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CA's Cap-and-Invest Changes Test Business Contract Readiness

The California Air Resources Board has [moved](#) the 2026 cap-and-Invest amendments into formal rulemaking. Cap-and-invest is California's market-based greenhouse gas program. CARB sets a declining limit on covered emissions, then requires regulated entities to surrender compliance instruments—allowances and approved offset credits—equal to their verified emissions.

By tightening the cap over time and allowing trading, the program drives emissions reductions where they cost less while generating auction proceeds that support climate and air-quality investments. The compliance-cost changes these amendments will produce are already embedded in existing commercial contracts in ways most businesses haven't examined.

The immediate legal question is whether those contracts can absorb amendment-driven cost variability without dispute.

The proposed amendments are more consequential than the label "program updates" suggests. CARB proposes removing approximately 118 million carbon allowances from the 2027–2030 annual budgets to reflect updated greenhouse gas inventory data and align the program with SB 32's 2030 targets. The proposal also revises post-2030 allowance budgets to support AB 1279's targets of reducing anthropogenic emissions 85% below 1990 levels by 2045 and achieving carbon neutrality by the same date.

Additional amendments introduce a new Allowance Removal for Offset Use mechanism—under which allowances are retired from annual budgets beginning in 2027 to account for offset credit use as directed by AB 1207—and update cost-containment and Allowance Price Containment Reserve provisions, market rules, and allocation provisions.

The public comment period on the rulemaking ended March 9, with a board hearing set for May 28 and a proposed Sept. 1 effective date.

The commercial agreements most at risk are the ones through which carbon costs move across the business: fuel and energy supply agreements, transportation and logistics contracts, tolling and processing agreements, industrial throughput arrangements, and other long-term pricing agreements between regulated entities and their customers, vendors, and service providers.

Those agreements often contain change-in-law clauses or pricing-adjustment provisions, but most weren't drafted to handle what these amendments actually do. Companies that take a proactive approach—by reviewing contract triggers, defining calculation methods, and aligning internal pricing assumptions now can reduce avoidable disputes and preserve leverage as the rulemaking moves towards adoption.

Existing Contract Drafting

The problem is rarely the absence of contract language. The problem is mismatch between generic pricing-adjustment clauses and the way cap-and-invest costs actually move.

Most change-in-law provisions were drafted for discrete legal events—a new tax, a permit fee, a statutory prohibition. The 2026 amendments present a structurally different issue. They adjust design features within an established program, and those adjustments alter compliance costs through allowance supply contractions and market mechanics—not through a single identifiable new charge.

The removal of 118 million allowances from near-term budgets isn't a new fee. It's a supply contraction that flows through to allowance prices in ways a generic "new law or regulation" trigger may not capture. If the contract doesn't expressly cover amendments to existing programs—as opposed to the enactment of entirely new ones—the clause may generate a foreseeable dispute over whether it applies at all.

The next failure point is measurement. Even when an agreement contemplates carbon-cost pass-through, it often doesn't define the baseline assumption, the calculation methodology, or the data source governing any adjustment. Without those terms, parties lack

a contractual method to resolve basic questions: what cost changed, how much, and what portion is attributable to the contract at issue.

Timing presents the same gap—agreements may allow adjustment in principle but say nothing about when the right may be invoked, how frequently pricing may be recalibrated, or when payment becomes due.

A separate failure point is dispute mechanics. Carbon-cost disagreements turn on emissions accounting, allowance price forecasting, and instrument valuation—not on contract interpretation alone. Standard dispute clauses aren't designed for that technical layer.

Without a mechanism to test underlying calculations first, parties escalate prematurely into adversarial posture over disputes a structured technical review could resolve faster and at lower cost.

Layered contract structures compound each of these problems. Carbon-cost language may appear in a master agreement, remain silent in a statement of work, and conflict in a pricing schedule—creating a foreseeable and avoidable basis for dispute that document-hierarchy clauses rarely resolve cleanly.

Pass-Through Language

Effective pass-through language identifies the baseline compliance-cost assumption, states the data source and methodology used to establish that baseline, and expressly covers amendments to existing regulatory programs — not only new laws. It ties adjustments to objective, verifiable inputs: verified emissions data, auction settlement prices, or documented allowance purchases. It specifies the frequency of review, the notice period required to invoke adjustment, and the effective date of any price change.

The dispute-resolution provision deserves equal specificity. A clause requiring carbon-cost disputes to proceed first through a structured technical expert review—before either party may invoke mediation or arbitration—addresses the mismatch between standard commercial dispute clauses and the technical nature of

emissions accounting disagreements.

The contract should designate the category of expert, specify a defined timeframe for review, identify the data sources the expert may consult, and establish whether findings are binding on factual questions or advisory inputs to a subsequent arbitration.

Businesses should harmonize these provisions across master agreements, statements of work, and pricing schedules by cross-referencing defined terms and including explicit integration clauses specifying which document governs carbon-cost adjustments.

What to Do

The rulemaking calendar is fixed, and the 2027–2030 budget reductions are near-term. Companies must start reviewing and revising their contracts now before the May 28 board hearing. Once CARB adopts final text, every sophisticated counterparty will price those rules into their negotiating position.

Companies that complete revisions before adoption negotiate against uncertainty. Companies that wait negotiate against certainty that has already been priced in.

Identify agreements with the greatest carbon-cost sensitivity, the longest remaining terms, and the weakest existing adjustment provisions. For each, review whether trigger language covers amendments to established programs, whether a baseline and calculation methodology are defined, whether timing is specified, and whether the document hierarchy resolves carbon-cost conflicts clearly. Align legal, finance, procurement, and operations so contract assumptions match budgeting and allowance-procurement decisions.

This will avoid circumstances that create unintended economic exposure for companies, such as finance modeling compliance costs under one allowance price trajectory and procurement negotiating supply agreements under another..

Companies that act before May 28 can reduce dispute risk, preserve commercial flexibility, and negotiate from a position of strength in a program that will govern compliance costs through

2045.

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