program. Auction revenue is a byproduct of the compliance system rather than its primary purpose. Program design should therefore prioritize cost containment, leakage prevention, and affordability alongside emissions reductions to preserve the long-term durability of California's climate policy framework.

Taken together, these adjustments would help ensure that the cap-and-invest program continues to deliver emissions reductions in a cost-effective manner while protecting California households and businesses from excessive compliance cost impacts.

IV. The Transition of Allowance Allocation from Natural Gas Corporations to Electrical Distribution Utilities Must Be Structured to Minimize Ratepayer Impacts

One of the central mechanisms for mitigating the cap-and-invest program's impacts on consumers is the free allocation of allowances to electrical distribution utilities (EDUs) and natural gas corporations (NGCs). The value of these allowances is returned to customers through bill credits intended to offset a portion of the compliance costs utilities incur under the cap-and-invest program. For electric customers, this value is typically returned as a semiannual bill credit. For natural gas customers, allowance value similarly supports the Natural Gas Climate Credit, helping moderate the rate impacts associated with carbon compliance obligations embedded in gas service.

These credits function as important ratepayer protection mechanisms to help ensure that the carbon price signal embedded in the system does not translate into abrupt or disproportionate increases in household energy bills. These credits have played a meaningful role in maintaining the affordability and public durability of the program by offsetting billions of dollars of cap-and-invest compliance costs that would have otherwise found their way into ratepayer bills.

AB 1207 directed CARB to update the Cap-and-Invest Program in a manner that advances California's climate goals while maintaining affordability and protecting ratepayers. In particular, the statute amended Health and Safety Code section 38562(b) to direct CARB to "design the regulations, including the distribution of emissions allowances ***where appropriate***, in a manner that transitions support from gas corporations to electrical distribution utilities, as defined in Section 95802 of Title 17 of the California Code of Regulations, on or before January 1, 2031, ***to minimize ratepayer impacts*** and achieve the requirements of Sections 38562.2 and 38566 and the purposes of this division."[6,7] The statute also reinforces an existing requirement that CARB ensure compliance activities do not disproportionately impact low-income communities.[8] Together, these provisions reflect a clear legislative expectation that the transition of California's energy system, particularly the relationship between the electric and natural gas systems, must be managed carefully to protect both electric and natural gas customers.

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[6] Health and Safety Code § 38562(b)(1)(B) (emphasis added).

[7] It is important to note that the addition of this section puts a timeline on when CARB must its regulatory design. It directs CARB to update its regulations by January 1, 2031, to facilitate the transition. It is not a mandate to complete a transition of support by January 1, 2031.

[8] Health and Safety Code § 38562(b)(2).

The Proposed Amendments begin to implement this transition by shifting the distribution of allowances currently associated with natural gas utilities toward electrical distribution utilities over time. The proposal contemplates beginning this transition in the late 2020s and completing it in the following decade. CalChamber recognizes that CARB has attempted to phase in this shift rather than implement it abruptly. Nonetheless, the rulemaking does not yet fully address the broader structural implications of this transition for ratepayers, particularly in light of the fact that a majority of California households and businesses continue to rely on natural gas as an essential energy service.

Natural gas remains a critical component of California's energy system. It provides cost-effective space heating, water heating, and cooking for millions of households. It also plays a significant role in industrial processes, commercial operations, and electricity generation reliability. While the State is pursuing policies that encourage electrification of end uses over time, the pace of electrification will depend on technology readiness, infrastructure upgrades, permitting timelines, building retrofits, and consumer adoption. These changes occur over long investment cycles and require substantial investments by both utilities and customers. As a result, the transition away from natural gas will occur gradually rather than instantaneously.

Against this backdrop, the distribution of Cap-and-Invest allowance value has historically served as an important mechanism for mitigating ratepayer impacts associated with carbon pricing. Shifting those allowances away from natural gas utilities necessarily reduces the resources available to moderate the rate impacts of the cap-and-invest program for gas customers. While such a shift may be consistent with long-term electrification objectives, the timing and structure of the transition must be carefully aligned with the pace at which households and businesses can realistically transition their energy use.

If the transition occurs more rapidly than electrification can occur in practice, the result may be an unintended cost imbalance. As allowance value shifts toward the electric sector and away from the gas system, natural gas customers may experience rising rates while many households remain dependent on gas service. Because gas utility infrastructure costs are largely fixed, they must be recovered from the remaining customer base even as overall gas demand gradually declines. If customers begin leaving the gas system faster than infrastructure costs can be retired, the remaining customers may face increasing per-customer cost burdens. This dynamic presents a significant challenge in managing the long-term gas system transition.

These concerns are particularly acute for low-income households and other consumers who may face significant barriers to electrification. Many households do not have the financial resources to replace functioning gas appliances with electric alternatives. Renters may not have control over building energy systems. Older housing stock may require electrical panel upgrades or other structural improvements before electrification is feasible. For these households, continued reliance on natural gas may not be a matter of preference but of economic necessity.

Maintaining some level of continued protection from the costs imposed by cap-and-invest on natural gas ratepayers beyond the transition period described in the Proposed Amendments may be necessary to avoid unintended equity and affordability impacts. This does not mean delaying the transition indefinitely; rather, it means ensuring that the transition occurs in a manner that aligns with technological readiness, infrastructure planning, and consumer capabilities.

The Legislature recognized these realities in AB 1207 when it directed CARB to design the allowance transition in a manner that minimizes ratepayer impacts and protects vulnerable communities. Consistent with that direction, the Proposed Amendments should be revised to allow natural gas utilities to petition CARB to adjust the schedule for the transition of allowances upon a showing that the transition is failing to minimize ratepayer impacts or protect vulnerable communities. Such a petition process would provide CARB with a targeted mechanism to respond to emerging affordability concerns while maintaining the long-term trajectory of the program.

V. The Proposed Manufacturing Decarbonization Incentive Requires Additional Flexibility to Function as an Effective Industrial Decarbonization and Leakage-Protection Tool

CalChamber appreciates CARB's recognition that declining allowance budgets alone may not be sufficient to drive deep emissions reductions in certain industrial sectors. Many manufacturing facilities operate complex, capital-intensive processes with long investment cycles, specialized equipment, and limited near-term technology substitution options. As a result, policies that encourage modernization investments at covered facilities can play an important role in reducing emissions while maintaining in-state production capacity and avoiding emissions leakage.

The proposed Manufacturing Decarbonization Incentive (MDI) reflects an important step in that direction. As described in the ISOR, the program is intended to support investments in emissions-reduction projects at covered industrial facilities and help mitigate leakage risks as the cap declines.

The policy objective is laudable. However, whether the program ultimately succeeds will depend on whether the regulatory structure allows the incentive to function as a practical capital-deployment mechanism for industrial facilities. If the design is too rigid or administratively complex, the program risks becoming aspirational rather than practical. Without additional flexibility in several key areas, participation in the program may be limited and the incentive may not achieve its intended objective of accelerating emissions-reduction investments in California's manufacturing sector.

A. The Program's Structure Aligns with Policy Objectives but Limits Practical Deployment

The proposed MDI is structured as a mechanism that allows certain industrial facilities to receive additional allowances through a modification of the Cap Adjustment Factor, provided that the value associated with those additional allowances is used to support qualifying emissions-reduction investments at the facility. This approach is conceptually consistent with the program's broader objective of reducing leakage risk while encouraging modernization in emissions-intensive sectors.

Eligibility is further limited to facilities in specified manufacturing sectors based on NAICS classifications used in the Mandatory Reporting Regulation. Many entities covered under the cap-and-invest program, including fuel suppliers and other energy-sector participants responsible for significant portions of the program's compliance obligations, are not eligible to participate.

While CARB may intend to focus the incentive on leakage-exposed manufacturing sectors, the narrow eligibility criteria substantially limit the potential scale of the program. As a result, the MDI should be viewed not as a broad decarbonization incentive across covered sectors, but rather as a targeted modernization tool for a subset of industrial facilities.

To improve the program's effectiveness, CARB should consider allowing participation by additional covered entities that can demonstrate emissions reductions from qualifying investments at covered facilities. Expanding eligibility to include other covered facilities undertaking verifiable emissions-reduction investments would increase the number of potential projects and improve the program's ability to deliver meaningful emissions reductions.

B. The Eligible Activity Structure May Not Reflect the Full Range of Industrial Decarbonization Pathways

The proposed MDI is structured as a restricted-use incentive tied to a defined set of eligible emissions-reduction activities. Under the Proposed Amendments, facilities receiving MDI allocations must use the value associated with those allowances to support one or more specified categories of greenhouse gas reduction investments at the facility. These categories include the use of exempt biomass-derived fuels for qualifying uses, electrification of equipment that reduces onsite fossil fuel combustion, procurement or use of qualifying low-carbon hydrogen, installation of renewable electricity generation or energy storage that displaces fossil fuel use, renewable thermal energy technologies such as solar thermal or geothermal systems, and electrified thermal energy procurement.

While these categories encompass several important decarbonization pathways, they may not capture the full range of emissions-reduction strategies available to many industrial facilities. Industrial

decarbonization is highly sector-specific, and facilities often pursue modernization through a combination of process improvements, material substitutions, waste heat recovery, efficiency upgrades, and other operational changes that do not necessarily fit within predefined technology categories. In some sectors, the most effective emissions-reduction strategies involve modifications to production processes or integrated system upgrades rather than discrete equipment substitutions.

Because the proposed rule structures eligibility around a defined list of qualifying activities, facilities whose most practical emissions-reduction opportunities fall outside these categories may have limited ability to utilize the incentive. This could reduce the effectiveness of the program by steering investments toward technologies that fit regulatory definitions rather than toward those that produce the most cost-effective emissions reductions for a particular facility.

This issue is particularly relevant for sectors with substantial process emissions or complex thermal systems, where decarbonization pathways may involve multiple incremental changes rather than a single identifiable project. Facilities in sectors such as cement, metals production, refining, glass manufacturing, and other energy-intensive industries often implement emissions reductions through coordinated operational changes across multiple systems. In such cases, the most effective modernization strategies may include process redesign, material efficiency improvements, carbon management, or integrated energy management strategies that do not align neatly with a single eligible activity category.

Providing greater flexibility in how qualifying investments are defined could significantly improve the program's ability to support meaningful industrial decarbonization. One approach would be to supplement the list of eligible activities with a performance-based eligibility provision allowing facilities to use incentive value for any investment that directly reduces covered greenhouse gas emissions at the facility and that can be verified through existing emissions reporting frameworks. Such an approach would preserve the environmental integrity of the program while allowing facilities to pursue the most effective decarbonization strategies for their operations.

Providing this additional flexibility would better align the Manufacturing Decarbonization Incentive with the realities of industrial operations while maintaining the program's objective of accelerating emissions-reduction investments in California's manufacturing sector. A more adaptable framework would allow facilities to pursue the most effective emissions-reduction strategies available to them, improving the program's overall environmental and economic performance.

C. The Return Requirement Should Be Evaluated in Light of the Program's Leakage-Prevention Objectives

The proposed five-year spending requirement should also be considered in the context of the cap-and-invest program's broader approach to mitigating emissions leakage.

Industrial allocation under the program is designed to reduce leakage risk by helping EITE facilities remain competitive during the transition to a lower-carbon economy. Through mechanisms such as the Cap Adjustment Factor and production allocation methodologies, the program seeks to maintain in-state production while facilities undertake emissions-reduction investments.

The proposed Manufacturing Decarbonization Incentive (MDI) operates within that framework by providing additional allocation to facilities that commit to undertaking qualifying emissions-reduction activities. Under the Proposed Amendments, however, facilities must spend the value associated with those additional allowances on eligible greenhouse-gas-reduction activities within five years of the vintage year of the allowances. If the value is not spent within that timeframe, the facility must return an equivalent number of allowances calculated based on the unspent value.

This structure introduces execution risk for facilities evaluating whether to participate in the program. Industrial modernization projects often unfold over extended planning horizons and can be influenced by factors outside the direct control of individual facilities, including environmental review timelines, infrastructure development schedules, equipment procurement lead times, and other regulatory approvals. When the incentive is conditioned on meeting a fixed spending window, facilities may need to consider the possibility that project timelines could extend beyond the regulatory deadline even when investments are progressing in good faith.

From an investment perspective, this uncertainty may affect how facilities evaluate the incentive when making long-term capital planning decisions. Companies typically evaluate major industrial modernization projects based on multi-year planning horizons and a range of regulatory and market considerations. If there is significant uncertainty regarding whether incentive allocations can ultimately be retained, the perceived value of the program may be discounted in internal investment analyses.

One factor that may influence the practical usability of the incentive is how CARB interprets the types of expenditures that qualify as spending on eligible activities. Industrial decarbonization projects typically require substantial upfront project development work before physical equipment can be installed. These efforts often include engineering design, feasibility studies, environmental review, permitting work, equipment procurement planning, and other technical analyses necessary to implement major facility modifications. These expenditures are integral components of implementing emissions-reduction investments and are commonly treated as capital project development costs within industrial investment planning.

For this reason, CARB should clarify that reasonable project development expenditures directly associated with eligible decarbonization investments, such as engineering studies, design work, environmental review preparation, permitting activities, and equipment procurement commitments, qualify as spending on eligible greenhouse-gas-reduction activities. These types of expenditures should not be categorized as administrative or overhead costs when they are directly tied to the development and implementation of qualifying emissions-reduction projects.

Providing this clarification would better align the program with the realities of industrial capital planning. Large industrial modernization projects often require several years of engineering, environmental review, and procurement planning before equipment installation can begin. Recognizing these activities as legitimate project expenditures would ensure that facilities can use the incentive in a manner consistent with the development timelines of complex decarbonization investments.

More broadly, CARB should also consider providing limited implementation flexibility where facilities demonstrate documented progress toward qualifying investments but encounter delays related to permitting processes, interconnection timelines, supply-chain disruptions, or other factors outside the facility's reasonable control. Allowing the Executive Officer to recognize documented project expenditures or binding contractual commitments toward eligible activities would preserve program accountability while improving the incentive's ability to support real-world industrial decarbonization efforts.

Ensuring that the Manufacturing Decarbonization Incentive can function as a practical capital-deployment mechanism, rather than only as a narrowly defined equipment purchase requirement, will help the program more effectively support emissions reductions while maintaining the competitiveness of California's manufacturing sector.

D. Initial Application Timeline and Administrative Feasibility

CARB should also re-evaluate whether the proposed application timelines for the initial MDI application cycle allow sufficient time for facilities to meaningfully participate. Proposed § 95891(g)(5) establishes an application deadline of September 1, 2026, for budget years 2027 and 2028, with subsequent deadlines for later years. Given that the Board hearing for the Proposed Amendments is scheduled for late May 2026, and that the rulemaking process will include final adoption and review by the Office of Administrative Law, the proposed September 2026 deadline may leave facilities with limited time to evaluate program requirements, develop qualifying project proposals, and prepare complete applications.

Industrial decarbonization projects typically require careful technical analysis, internal capital planning, and coordination with engineering, permitting, and financing teams before a facility can commit to a specific investment proposal. If the initial application window occurs before facilities have sufficient clarity regarding program implementation details or guidance, otherwise viable projects may be unable to participate simply due to timing constraints.

To improve administrative feasibility and maximize participation in the program's early years, CARB should consider extending the initial application deadline for the 2027 and 2028 budget years or adopting a two-step application structure. Under such an approach, facilities could submit a short-form notice of

intent within the initial deadline to indicate interest in pursuing a qualifying project, followed by a more detailed application once implementing guidance and program administration procedures are fully established. Providing additional flexibility in the early application timeline would help ensure that the MDI is accessible to facilities with legitimate emissions-reduction projects while maintaining the integrity of the program's review process.

VI. CARB's Proposed Offset Accounting Mechanism Is a Constructive Approach to Implementing AB 1207 and Stabilizing the Allowance Market; However Additional Safeguards to Protect Consumers are Needed

CalChamber supports CARB's proposal to implement AB 1207's offset-related allowance retirement requirement through the creation of an "Allowance Removals for Offset Use" account under proposed § 95871(j). AB 1207 requires that a number of allowances equal to the total number of offset credits used for compliance obligations in the prior year be removed from the following year's annual allowance budget and retired. Implementing this requirement in a way that preserves market stability is critical to maintaining the affordability and durability of the cap-and-invest program.

CARB's proposed mechanism represents a thoughtful attempt to operationalize this statutory requirement while minimizing disruptive fluctuations in allowance supply. Under the proposal, CARB would remove a quantity of allowances each year based on the maximum allowable offset usage for covered emissions and place those allowances into a newly created account. After the completion of each full compliance period, CARB would retire allowances from this account equal to the actual number of offset credits used for emissions compliance during that period and gradually return any excess allowances to auction in subsequent years.

This account-based approach appropriately recognizes that offset usage is not evenly distributed across years. Historically, regulated entities have tended to utilize offsets later in a compliance period, which can lead to significant year-to-year variation in the number of offsets used for compliance. Without a smoothing mechanism, AB 1207's retirement requirement could create predictable "spike years" in which large quantities of allowances are removed from auction supply following periods of high offset usage. Such swings could create unnecessary volatility in allowance availability and increase the risk of price instability.

CalChamber agrees with CARB's diagnosis that predictable supply spikes could create volatility and planning challenges for regulated entities and market participants. The use of an account-based approach to smooth these effects is therefore a constructive policy choice that supports market stability and affordability while remaining faithful to the statutory requirements of AB 1207.

At the same time, anchoring annual allowance withdrawals to the theoretical maximum offset usage may result in the removal of more allowances from near-term supply than is necessary in years when actual offset usage is below that maximum threshold. If actual offset utilization remains materially below the maximum allowable level, the account could accumulate a significant volume of allowances that are temporarily withheld from the market. While these allowances would eventually be returned to auction under the proposal, the interim tightening of allowance supply could contribute to unnecessary price pressure.

CARB has appropriately recognized this possibility and has invited stakeholder feedback on whether alternative implementation approaches may better balance statutory compliance with market stability. CalChamber recommends that CARB retain the core account-based smoothing mechanism but incorporate additional safeguards to ensure that the mechanism does not unintentionally constrain allowance supply.

First, CARB should consider establishing a mid-period review or within-compliance-period true-up mechanism that would allow excess allowances held in the account to be returned to auction earlier if actual offset usage trends materially below the maximum assumed level. Such a provision would help

ensure that the account functions as a supply-smoothing mechanism rather than as a source of unnecessary scarcity.

Second, CARB should provide transparent and regular reporting on the operation of the account. At a minimum, annual public reporting should include the number of allowances withdrawn from the budget, the quantity held within the account, the number retired following each compliance period, and the number returned to auction. Providing this level of transparency will allow market participants to evaluate whether the mechanism is functioning as intended and will strengthen confidence that the system is not producing unintended market distortions.

With these modest refinements, the proposed offset accounting structure could effectively implement AB 1207's statutory requirements while minimizing unnecessary volatility in allowance supply. Maintaining predictable allowance availability is essential to ensuring that the cap-and-invest program continues to deliver emissions reductions in a cost-effective manner while protecting California households and businesses from unnecessary compliance cost fluctuations.

VII. Conclusion

California's cap-and-invest program has remained durable because it balances environmental ambition with economic practicality. Its market-based design, grounded in cost containment, compliance flexibility, and strong leakage protections, has allowed the State to reduce emissions while maintaining economic competitiveness and moderating impacts on consumers.

As the cap tightens and the program enters a significantly more stringent phase, preserving that balance becomes even more important. Achieving California's long-term climate goals depends on keeping the program affordable and predictable just as much as it depends on the level of ambition embedded in the cap.

Several elements of the Proposed Amendments move in a constructive direction, including the proposed Manufacturing Decarbonization Incentive and offset account. However, additional refinement is necessary to ensure the program minimizes leakage and limits the costs imposed on consumers and businesses. Strengthening cost-containment mechanisms, maintaining robust industrial allocation, protecting ratepayers during the transition of allowance value, and improving the practical usability of the Manufacturing Decarbonization Incentive will help preserve the program's long-standing balance between climate ambition and economic durability.

CalChamber appreciates the opportunity to provide these comments and looks forward to continued engagement with CARB as the rulemaking proceeds.

Sincerely,

Jonathan Kendrick
California Chamber of Commerce