Memorandum

To: ISO Board of Governors and Western Energy Markets Governing Body

From: James Bushnell, Chair, Market Surveillance Committee

Date: August 21, 2026

Re: **Briefing on Market Surveillance Committee activities: July - August 2026**

This memorandum does not require ISO Board of Governors WEM Governing Body action.

This memo covers the MSC's activity and topics of focus from July through August 2026. The Committee's attention during this period has been directed primarily at the second phase of the Extended Day-Ahead Market (EDAM) congestion revenue allocation (CRA) initiative, which resumed its stakeholder process after a hiatus of roughly two months following EDAM go-live on May 1. The CAISO convened working group sessions on July 28 and August 13, 2026. The MSC did not hold a public general session during this period, but members monitored the CRA working groups and met internally with CAISO staff.

In addition, MSC member Ross Baldick has been interacting internally with staff on technical aspects of the network application process. These issues relate to potential sources of CRR revenue inadequacy and therefore impact directly CRR issues and indirectly the CRA issues discussed below.

THE CRA PHASE 2 STAKEHOLDER PROCESS

As we described in our April memo, the CRA design that took effect with EDAM go-live was always understood to be transitional. Under the Phase 1 design, congestion revenues from an internal constraint flow to the balancing area in which that constraint sits, with an additional component allocating revenues from parallel-flow effects on cleared, self-scheduled, balanced portions of firm OATT transmission rights to the EDAM entity holding those rights. Two problems were acknowledged at the outset. First, the design creates an incentive to self-schedule, since only rights associated with self-scheduled transactions qualify for the allocation. Second, the current policy is nominally asymmetric given that the CAISO balancing area receives no comparable allocation when constraints elsewhere in the footprint affect prices within CAISO.

Phase 2 has been organized around three design concepts. Concept 1 is an expansion of the current structure: it would allocate revenue on the basis of cleared balanced schedules associated with OATT rights whether self-scheduled or economically bid and would create a reciprocal allocation to the CAISO to help fund congestion revenue rights (CRRs) when constraints outside CAISO affect CRR source and sink locations. Concept 2 would anchor congestion allocations to some criterion that is decoupled from ongoing market activity, such as a historical baseline. Concept 2 faced broad opposition, for reasons discussed below, and is for the moment dormant. Concept 3 would evaluate the OATT rights issued by non-CAISO EDAM members and the CAISO CRRs together in a common simultaneous feasibility test, determining entitlements on the basis of system-wide feasibility rather than schedules. Concept 3 has to date attracted the broadest support in principle as the preferred long-term design, although the implementation details remain substantially unresolved.

The July 28 session was devoted almost entirely to Concept 1 and to a data presentation from CAISO's Market Performance and Advanced Analytics group. Staff were candid about Concept 1's limitations, acknowledging that it may not meaningfully reduce the self-scheduling incentive, since participants could bid low enough to guarantee clearing and thereby qualify for the allocation. Staff's preliminary implementation assessment also found Concept 1 to carry higher implementation risk and a heavier lift than Concept 3, principally because a single energy bid carries no association with a specific transmission right and a new attribution mechanism would be required. Stakeholder reaction at the meeting was skeptical, and the written comments submitted on August 10 were considerably more so. We read these comments as showing that Concept 1 no longer has substantial support. The August 13 session was dedicated to Concept 3. None of us were able to attend the August 13 session, so our comments are based upon observations of the earlier meeting and internal discussions with CAISO staff. The ISO has scheduled a further session on Concept 3 for August 21, with comments on both August sessions due September 3.

The stakeholder process is working through several difficult issues but has been somewhat hampered by aspects of the framing of the respective concepts.

IMPLICATIONS OF CONCEPT 1

The first issue is the question of whether concept 1 really provides the elements of symmetry that had initially made the concept appear attractive, particularly to California stakeholders. The analysis of historical congestion presented at the July 28th meeting strongly implied that the "symmetry" that Concept 1 offers would be a theoretical benefit with little practical value to CAISO ratepayers. The implication of the analysis is that the volume of congestion revenue that would actually flow back to the CAISO under a reciprocal allocation would be de minimis. This is because in recent years the vast majority of EDAM and EIM congestion costs can be linked to congestion within the CAISO system. There is little congestion revenue in those non-CAISO BAAs to allocate, simply because there is almost no congestion. We have suspected that, as these implications became clearer, support for concept 1 would significantly weaken. The August 10 comments suggest this has already occurred.

A second, and more consequential, implication of the analysis shows that the counterflow contributed by certain EDAM entities is significant. This matters because

Concept 1, like the current design, permits balancing areas to retain payments for counterflow while avoiding payment for the costly flows they impose. In contrast, counterflow provided by systems that are not participating in EDAM is not compensated. Under the EIM, costly loop flow imposed by day ahead schedules outside of EDAM is not priced, but neither are the benefits of "counter loopflow."

The prospect of significant counterflow implies that concept 1 could significantly increase implicit transfer of congestion revenue from California to outside balancing areas, relative to a counterfactual in which they remain outside EDAM and are therefore not compensated for providing counterflow. Taken together with the first point, the two observations cut in the same direction: the reciprocity Concept 1 offers California is nominal, while the exposure it creates is real.

PROSPECTS FOR CONCEPT 3

A second issue is that the early-stage framing of concept 3, which is largely a set of principles, has yet to confront the more difficult trade-offs underpinning its execution. The process is analogous to the debate over the Affordable Care Act fifteen years ago. Principles such as "members can continue their current transmission right approach" and "everyone will get their fair share of a simultaneously feasible allocation" are reminiscent of goals such as "everyone will get health care" and "you can keep your own insurance if you want." These goals can be articulated as principles, but, as with health care policy, we suspect that once the costs and tradeoffs involved in implementing the details of concept 3 become more concrete, the consensus around it will weaken and the time horizon to implementation will lengthen.

At its current stage, the proposal offers a means to determine how competing nominations for allocations would be compared and adjudicated. Some form of simultaneous feasibility testing is a necessary component of any workable allocation mechanism, whichever concept is ultimately adopted. What distinguishes Concept 3 is the scope of the test. But feasibility testing alone does not fully specify a design, and the harder question — how many rights each balancing area will be able to nominate into the process — remains open." Absent a limiting mechanism, there will be a strong bias for each BAA to create more transmission rights as doing so will increase that BAA's share of the jointly feasible allocation. A related concern is that the mechanics of concept 3 would be derived from the current CRR allocation process, which we feel has potentially significant shortcomings.

THE FATE OF CONCEPT 2

A final unfortunate dynamic of the stakeholder process emerged as a consequence of framing concept 2 as basing congestion allocation immutably on historical flows. In fact, the key principle behind concept 2 is that the congestion allocations across members of the EDAM would be based upon criteria that are decoupled from ongoing market behavior - such as the bidding or scheduling of specific units, or the sale of more OATT-based transmission rights. Historical flows are only one possible example of an exogenous standard, although a natural starting point for discussion.