

State, Federal Policies Complicate Fuel And Carbon Markets

By **Sarah Grey** (February 27, 2026)

The U.S. transportation fuel industry stands at an important juncture as federal and state regulators advance a complex web of mandatory and voluntary programs and incentives that shape how transportation fuels are produced, traded and valued.

From California's maturing Low Carbon Fuel Standard, or LCFS, to emerging state programs and federal tax incentives, added complexity is emerging for industry participants, both in managing new compliance obligations and in navigating new opportunities.

This article examines the key regulatory developments across California's LCFS and New Mexico's Clean Fuel Program, or CFP, initiatives; cap-and-invest programs; the federal Renewable Fuel Standard, or RFS, program; and federal tax incentives that complicate an already dynamic fuel marketplace.



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LCFS and CFP: State-Level Leadership

LCFS: Traceability Requirements Enter First Year

California's LCFS program, the nation's longest standing state-level low-carbon fuel initiative, reaches a significant milestone this year with mandatory traceability and attestation requirements applying to crop-based fuels like corn ethanol and soy-based biodiesel sold into the California market.

Certain feedstocks used to produce biofuels sold in the state are now subject to broad mapping, traceability and attestation requirements, for which the California Air Resources Board has offered limited guidance on compliance requirements and enforcement risks.

Meanwhile, so-called specified source feedstocks, such as fats and used cooking oil, require supply-chain attestations back to the origin of the feedstock.

The 2027 verification process presents the first juncture at which third-party auditors will judge the sufficiency of documentation fuel producers are compiling to meet the new requirements. In the interim, *Communities for a Better Environment vs. CARB*, a lawsuit commenced in December 2024 in the Superior Court of California, Fresno Central Division, hangs over the LCFS amendments.[1]

For now, market participants are seeking to adapt to the new rules with scant guidance, and fuel producers selling into California are left with new compliance burdens, uncertainty and costs.

CFP: The Southwest Expands

New Mexico's CFP represents an important geographic expansion of comprehensive low-carbon fuel policy beyond the West Coast.

Modeled substantially on California's LCFS framework, the New Mexico program — finalized and adopted on Jan. 22 — creates new compliance obligations for fuel suppliers operating in

the state, while opening credit generation opportunities for biofuel producers and other low-carbon fuel providers.

The program takes effect April 1, with declining carbon intensity targets designed to achieve a 20% reduction in transportation fuel emissions by 2030, and a 30% reduction by 2040, from a 2018 baseline.

Early engagement — particularly pathway approvals and verification readiness — may confer first-mover advantages as credit supply and demand balance evolves.

The impacts on gasoline and diesel prices are sure to be closely watched as industry participants adjust to the new program, and to the differences in supply chains and market opportunities in New Mexico, in contrast with the more established West Coast programs.

State Legislative Activity: The Next Wave

Beyond California, Oregon, Washington and New Mexico, several state legislatures are actively considering LCFS or CFP frameworks, signaling potential expansion of these regulatory models.

Legislatures in states including Colorado, Minnesota, New York, Hawaii, Illinois and Massachusetts have seen introduction of clean fuel standard bills, while other states are conducting preliminary studies and stakeholder engagement processes.

The specific design features under consideration vary significantly across jurisdictions, with some states favoring California-style comprehensive programs, while others are exploring more limited approaches focused on specific fuel sectors or greenhouse gas reduction targets.

Common themes across many proposals include emphasis on in-state economic development opportunities, agricultural sector engagement and coordination with existing state climate policies.

For market participants, this legislative activity creates both opportunity and complexity. Each new state program potentially opens additional credit markets and revenue streams for low-carbon fuel producers, but also fragments the regulatory landscape and creates compliance challenges for fuel suppliers operating across multiple jurisdictions.

Strategic planning must account for the possibility of significant state-level policy expansion over the next several years, with attendant implications for infrastructure investment, feedstock procurement and market positioning.

Federal RFS: The EPA's 2026-2027 Rulemaking Timeline

Amid the flurry of state-level activity, the U.S. Environmental Protection Agency recently informed the court adjudicating *HF Sinclair Refining & Marketing LLC v. EPA* — the deadline litigation over the 2026 renewable volume obligations in the RFS program — that it expects to complete the 2026-2027 renewable volume obligations rulemaking during the first quarter of 2026.

The EPA is poised to make several critical policy determinations that may significantly affect renewable identification number, or RIN, markets, including related to imported fuels and feedstocks and small refinery exemptions.

As to the former, the EPA's 2026-2027 proposal received a mixed reception with respect to the proposed 50% RIN reduction for imported fuels and fuel produced from imported feedstocks.

The final rule's treatment of import RINs will directly affect the economics of international biofuel trade, and could reshape North American supply patterns.

In addition, the EPA is likely to finalize its proposed exclusion of electricity-based RINs, or eRINs, from the RFS program, consistent with the current administration's shift away from electric vehicles and EV-related subsidies.

The durability of these and other factual and legal determinations underlying the 2026-2027 renewable volume obligations will almost certainly face scrutiny before a panel of the D.C. Circuit.

Federal Tax Incentives: IRS' Proposed 45Z Regulations

Against the backdrop of these mandatory compliance programs at the state and federal level, fuel markets are seeking to adapt to opportunities presented by the Internal Revenue Service's proposed regulations implementing the Clean Fuel Production Credit under Section 45Z of the Internal Revenue Code.

The proposed rules, published on Feb. 3, represent forward movement on a number of issues important to biofuels industry participants, including with respect to a widened aperture for qualified sales, potential incorporation of climate-smart agriculture practices and exclusion of indirect land use change penalties, as required by the One Big Beautiful Bill Act.

The Section 45Z credit interacts with state LCFS programs and the federal RFS program in complex ways, and creates the potential stacking of multiple revenue streams for certain fuels with the potential for substantially higher incentives available for domestically produced fuels and feedstocks.

As the IRS moves toward finalizing these regulations in the coming months, industry participants should engage in the comment process to address key legal and technical issues in unlocking maximum Section 45Z value.

Cap-and-Invest Programs: Expanding State-Level GHG Regulation

California's Proposed Cap-and-Invest Revisions

In contrast to the federal government's repeal of the EPA's 2009 GHG endangerment finding, state level GHG regulation continues apace.

California continues to refine its economy-wide cap-and-invest program, with proposed revisions to both GHG reporting requirements and the cap-and-invest regulatory structure.

Proposed changes announced on Jan. 13 could affect allowance supply, price containment mechanisms and usage of offsets, with downstream implications for carbon project development and compliance strategies.

For example, California is considering modifications to offset credit protocols, including

potential restrictions on the types of projects eligible to generate compliance-grade offsets and tightened additionality and permanence requirements.

These changes would affect the supply of offset credits available to covered entities for compliance, potentially influencing offset prices and creating ripple effects in voluntary carbon markets as project developers reassess their investment priorities.

California-Washington Linkage: Potential Regional Market Integration

California and Washington continue to explore linkage of Washington's cap-and-invest program with the existing California-Québec market.

Agency statements suggest that, subject to regulatory alignment and environmental justice reviews, a linked market could begin operating as early as 2027, potentially increasing market liquidity and harmonizing carbon price signals across jurisdictions.

Key implementation issues that market participants should monitor include harmonization of offset protocols, treatment of allowance banking and borrowing across jurisdictions, and coordination of auction mechanisms and price containment measures.

For fuel suppliers and other regulated parties under Washington's Climate Commitment Act, timing of linkage and potential realignment of compliance deadlines is critical to allowance liquidity and pricing and warrant careful monitoring.

New York's New GHG Reporting Regime

In December 2025, the New York Department of Environmental Conservation finalized a comprehensive GHG reporting regime that significantly expands the state's climate regulatory infrastructure.

The new requirements establish mandatory reporting thresholds for a broad range of emission sources, and create the foundation for potential future cap-and-invest or other market-based regulatory programs.

For fuel suppliers operating in or selling into New York, the reporting regime reflects a significant expansion on the models established with the West Coast programs along with several similar features, including verification requirements.

Industry participants may wish to engage with the department as it irons out the myriad questions left unanswered or ambiguous in the regulations, and finalizes the GHG reporting tools needed for compliance.

Although the program exclusively encompasses reporting at this stage, clarity on the reporting framework and requirements, particularly with respect to ensuring there is not double-counting of emissions reporting across fuel industry market participants, will be important once carbon is priced in New York state economywide.

Conclusion

The convergence of these regulatory developments creates a dynamic environment that requires deftly navigating overlapping, and sometimes conflicting, policy and fuel pricing signals.

The creep of LCFS and GHG reporting programs along a steady trend toward more complex compliance obligations presents both risks and opportunities for fuel market and carbon market participants alike.

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[1] See *Communities for a Better Environment v. California Air Resources Board*, Lead Case No. 24CECG05430, Superior Court of California, Fresno Central Division.