

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

GABRIEL PETEK | LEGISLATIVE ANALYST | DECEMBER 2025

SUMMARY

Legislature Recently Extended and Modified Cap-and-Invest Program. In September 2025, the Legislature adopted Chapter 117 of 2025 (AB 1207, Irwin) and Chapter 121 of 2025 (SB 840, Limón), which extended and made various changes to the cap-and-invest program. These changes: (1) modified the program’s design features and allowance allocations; (2) added reporting, evaluation, and oversight provisions; and (3) changed the allocation of Greenhouse Gas Reduction Fund (GGRF) revenues.

Issues for Legislative Consideration and Oversight. In this report, we summarize the major changes contained in AB 1207 and SB 840 and identify some key potential implications, including:

- **Extension Provides Certainty That Key Climate Strategy Can Continue.** The passage of these two pieces of legislation ensures one of the state’s main climate strategies—the cap-and-invest program—can continue for the next two decades. Also, by providing clear statutory authority, the legislation removes potential legal uncertainty, which helps businesses make long-term investment decisions and facilitates the state’s plans for how it can pursue its greenhouse gas (GHG) goals.
- **While the Legislation Maintains Most Aspects of the Program, Changes Reflect Legislative Goals.** The legislation maintains most aspects of the program, including retaining significant discretion for the implementing department, the California Air Resources Board (CARB), to make important decisions on the program’s design. However, the legislation also makes some notable changes to reflect legislative priorities and goals, such as related to affordability and GHG reduction.
- **Changes in GGRF Allocations Will Affect Funding for Particular Programs.** Senate Bill 840 allocates GGRF to a similar mix of programs as has been the case historically, while making some key modifications that will affect the funding levels that particular programs receive. For example, SB 840 makes some allocations fixed amounts rather than percentage allocations, which frees up funding for other legislative priorities in years when revenues are relatively high.
- **Certain Effects of the Legislation Will Become Clearer Over Time and Will Depend on CARB Decisions.** The legislation has important potential implications for key state priorities, such as addressing climate change and preserving affordability. However, how the impacts will unfold still is uncertain and will depend heavily on CARB’s forthcoming decisions.
- **Some Important Legislative Decisions Remain.** Some important decisions remain for the Legislature, such as related to establishing a new oversight entity envisioned by the legislation and spending the portion of GGRF that is not already allocated to specific programs through statute.
- **Legislative Oversight of Program Continues to Be Important.** Continued and robust legislative oversight of the program—including related to CARB’s future rulemakings—can help ensure that it operates effectively and balances competing policy trade-offs in a way that is consistent with legislative priorities.
- **Oversight Provisions Have Potential to Help Ensure the Program Is Meeting Intended Goals, but Effectiveness Will Depend Upon Implementation.** The new oversight provisions added by AB 1207 and SB 840 could provide the Legislature and other interested parties with important information to help direct future policy and regulatory decisions. The ultimate effectiveness of these provisions, however, will depend on the specifics of how they are implemented.

INTRODUCTION

Legislature Adopted Cap-and-Invest Legislation at the End of the 2025 Session.

In September 2025, the Legislature adopted a package of several pieces of energy and climate-related legislation. This package included two bills, AB 1207 and SB 840, that extended and made important changes to the cap-and-invest program, one of the state's core efforts aimed at reducing GHG emissions. (This program historically has been called "cap-and-trade." As we discuss later in this report, AB 1207 expresses the Legislature's intent to rename the program "cap-and-invest." Accordingly, for simplicity,

we refer to the program as cap-and-invest throughout this report.)

This Report Summarizes and Comments on the 2025 Cap-and-Invest Legislation. This report begins with some background information. Next, we provide a summary of the key components of AB 1207 and SB 840, which include changes that (1) modify the program's design features and allowance allocation; (2) add reporting, evaluation, and oversight provisions; and (3) modify the allocation of the auction proceeds that are deposited into GGRF. Finally, we summarize some notable implications of these two pieces of legislation and provide some concluding thoughts.

BACKGROUND

State Created Cap-and-Invest Program 13 Years Ago to Help Meet Climate Goals.

To try to reduce California's contributions to climate change and encourage innovations that influence actions in other states and countries, the Legislature has adopted three successive statewide GHG emission reduction goals for 2020, 2030, and 2045. The state has implemented various programs and policies in order to meet these goals. For example, in 2006, the Legislature adopted Chapter 488 (AB 32, Núñez), which authorized CARB to create a market-based mechanism to reduce GHG emissions from large emitters through 2020. Under this authority, CARB established the cap-and-invest program—which first took effect in 2012—as the market-based mechanism.

Cap-and-Invest Program Aims to Limit the Overall Level of Emissions From Large Emitters.

Under the cap-and-invest program, CARB issues a limited number of allowances each year—this is what is referred to as the "cap" on emissions. Entities that must comply with the program represent roughly three-quarters of the state's GHG emissions and include oil refineries, electricity generators and importers, and manufacturing facilities. These "covered entities" can meet compliance obligations under the program through a combination of the following actions:

- Reducing their GHG emissions.
- Obtaining allowances (essentially a permit to emit one ton of carbon dioxide equivalent) to cover their emissions.
- Purchasing "offsets" (paying to support a GHG reduction project outside of the capped sectors) to cover their emissions.

We provide additional background on the cap-and-invest program in other publications, including [California's Cap-and-Trade Program: Frequently Asked Questions](#) and [Assessing California's Climate Policies: Cap-and-Trade Reauthorization](#).

In 2017, Cap-and-Invest Was Extended Through 2030. Subsequent to AB 32, in 2017, the Legislature enacted Chapter 135 (AB 398, E. Garcia) to extend the explicit statutory authorization for the cap-and-invest program through 2030. With the passage of AB 398, the Legislature opted to provide more specific direction about certain program design features, including the use of offsets. However, AB 398 still granted CARB broad authority to make decisions about many aspects of the program, such as determining the number of allowances to be issued each year and the maximum amount at which an allowance could be sold (known as the price ceiling).

Governor Proposed Budget Trailer Legislation to Extend Program Largely “As Is” Through 2045... In May 2025, the Governor proposed budget trailer legislation to extend the cap-and-invest program through 2045. The proposal generally would have maintained the same statutory guidance as was contained in AB 398 (sometimes referred to as a “straight reauthorization”). (We discussed this proposal in [The 2025-26 Budget: May Revision Proposals for Cap-and-Trade Reauthorization and Greenhouse Gas Reduction Fund](#).)

...But Legislature Extended a Modified Version of Program Through the Policy Process Instead. The enacted June 2025 budget agreement did not include action on the Governor’s proposed budget trailer legislation, instead deferring consideration of the cap-and-invest program to the policy process. Ultimately, in September 2025, the Legislature adopted two policy bills related to the program—AB 1207 and SB 840. Assembly Bill 1207 included most of the changes to the program itself and to the allocation of the program’s allowances, while SB 840 mainly focused on modifications to the allocation of the associated GGRF revenues. We discuss these two pieces of legislation in greater detail below.

KEY COMPONENTS OF LEGISLATION

Assembly Bill 1207 and SB 840 include provisions that (1) make various changes to the program’s design features and allocation of allowances; (2) add new reporting, evaluation, and oversight requirements; and (3) modify the allocation of GGRF revenues to various programs.

Key Changes to Program’s Design Features and Allowance Allocations

Assembly Bill 1207, and to a lesser extent SB 840, modify the design of the program and the use of the free allowances that are provided to utilities and industry. We summarize the key changes in **Figure 1** on the next page, and briefly highlight a few of them below.

Extends Program Through 2045 and Renames It Cap-and-Invest. Assembly Bill 1207 extends CARB’s explicit authority to operate the program—which had been set to expire at the end of 2030—through the end of 2045. The legislation also states the intent of the Legislature to rename the program cap-and-invest.

Makes Some Changes to Program’s Design Features. Assembly Bill 1207 and SB 840 make some changes to the design of the cap-and-invest program. Most notably, they modify the way the program handles offsets. For example, AB 1207 specifies that for each offset that is used to meet a compliance obligation, an allowance is removed

from the subsequent year’s allowance budget. (This approach is often referred to as placing offsets “under the cap.”) This is a significant change from the program’s prior approach, under which the use of offsets did not affect the number of allowances available for purchase and use by entities covered under the program. Senate Bill 840 also includes some provisions related to offsets. For example, the legislation requires CARB to update the rules governing the eligibility and quantification of offsets (known as offset compliance protocols) to reflect the best available science by January 1, 2029, and evaluate them for potential update every five years thereafter.

Modifies Utility and Industry Allowances.

Assembly Bill 1207 makes various modifications to the way free allowances are provided to utilities and industry, including:

- ***Reallocates Allowances Across Different Types of Utilities.*** Currently, both natural gas and electric utilities receive free allowances. These are intended to be used primarily to benefit ratepayers, such as by providing annual or biannual rebates known as the “California Climate Credit.” Assembly Bill 1207 requires CARB, by January 1, 2031, to design regulations that shift the free allowances that natural gas utilities currently receive to instead

Figure 1

Key Changes in Cap-and-Invest Design Features and Allowance Allocations

Prior Law and/or Regulation	AB 1207 and SB 840 ^a
Program Sunset and Name	
<ul style="list-style-type: none"> Sunset date of January 1, 2031. Program named “cap-and-trade.” 	<ul style="list-style-type: none"> Sunset date of January 1, 2046. Expresses intent to rename the program “cap-and-invest.”
Linkage to State Climate Goals	
<ul style="list-style-type: none"> General guidance to CARB to set emission limits to meet the state’s GHG reduction goals. 	<ul style="list-style-type: none"> Explicit requirement that CARB set emission limits to ensure the state meets, at a minimum, its 2030 and 2045 goals.
Use of Offsets	
<ul style="list-style-type: none"> Use of offsets does not affect allowance budget. Covered entities can meet 6 percent of compliance obligations with offsets in 2026 through 2030. No requirement that CARB update its offset protocols. No requirement for CARB to prepare a study on offsets. 	<ul style="list-style-type: none"> Reduces the subsequent year’s allowance budget for each offset used. CARB to determine the degree to which covered entities can meet compliance obligations with offsets (no more than 6 percent). CARB must update its offset compliance protocols by January 1, 2029, evaluate them for potential update every five years thereafter, and consider expanding protocols to new sectors. CARB must prepare a study on offsets by December 31, 2026.
Allowances Provided to Utilities	
<ul style="list-style-type: none"> Electric and natural gas utilities allocated free allowances (roughly one-quarter and one-eighth of total allowances, respectively) to benefit ratepayers. 15 percent of electric IOU allowances may be provided for clean energy and energy efficiency. Electric IOU rebates must be provided to residential, small business, and emissions-intensive trade-exposed retail customers. Electric IOU rebates provided twice annually (in April and October) and natural gas rebates provided once annually (in April). Electric IOUs required to adopt and implement customer outreach plans to inform the public about utility rebates. POUs can use allowances for various purposes that benefit ratepayers. 	<ul style="list-style-type: none"> CARB must develop regulations to transition gas utilities’ free allowances to electric utilities by January 1, 2031. 5 percent of electric IOU allowances must be provided to support a California Transmission Accelerator Revolving Fund through July 1, 2031. Electric IOU rebates must be provided to residential customers. Small business and certain retail customers may also be provided rebates, as determined by CPUC. Residential electric IOU rebates must be provided in up to the four highest-billed months. Electric IOUs required to update their customer outreach plans. POUs must use the incremental allowances they receive from the transition away from natural gas allowances for customer rebates. (No changes to requirements for POU’s other allowances.)
Allowances Provided to Industry	
<ul style="list-style-type: none"> CARB must assume the highest leakage risk for all industries. 	<ul style="list-style-type: none"> Starting in 2031, CARB must distribute allowances to minimize leakage risk to cost-effectively meeting the state’s climate goals.
Price Ceiling	
<ul style="list-style-type: none"> Proceeds from permits sold at the price ceiling must be used to purchase offsets. General direction for CARB to consider avoiding adverse impacts on households, businesses, and the economy (among various other factors) when establishing the price ceiling. 	<ul style="list-style-type: none"> Proceeds from permits sold at the price ceiling must be deposited into Climate Mitigation Fund to be appropriated by the Legislature to reduce energy costs and for other purposes. CARB also directed to consider actions to ensure consumers are protected if it finds that the price ceiling and/or price containment reserve do not adequately protect consumers.

^a Most changes in the program design and allowance allocations are pursuant to Chapter 117 of 2025 (AB 1207, Irwin). However, some offset-related provisions are also included in Chapter 121 of 2025 (SB 840, Limón).

CARB = California Air Resources Board; GHG = greenhouse gas; IOUs = investor-owned utilities; CPUC = California Public Utilities Commission; and POU’s = publicly owned utilities.

be allocated to electric utilities. It further specifies that the California Climate Credit be provided to residential electric customers of investor-owned utilities up to four times a year (during the highest billed months) or to address unforeseen circumstances.

- ***Reduces Allowances for Certain Industries.***

Starting in 2031, AB 1207 directs CARB to change how allowances are allocated to industry to reduce the risk of leakage. (Leakage occurs when companies move their operations outside of California to avoid the need to comply with the program.) Specifically, the legislation replaces an existing statutory requirement—put in place by AB 398—that CARB assume the highest leakage for all industries with a requirement that CARB distribute allowances in a way that reduces leakage risk to cost-effectively meeting the state’s GHG reduction goals. When this change is implemented, it could reduce the number of free allowances provided to industries that are deemed to be at lower risk for leakage.

Changes Related to the Price Ceiling.

Assembly Bill 398 directed CARB to establish a “hard” price ceiling, meaning a set maximum amount at which an allowance could be sold. To date, allowance prices have never gotten close to that ceiling (roughly \$95 per allowance in 2025). However, if allowance prices were to reach the ceiling, CARB could sell an unlimited number of permits at that price level. Effectively, this would ensure that the market price for allowances could not exceed the price ceiling level. While AB 1207 does not explicitly change these policies, it does make a couple of changes related to the price ceiling. First, the legislation specifies that the proceeds from the sale of permits sold at the price ceiling must be deposited into a newly established Climate Mitigation Fund to be available, upon legislative appropriation, for direct rebates and other purposes. This is in contrast to AB 398, which specified that these proceeds had to be used to pay for mitigation activities outside of the capped sectors, such as those funded by offsets. Second, AB 1207 adds new direction to CARB

to consider actions to ensure consumers are protected—such as modifying the price ceiling—if it finds that the program’s structure does not adequately protect consumers.

Adds New Reporting, Evaluation, and Oversight Requirements

Assembly Bill 1207 and SB 840 add several new requirements meant to enhance oversight and accountability. As we discuss further below, these provisions express intent to create a new oversight entity, extend statutory authority and requirements for some existing oversight entities, and augment CARB’s reporting and evaluation requirements.

Expresses Intent to Create a New Oversight Entity. Senate Bill 840 expresses the Legislature’s intent to create a new entity to provide advice and investigation services to the Legislature related to climate change, energy, environmental quality, resources, and water. This new entity—to be called the Legislative Counsel Climate Bureau (Climate Bureau)—is envisioned to be housed within the Office of Legislative Counsel. The roles and responsibilities of the new bureau are to be determined through subsequent legislation.

Makes Changes Affecting Existing Oversight Entities. Assembly Bill 398 tasked various new and existing entities with oversight roles related to the cap-and-invest program. Assembly Bill 1207 extends and modifies these oversight roles as follows:

- ***Extends Sunset for Prior Oversight Organizations and Modifies Certain Requirements.*** Assembly Bill 398 created two new entities with oversight responsibilities over the cap-and-invest program: the Compliance Offset Protocol Task Force and the Independent Emissions Market Advisory Committee (IEMAC). Assembly Bill 1207 extends the sunset dates for these two oversight organizations from the end of 2030 to the end of 2045. Assembly Bill 1207 also specifies that IEMAC members are subject to the state’s Political Reform Act. As such, IEMAC members will be required to file annual conflict of interest forms and comply with certain other requirements.

- ***Extends Legislative Analyst’s Office’s (LAO’s) Annual Reporting Requirement.***

Assembly Bill 398 also established a requirement that our office report annually, through January 1, 2031, on the economic impacts and benefits of the state’s GHG reduction targets and the state’s progress towards achieving those targets. Assembly Bill 1207 extends this annual reporting requirement through January 1, 2046.

Requires CARB to Conduct Additional Reporting and Other Actions. Assembly Bill 1207 and SB 840 also include various new requirements for CARB, including:

- ***Make Recommendations in Scoping Plan.*** Under current law, CARB is required to prepare a Scoping Plan every five years that is meant to identify its strategy for achieving the state’s GHG targets. Assembly Bill 1207 requires that future such plans include a summary of the state’s progress toward meeting its 2045 GHG reduction goal and recommendations on statutory changes to further cost-effective emission reductions.
- ***Evaluate Cost Impacts.*** Assembly Bill 1207 requires CARB to evaluate the cost impacts of the cap-and-invest program when it revises regulations for the program.
- ***Communicate With Legislature on Major Regulations.*** Under existing law, when CARB initiates major regulations, it is required to conduct certain activities, including preparing economic analyses. Assembly Bill 1207 adds a new requirement that CARB transmit these economic analyses to the Legislature. The legislation also adds requirements that CARB transmit any major regulations pertaining to the cap-and-invest program—as well as related board hearing agendas—to relevant committees of the Legislature.
- ***Make Annual Presentations at Hearings.*** Assembly Bill 1207 requires that, upon request, CARB and other departments that receive GGRF funding must present annually to the Legislature’s Joint Legislative Committee on Climate Change Policies and relevant budget subcommittees on GGRF expenditures, as well as on new major cap-and-invest regulations.

Makes Various Changes to GGRF Allocations

Proceeds from the cap-and-invest auctions are deposited into GGRF. The Legislature has typically approached appropriating GGRF revenues through two methods, which we refer to as “statutory” and “discretionary” allocations. The statutory allocations generally set aside ongoing GGRF funding each year for certain programs or projects articulated in legislation. The Legislature then allocates the remaining discretionary GGRF revenues for various purposes through the annual budget process. (We refer to these as discretionary allocations because prior statute does not set them aside for specific programs but rather leaves them up to the Legislature’s decisions in a given year. And, as we discuss in further detail below, cap-and-invest auction revenues can be allocated for any purpose, as they are considered akin to tax revenues. Despite this labeling distinction, we would note that *all* GGRF allocations are discretionary in the sense that the Legislature has the authority to modify them at any time.) Starting in 2026-27, SB 840 modifies the existing statutory GGRF allocations that support particular activities. We summarize these changes in **Figure 2** and discuss them below.

Changes Various Percentage Allocations to Set Amounts and Eliminates a Sunset. Under prior law, certain programs received a *percentage* of annual GGRF revenues. These consist of the high-speed rail project, Affordable Housing and Sustainable Communities Program, Transit and Intercity Rail Capital Program, Low Carbon Transit Operations Program, and Safe and Affordable Drinking Water Program. In contrast, beginning in 2026-27, SB 840 provides these programs with *fixed amounts* of funding. These set amounts generally are equal to the funding levels the programs would have received under prior law if GGRF revenues totaled about \$4 billion in a given year. (For reference, over the past decade, annual GGRF revenues have varied from a low of less than \$1 billion to a high of just over \$5 billion.) Senate Bill 840 also eliminates the prior sunset date for the Safe and Affordable Drinking Water Program, thereby extending its funding indefinitely. (The other programs did not previously have statutory sunset dates.)

Figure 2

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

Program	Department	Existing Statutory Allocations	Starting in 2026-27 ^b
Starting in 2026-27, funding will be allocated first to the following programs:			
Manufacturing tax exemption	N/A	<ul style="list-style-type: none"> • Roughly \$100-\$140 million. • Sunsets on July 1, 2030. 	<ul style="list-style-type: none"> • No changes (maintains sunset).
State Responsibility Area fee backfill	CalFire	<ul style="list-style-type: none"> • Roughly \$70-\$90 million. • Sunsets on January 1, 2031. 	<ul style="list-style-type: none"> • No changes (maintains sunset).
Legislative Counsel Climate Bureau	Legislative Counsel	<ul style="list-style-type: none"> • None. 	<ul style="list-style-type: none"> • \$3 million annually.
Then second to the following programs:			
High-speed rail project	HSRA	<ul style="list-style-type: none"> • 25 percent of annual revenues. • No sunset. 	<ul style="list-style-type: none"> • \$1 billion annually.
Unspecified programs subject to appropriation	Various	<ul style="list-style-type: none"> • None. 	<ul style="list-style-type: none"> • \$1 billion annually.
Then third, if funding is available, to the following programs:^c			
Affordable Housing and Sustainable Communities Program	SGC	<ul style="list-style-type: none"> • 20 percent of annual revenues. • No sunset. 	<ul style="list-style-type: none"> • \$800 million annually.
TIRCP	CalSTA	<ul style="list-style-type: none"> • 10 percent of annual revenues. • No sunset. 	<ul style="list-style-type: none"> • \$400 million annually.
Community Air Protection Program—AB 617 ^d	CARB	<ul style="list-style-type: none"> • None.^e 	<ul style="list-style-type: none"> • \$250 million annually.
Low Carbon Transit Operations Program	Caltrans	<ul style="list-style-type: none"> • 5 percent of annual revenues. • No sunset. 	<ul style="list-style-type: none"> • \$200 million annually.
Wildfire and forest resilience—SB 901 ^f	CalFire	<ul style="list-style-type: none"> • \$200 million annually. • Sunsets on June 30, 2029. 	<ul style="list-style-type: none"> • \$200 million annually.
Safe and Affordable Drinking Water Program	SWRCB	<ul style="list-style-type: none"> • 5 percent of annual revenues (up to \$130 million). • Sunsets on June 30, 2030. 	<ul style="list-style-type: none"> • \$130 million annually.
Then fourth, remaining funding is subject to legislative appropriation for discretionary purposes.			

^a Chapter 121 of 2025 (SB 840, Limón).^b No sunset date unless otherwise noted.^c Senate Bill 840 requires the Department of Finance to proportionately reduce the amounts for these programs if funding is not sufficient to fully support them and pay for state administrative costs.^d Chapter 136 of 2017 (AB 617, C. Garcia).^e AB 617 did not have a prior statutory allocation, but the program historically has received roughly \$250 million annually on a discretionary basis.^f Chapter 626 of 2018 (SB 901, Dodd).

GGRF = Greenhouse Gas Reduction Fund; CalFire = California Department of Forestry and Fire Prevention; HSRA = High Speed Rail Authority; SGC = Strategic Growth Council; TIRCP = Transit and Intercity Rail Capital Program; CalSTA = California State Transportation Agency; Caltrans = California Department of Transportation; and SWRCB = State Water Resources Control Board.

Continues Existing Funding Levels for Some Allocations and Eliminates a Sunset.

Prior law provided three other programs with fixed annual amounts of GGRF. Under SB 840, funding for these programs—which include wildfire and forest resilience activities specified under Chapter 626 of 2018 (SB 901, Dodd), a backfill of the State Responsibility Area (SRA) fee, and lost revenue associated with AB 398's expansion of a manufacturing tax exemption—is

maintained at existing levels. Senate Bill 840 also removes the existing sunset for the wildfire and forest resilience funding. Notably, however, the legislation does not modify the existing sunsets that apply to the other two programs. Accordingly, the statutorily required GGRF allocations for the SRA fee backfill and manufacturing tax exemption still are scheduled to end January 1, 2031 and July 30, 2030, respectively.

Adds a Few New Statutory Allocations. Senate Bill 840 also adds statutory allocations for a few new programs, including the following:

- **Set Aside for Future Legislative Appropriation.** The legislation sets aside \$1 billion annually to be appropriated by the Legislature through the annual budget act or other statute. It also expresses the Legislature's intent that some specific activities be funded from this \$1 billion set aside in 2026-27, as discussed in the nearby box.
- **Community Air Protection Program.** The legislation provides a statutory allocation of \$250 million annually to implement Chapter 136 of 2017 (AB 617, C. García). This program has not received a statutory allocation in the past. However, since the passage of AB 398, the Legislature typically has provided roughly this amount on an annual basis for this program.
- **Climate Bureau.** The legislation allocates \$3 million annually for the Climate Bureau discussed above. This funding is contingent on the adoption of subsequent legislation that formally establishes the Climate Bureau and identifies its roles and responsibilities.

Modifies Order in Which Program Allocations Are Made. Senate Bill 840 changes the order in which the GGRF statutory allocations are to be made each year. This, in turn, will affect which programs ultimately are funded if there are years in which GGRF revenues are insufficient to fully support all of the statutory allocations, as well as the costs to CARB and other state departments associated with administering the programs (known as state administrative costs). In Figure 2, we display the order in which SB 840 allocates funding to four categories of activities. Specifically, beginning in 2026-27, first priorities for available GGRF funds are the SRA fee backfill, the manufacturing tax exemption, and the Climate Bureau. After those programs receive their allotted allocations, funding must next be provided to the high-speed rail project and the \$1 billion set aside for discretionary allocations. The remaining statutory allocations are next in priority order, to the degree sufficient GGRF revenues remain. If GGRF funding is insufficient to fully support the statutory amounts for all of these programs and pay for state administrative costs, then the legislation directs the Department of Finance to reduce the statutory allocations in this third category proportionately.

Legislative Intent for Discretionary Greenhouse Gas Reduction Fund Expenditures

Through the passage of recent legislation, the Legislature has expressed its intent to use discretionary Greenhouse Gas Reduction Fund (GGRF) monies to support certain activities in future years. For example, Chapter 121 of 2025 (SB 840, Limón) expresses the Legislature's intent to fund the following specific activities from the \$1 billion discretionary GGRF set aside in 2026-27:

- \$125 million for transit passes.
- \$85 million for climate-focused technological innovation.
- \$25 million for seed funding for a University of California Climate Research Center.
- \$15 million to rebuild Topanga Park (which sustained damage in the Palisades fire).

Additionally, Chapter 5 of 2025 (AB 102, Gabriel)—expresses the Legislature's intent to provide GGRF in 2026-27 and potentially future years to support some California Department of Forestry and Fire Protection (CalFire) activities that otherwise would be funded from the General Fund. Specifically, if the General Fund continues to experience deficits, AB 102 expresses the Legislature's intent that GGRF cover \$1.25 billion of CalFire's costs in 2026-27, \$500 million in 2027-28, and \$500 million in 2028-29. If the General Fund is not projected to be in a deficit in 2026-27, GGRF would only cover \$500 million for CalFire in that year.

(For reference, roughly \$4.2 billion and \$100 million annually, respectively, are required to fully fund all of the statutory allocations under SB 840 and state administrative costs.) Any residual revenues after funding these statutory allocations will be available for appropriation by the Legislature. Notably, SB 840's priority order for GGRF revenues is somewhat different from prior law. For example, high-speed rail was not previously prioritized relative to other programs receiving statutory allocations, whereas it receives a comparatively higher priority for funding under SB 840.

Expresses Legislative Intent to Allocate Funding to Broad Program Categories. Senate Bill 840 states that the Legislature intends to

direct specific percentages of future GGRF to new individual Funds dedicated to supporting (1) clean transportation, (2) housing and community investment, (3) clean air and water, (4) wildfire prevention and resilience, (5) agriculture, (6) clean energy, and (7) climate-focused innovation. The legislation further states legislative intent that appropriations from each of those individual Funds be guided by a multiyear spending plan. Senate Bill 840 is not specific as to which future GGRF allocations the Legislature intends this language to apply, such as the \$1 billion set aside and/or whatever residual monies remain, if any, after all of the statutory allocations are satisfied.

ISSUES FOR LEGISLATIVE CONSIDERATION AND OVERSIGHT

In this section, we highlight what we see as some of the key potential implications of AB 1207 and SB 840, which we also summarize in **Figure 3**. Our comments are not intended to serve as a comprehensive evaluation of these pieces of legislation and their potential impacts, but rather to provide some initial observations to assist the Legislature in its policymaking and oversight roles.

Extension Helps Ensure Key Climate Strategy Can Continue... The continued operation of the cap-and-invest program through 2045, as authorized by AB 1207, could be a key tool in helping the state achieve its climate goals cost-effectively. This is because the program creates financial incentives for entities to try to find relatively low-cost approaches for

Figure 3

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

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

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

emission reductions. Moreover, the program has the potential to serve as a “backstop” to help the state meet its targets. That is, to the degree other policies collectively fall short of meeting the state’s GHG reduction goals, the cap-and-invest program could help ensure that covered entities reduce emissions further to make up the difference.

...And Provides Important Program Certainty and Flexibility. By providing an explicit statutory extension of the cap-and-invest program to the end of 2045, AB 1207 gives clear legal authority for CARB to implement the program for the next two decades. This is important because whether CARB could have continued the program beyond 2030 absent explicit statutory authority—under the broad powers it has been granted by the Legislature—had been subject to some legal uncertainty. Moreover, even if CARB could have continued to operate the program absent explicit statutory reauthorization, it could have faced limitations around the structure of the program and the use of GGRF revenues. By resolving this legal uncertainty, AB 1207 helps businesses make long-term investment decisions and facilitates the state’s plans for how it can pursue its GHG goals and support high-priority programs. Also, importantly, AB 1207 not only provides explicit statutory authority to continue the program, but the legislation also received a two-thirds vote of both houses of the Legislature. Accordingly, GGRF funds can continue to be viewed as akin to tax revenues and be legally available to expend for any purpose. This allows the Legislature flexibility to use GGRF for its highest priorities—including activities to reduce GHGs but potentially also climate adaptation initiatives, offsetting consumer costs, or other purposes.

While Legislation Maintains Most Aspects of Program—Including Significant Discretion for CARB—Changes Reflect Legislative Goals. Assembly Bill 1207 and SB 840 maintain most of the elements of the existing program, including continuing to provide CARB with significant discretion in many key areas. For example, under these pieces of legislation, CARB continues to have authority to set the level of the program’s price ceiling and floor, the total number of allowances issued, and the share of allowances to sell versus provide for free to industry and utilities. However, as

summarized above, the pieces of legislation also make some key modifications to the program, particularly around the use of offsets. Together, these modifications generally are aimed at helping the program better accomplish the Legislature’s policy goals, including around GHG reduction and affordability. In particular:

- Some Provisions Are Likely to Have Implications for GHG Reduction.** In contrast to prior law, by directing CARB to put offsets under the cap, AB 1207 will effectively lower the overall emissions limit compared to what it otherwise would have been. This, in turn, means that the program will allow fewer GHGs to be emitted from entities covered by the program, thereby strengthening the program from an environmental perspective. Some other provisions of the legislation also could have some effects on the state’s climate goals, though these likely will be comparatively more modest and/or uncertain. For example, SB 840’s requirement that CARB update offset compliance protocols to reflect the best available science could potentially result in lower emissions if they lead to a greater number of offset projects that provide real, permanent GHG reductions.
- Some Provisions Are Also Likely to Have Implications for Affordability for Consumers.** Assembly Bill 1207 and SB 840 include components that could have a variety of potential implications for consumer affordability. Certain provisions could potentially help improve affordability. For example, if allowance prices reach the ceiling, redirecting the proceeds from the sale of those allowances from the purchase of offsets to other purposes that could reduce consumer costs (such as rebates) would help mitigate the costs of the program on consumers. Additionally, directing CARB to consider actions to ensure consumers are protected if it finds that the program structure does not adequately protect them could potentially encourage CARB to modify the program’s structure—such as by lowering the price ceiling—in the event significant affordability concerns

arise. However, some of the provisions are likely to put upward pressure on costs, and thus reduce affordability for consumers. For example, putting offsets under the cap is likely to increase the scarcity and associated costs of allowances. Many of these higher allowance costs likely would be passed on to consumers in the form of higher prices for GHG-intensive products.

Changes in GGRF Allocations Will Affect Funding for Particular Programs. The changes SB 840 makes to the statutory allocations of GGRF revenues are likely to have a variety of implications starting in 2026-27, including:

- **Allowance Allocations Affirm Legislative Priorities.** While many of the current GGRF statutory allocations were first established roughly a decade ago, reauthorizing them in SB 840 allowed the Legislature an opportunity to reaffirm that they continue to reflect legislative priorities. Moreover, SB 840 added two new statutory allocations for the Climate Bureau and AB 617, signaling the Legislature's interest in prioritizing ongoing funding in these areas.
- **Modifying Prioritization Order Affects How Much Funding Programs Receive Under Lower Revenue Scenarios.** The order in which statutory allocations are made plays a key role in determining how much funding goes to each program under lower revenue scenarios. This is because if GGRF revenues are insufficient to fund all of the identified statutory allocations and state administrative costs, the programs that receive funding later in the ordering will have their funding proportionally reduced. By modifying this ordering relative to existing law, SB 840 prioritizes a somewhat different set of programs for funding than currently is the case. For example, by setting aside \$1 billion for discretionary allocations earlier in the priority list, SB 840 makes it more likely that a significant amount of funding will still be available to address the most pressing legislative priorities for these categories even if revenues are relatively low.
- **Making Program Allocations Fixed Amounts Frees Up Funding for Other Legislative Priorities if Revenues Are Comparatively High.** By changing from percentage-based to fixed allocations for existing programs, SB 840 effectively caps the amount of funding provided to these programs at predetermined, set amounts. This, in turn, means that these programs will not automatically receive additional new GGRF monies if revenues increase substantially. Instead, the "excess" revenues will now be available to expend on other legislative priorities in years where auction revenues are comparatively high. Notably, the specific fixed amounts provided by SB 840 are higher than historical average funding levels for these programs, as GGRF revenues have trended mostly upward over time.
- **Changes Provide Additional Funding Certainty for High-Speed Rail Project.** The changes contained in SB 840 will result in greater certainty around annual funding levels for the high-speed rail project. Historically, the project received 25 percent of annual GGRF monies, which resulted in varying annual amounts depending on auction revenues. Under SB 840, the project will receive a set \$1 billion annually before allocations are made to most other funding commitments, which makes it much more likely that it will receive this amount each year. This higher level of funding certainty, in turn, may make it easier for the project to plan and potentially seek financing support, as it seeks to address its large funding gap. Financing is important for the project, since its funding needs are not well-aligned with the timing of cap-and-invest revenue allocations.

Certain Effects of Legislation Will Become Clearer Over Time and Will Depend on CARB Decisions. Accurately predicting the net effects of the extension of the cap-and-invest program on the Legislature's key policy priorities—such as GHG reduction and affordability—is difficult, if not impossible. This is in part because AB 1207 and SB 840 include provisions that have various, sometimes opposing, effects on key policy goals.

Additionally, and perhaps more importantly, the program's impacts on GHG reductions and consumer costs will be heavily dependent on CARB's forthcoming decisions, including the following:

- **Price Ceiling and Floor.** If CARB were to set a relatively low ceiling price, it would help limit the costs of the program on businesses and households—improving affordability—but would also increase the likelihood that prices reach the ceiling. This, in turn, would increase the likelihood that emissions exceed the cap (as it would lead the state to sell additional permits)—resulting in comparatively fewer GHG reductions.
- **Number of Allowances Issued.** The aggregate number of allowances CARB decides to issue will affect not only emissions levels but also the scarcity of allowances. This will, in turn, impact allowance prices and costs paid by households and businesses.
- **Allocation of Allowances Among Purposes.** How CARB decides to allocate allowances across various broad purposes—such as selling them to benefit GGRF or providing them for free to industry and/or utilities—ultimately will determine where the revenue from the charges paid by emitters will go, including which entities will receive these revenues and for what purposes. If, for example, CARB allocates a relatively smaller share of allowances to utilities (and a larger share to GGRF and/or industry), utility customers would receive smaller rebates—and therefore experience higher costs—than would otherwise be the case.

Some Important Legislative Decisions

Remain. While AB 1207 and SB 840 made a number of key changes to the cap-and-invest program and delegated many other decisions to CARB, some important decisions also remain for the Legislature. In particular:

- **Defining Scope and Direction for the Climate Bureau.** Assembly Bill 1207 and SB 840 express legislative intent to pass subsequent legislation establishing

the Climate Bureau. Such legislation would provide an opportunity for the Legislature to clarify and refine direction for this new entity. For example, such legislation could (1) clarify the Climate Bureau's roles and responsibilities, such as identifying specific areas of focus or types of work to be completed; (2) provide any additional powers deemed necessary to carry out the identified roles and responsibilities; (3) identify the organizational structure of the Climate Bureau and the process for selecting its leadership; and (4) clarify how it should relate to other existing oversight entities, such as the LAO, IEMAC, and Compliance Offset Protocol Task Force. Providing specific direction would increase the likelihood that the Climate Bureau will provide the type of oversight and information the Legislature will find most valuable.

- **Allocating Discretionary GGRF.** The Legislature will face annual decisions about how to allocate discretionary GGRF, including both the \$1 billion set aside and any remaining funding that is available after statutory allocations are fully funded. In making these decisions, the Legislature will face choices about how much funding to allocate to any new individual category-specific Funds it intends to create, as well as how to most effectively use the envisioned Fund-specific, multiyear spending plans to guide that funding. Additionally, the Legislature will face some near-term decisions in 2026-27. Specifically, budget bill language expressed intent to fund up to \$1.5 billion from GGRF for purposes outside the statutory program allocations in 2026-27 (\$250 million for various purposes specified in SB 840 and \$1.25 billion for California Department of Forestry and Fire Protection activities that otherwise would be paid for by the General Fund). Should GGRF be insufficient in 2026-27 to fully fund all of these intended activities (along with the statutory allocations and state administrative costs), the Legislature will face choices about how to prioritize among them.

Legislative Oversight of Program Continues to Be Important. Over the coming years, the Legislature can use its oversight role to closely monitor the continued implementation of the cap-and-invest program. Some reasons this oversight role remains important include:

- **Stakes Are High.** As mentioned above, the program has the potential to have significant implications for some of the state's key priorities, such as GHG reduction and affordability. However, the specifics of how the program operates over the coming years will determine how effective it is at achieving those priorities.
- **Meeting All of the Legislature's Goals Will Be Difficult.** The Legislature's climate goals are ambitious and are likely to come with trade-offs, such as related to costs to households and businesses. Monitoring the program's implementation will be an important way for the Legislature to help ensure that the state is striking its intended balance between key goals and priorities.
- **CARB's Regulations Could Have Important Implications for the Program.** In September 2025, CARB issued a [notice](#) that it plans to begin updating the regulations governing the program to reflect the requirements of AB 1207, as well as make other modifications to the program. Closely monitoring this and other future rulemaking efforts—and providing input on them, as appropriate—can help ensure the board's decisions are in line with the Legislature's vision.
- **Ensuring State Funding Achieves Goals Effectively Will Be Important.** Cap-and-invest auction revenues support a variety of programs and policy priorities. As such, ensuring that GGRF is being used in the most effective way to meet these priorities is an important role for the Legislature. Notably, under the revised allocation structure, nearly \$3 billion in GGRF monies could be continuously appropriated annually to specific programs and activities. Since funding for those programs does not require annual budget action, the Legislature generally has fewer natural opportunities to oversee them.

However, the Legislature can be proactive about monitoring these programs to ensure that they are achieving legislative goals in a cost-effective manner, such as through requesting information, reviewing outcomes, holding oversight hearings, and/or adjusting them as warranted.

Oversight Provisions Could Potentially Help Legislature Ensure Program Is Meeting Intended Goals...

The new oversight provisions added by AB 1207 and SB 840 have the potential to provide the Legislature and other interested parties with important information to help direct future policy and regulatory decisions. For example, the new Climate Bureau could serve as a helpful resource to the Legislature, adding valuable capacity to conduct program reviews and evaluations that are independent of the Executive Branch. Additionally, the requirements under AB 1207 that CARB report certain information and participate in various legislative hearings may improve information flow to the Legislature on key topics, such as the cost and impacts of the cap-and-invest program and other market-based regulations.

...But Effectiveness Will Depend Upon Implementation. The ultimate effectiveness of the new oversight provisions, however, will depend heavily on the specifics of how they are implemented. The Legislature can play an important role overseeing and guiding these efforts. For instance, the newly envisioned Climate Bureau's usefulness is likely to be enhanced if its activities are directed to high-priority topics and if it is created such that it can build a reputation as a credible source of timely analyses. Additionally, CARB's required reporting is likely to be more helpful if the Legislature closely reviews its reports and notifications and takes subsequent actions if they raise questions or identify areas of concern. The Legislature can use oversight hearings to provide a venue to follow up on areas of concern identified by the Climate Bureau or CARB's reporting, gather key information, monitor the state's progress towards meeting legislative goals, identify lessons learned, and determine whether additional legislative intervention might be merited.

CONCLUSION

Enacting AB 1207 and SB 840 and reauthorizing the cap-and-invest program represent significant steps in the Legislature's ongoing efforts to limit GHG emissions. However, numerous aspects of how the program operates and what its ultimate impacts will be on the state's climate goals—as well as on costs that Californians experience

as a result—remain uncertain and subject to future implementation decisions. Continued and robust legislative oversight will be key to helping ensure that the cap-and-invest program operates effectively and balances competing policy trade-offs in a way that is consistent with legislative priorities.

LAO PUBLICATIONS

This report was prepared by Helen Kerstein, and reviewed by Rachel Ehlers and Ross Brown. The Legislative Analyst's Office (LAO) is a nonpartisan office that provides fiscal and policy information and advice to the Legislature.

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