



Memorandum

To: ISO Board of Governors and Western Energy Markets Governing Body
From: James Bushnell, Chair, Market Surveillance Committee
Date: October 13, 2026
Re: **Briefing on Market Surveillance Committee activities: September-October 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 for September 2026. The Committee's attention during this period continues to be directed at the second phase of the Extended Day-Ahead Market (EDAM) congestion revenue allocation (CRA) initiative along with issues related to price formation enhancements, discussed further below. The MSC did not hold a public general session during this period, but members monitored the CRA working groups and continued regular internal meetings with CAISO staff. Both Jacob Mays and James Bushnell presented work on the topic of the interaction of transmission investment and CRA to the CAISOs internal working group on market design. Ross Baldick has continued to consult on state of charge bidding for storage resources.

PRICE FORMATION ENHANCEMENTS (PFE)

The Price Formation Enhancements initiative has been active since the summer of 2022 and had two broad goals: the implementation of better scarcity pricing and the improvement of the process for market power mitigation at the Balancing Area (BAA) level. Progress has been slow due in part to technical challenges but also due to the fact that these topics are divisive and it will be very difficult to obtain stakeholder consensus. The process is further complicated by the fact that it coincides with EDAM expansion.

SCARCITY PRICING

The term scarcity pricing refers to the process of setting prices when the market starts to, or does, run out of available bid-in supply. There are two important aspects. The first is the question of how fast prices should rise toward maximum price levels during periods of "near scarcity." The second is what the maximum price level should be when it is reached.

The current approach to scarcity pricing is largely confined to what is known as the “power balance constraint” which requires that bid-in energy supply (not including reserves) be greater than or equal to expected demand. When this constraint binds, a penalty price of \$1000/MWh, or in special cases \$2000/MWh is applied. Traditionally these levels were well above market bids, so when this condition would bind prices would jump considerably.

This part of the stakeholder process has gotten bogged down in various disagreements over the process of when and how prices should rise to scarcity levels and has not focused enough on the other pressing issue: the fact that the maximum price, with some exceptions, has not been adjusted for nearly two decades and in the opinion of the prior MSC needs to be adjusted upward. This adjustment could be accomplished without significant changes to the existing market design through the adjustment of the penalty prices that are applied to the market. It is quite possible that other changes to the market, including the addition of new flexible operating reserve products, along with increased storage and demand bidding, providing a smoother trajectory of prices even without further explicit scarcity pricing mechanisms.

One objection to raising the maximum penalty (scarcity) price has been the timing. Given the expansion of EDAM and the new elements of Day Ahead Market Enhancements, it is not unreasonable to give the market some time to adapt to and fine tune these new elements. However, EDAM could also commit to a set schedule of rising penalty prices that would give the market time to anticipate and prepare for higher maximum price levels.

MARKET POWER MITIGATION

The market power mitigation topic was twinned with the scarcity pricing topic in part to provide some assurance to those concerned about higher scarcity prices that these prices would not be unduly influenced by market power. That said, the changes that had originally been envisioned addressed concerns of both over-mitigation and under-mitigation.

The concerns about over-mitigation were largely concentrated in the non-CAISO EIM. Each EIM (and now EDAM) BAA is tested for its competitiveness, largely in isolation, when there is separation between CAISO prices and those in the subject BAA. The proposed changes would move toward a more rationalized grouping approach, whereby clusters of BAAs would be tested together as long as transfers between them were uncongested. The changes would also apply new mechanisms that would consider the load obligations of vertically integrated suppliers when assessing their risk of exercising market power to raise prices, and would include new provisions that would allow smaller suppliers to avoid mitigation when it is triggered by the structural market power of their larger competitors. These ideas have been supported by the MSC as positive developments, although some details remain to be worked through.

The concerns about under-mitigation largely involve the CAISO footprint. Historically, market power mitigation is applied in the CAISO only when “local” markets are served by a small number of suppliers due to internal transmission constraints. Mitigation is not applied across the whole CAISO footprint, even when the market structure screen (known as the three pivotal supplier test) indicates a lack of competition at the system level. The DMM has documented that this test has indicated three pivotal suppliers in the systemwide CAISO dozens to hundreds of hours annually in the past, but there is no provision to mitigate offers under these circumstances. There is therefore a theoretical concern that there is market power going unmitigated during these hours. However, DMM has not, to our knowledge, documented the market outcomes in terms of competitive performance during those hours. Absent such evidence there is not much empirical support for the assertion that there is a serious systemwide market power problem in CAISO. Further, the DMM’s analysis also shows that the frequency of systemwide pivotal supplier concentration has decreased significantly over the last few years due to the rapid expansion of capacity in the CAISO footprint.

In the past the MSC has expressed concern that the costs of “false positive” mitigation is rising because mitigation in today’s environment frequently requires estimating the marginal cost of resources such as batteries and even renewable sources. Such estimates are much more difficult, and more prone to error, than those of conventional natural gas plants. Even the costs of gas plants has been difficult to estimate in parts of the WEIM that lack liquid and transparent gas indices. We have therefore been reluctant to endorse expanding mitigation within the CAISO absent strong evidence of a serious problem. The DMM could potentially shed light on this by reporting in detail the market outcomes during the historical test failure hours.

As described above there is wide stakeholder disagreement on several of these topics, with strongly held views on both sides of many of these issues. The CAISO has decided to extend the stakeholder process in an effort to try to narrow the gaps in at least some of these positions. The MSC continues to support the effort to both rationalize mitigation in the WEIM and EDAM and believes that a schedule ramp up in market penalty prices should be considered as part of this extended process.