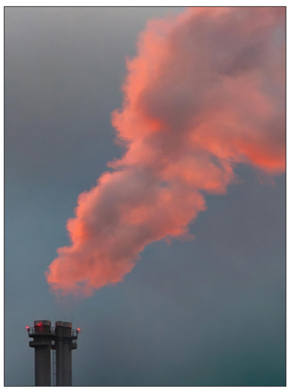
Environmental Defense Fund

CALIFORNIA'S CAP-AND-INVEST PROGRAM



"California's [Cap-and-Invest] program is the strongest, most cost-effective emissions reduction program in the world."

—

Jacqui Irwin,
California Assemblymember,
Author of AB 1207

WHAT IS CAP-AND-INVEST?

California's Cap-and-Invest program is the state's only policy that places a firm, declining limit on the amount of climate pollution that enters the atmosphere each year. Launched in 2013, it covers roughly 85% of statewide emissions and has been linked with Québec's program since 2014.

The program works in two steps:

The CAP — Every year, the California Air Resources Board issues a declining number of emissions allowances, with each allowance represents one ton of greenhouse gas emissions. Every polluting facility covered under the program needs to hold one allowance for every ton of greenhouse gas that it emits — and, critically, each year CARB will create only as many allowances as the declining cap allows. Most of the allowances are auctioned off to businesses that need them for compliance under the cap. Utilities and some industries are given allowances for free to benefit ratepayers and to prevent businesses from moving across state borders to pollute without limits.

The INVEST — Revenue from the purchase of allowances at auctions is reinvested into the state's Greenhouse Gas Reduction Fund, which finances projects that further reduce greenhouse gas emissions, improve public health, strengthen the economy, and deliver benefits to disadvantaged communities. A minimum of 35% of GGRF investments must directly benefit disadvantaged communities across California. Over the past ten years, California has delivered $11 billion from the GGRF to more than half a million projects that yield meaningful community and environmental benefits, including 1,248 new or expanded transit projects, 29,800 new jobs and 12,606 affordable housing projects under contract. The revenue generated also helps improve cost of living and energy affordability. A portion of the auction revenue is returned to residents via the California Climate Credit, applied twice a year to gas and electric bills.

The cap is California's guarantee that emissions decline

Cap-and-Invest operates alongside clean energy standards, building codes and transportation electrification policies. The cap is what ties them all together: it is the only mechanism that ensures economy-wide emissions decline on schedule, regardless of whether any individual policy achieves its projected impact.

A binding, declining emissions cap gives California the greatest possible certainty of meeting its climate commitments and protects communities from the most dangerous impacts of climate change. Each year, CARB issues fewer allowances, ratcheting down the total emissions covered entities are legally permitted to produce. The cap's declining trajectory is what creates both the environmental guarantee and the revenue that flows from the program. Without the cap, there is no limit on pollution and no mechanism to generate auction revenue.

How allowances are distributed

Most allowances are sold at quarterly auctions administered by CARB. However, some allowances are allocated at no cost to protect consumers:

- Electric and natural gas utilities receive free allowances to offset potential cost increases on customer bills, with all proceeds or direct benefit required to flow to ratepayers, prioritizing low-income customers. AB 1207 directed CARB to begin shifting the allocation of free allowances to prioritize electric utilities, further incentivizing California's transition to electrification.
- Some industries at risk of relocating out of state ('leakage') also receive limited free allocations to retain jobs and prevent emissions from simply shifting elsewhere.
- In May 2026, CARB also approved the creation of a new Manufacturing Decarbonization Incentive which creates allowances outside of the declining cap, designed to encourage investment in decarbonization technologies. CARB is planning additional workshops to further refine this new mechanism and add necessary guardrails before it becomes operational.

Faciliites that fail to submit enough allowances to cover their emissions face steep penalties: they are fined and must submit four allowances for every allowance that is missing — making the compliance obligation four times what it would otherwise be. The program has had nearly 100% compliance thus far.

Price containment mechanisms

California's program includes robust price stability mechanisms:

- **Price floor** — Ensures a minimum price signal, preventing allowance prices from collapsing even if demand drops unexpectedly. Also guarantees a minimum revenue floor for community investments.
- **Allowance Price Containment Reserve** — A "speed bump" designed to respond to high demand and keep prices in check, released only if prices exceed trigger thresholds. All APCR allowances come from under the cap, meaning even if they are released, the emissions they represent are still within the overall limit.
- **Price ceiling** — If the allowance price reaches the price ceiling, additional allowances are made available at the ceiling price. Any revenue from the sale of allowances at the price ceiling will be used to secure additional emissions reductions on a ton-for-ton basis for every allowance that is sold at the price ceiling, keeping California on track to achieve its climate goals.

LINKAGE WITH WASHINGTON STATE

California's Cap-and-Invest program has been linked with Québec's since 2014, creating a joint carbon market where covered entities in both jurisdictions participate in shared auctions and trade allowances freely across borders.

Washington's program was designed to be compatible with this existing market, and all three jurisdictions have been working toward incorporating Washington into the linked market.

A draft agreement from all three jurisdictions was released in early 2026, and Washington announced their formal linkage rulemaking in June. CARB indicated at their May Board meeting that linkage is a high priority, so action on linkage is expected from California in the coming months, as well as from Quebec.

Revenue

California's Cap-and-Invest program has generated nearly $28 billion in auction revenue since 2013, all of which flows into the Greenhouse Gas Reduction Fund and is invested through a suite of programs collectively known as California Climate Investments.

To date, over $11 billion of that has been implemented across more than 146,000 individual projects, and roughly 75% of those project funds have directly benefited priority populations. Modeling projects that over the next 15 years, Cap-and-Invest investments could create 287,000 new jobs and $55 billion in total economic output.

Offsets

Offsets are another type of compliance instrument in California's program that represent a reduction or removal of one metric ton of emissions from a sector not covered by the program, such as forestry. Using offsets allows covered entities to meet a small part of their emissions reduction obligations by investing in emission reduction projects beyond their emitting facility. There are limits to the percentage of an entity's compliance obligation that can be met using offsets (4% in 2025 and 6% after 2025) to ensure the focus of covered entities is still on reducing emissions from their operations.

Offsets are an essential tool to drive investment in nature-based climate solutions and represent critical funding streams for some Tribes. AB 1207 required that CARB remove allowances from the program in accordance with the number of offsets that are turned in for compliance, known as bringing offsets "under the cap". This ensures greater environmental ambition and aligns with the approach taken in Washington.

For more information, please contact Caroline Jones, Manager, Energy Transition & Carbon Markets, **cajones@edf.org**

123 Mission St. — 28th floor
San Francisco, CA 94105

EDF.org
T 212 505 2100

Environmental Defense Fund works around the world from offices in
New York / Washington / San Francisco / London / Beijing / La Paz, Mexico / and other cities