



Memorandum

To: ISO Board of Governors and Western Energy Markets Governing Body
From: Benjamin F. Hobbs, Chair, Market Surveillance Committee
Date: July 16, 2025
Re: **Briefing on Market Surveillance Committee activities: May 19, 2025 – July 15, 2025**

This memorandum does not require ISO Board of Governors or Western Energy Markets Governing Body action.

During the period of time covered by this memorandum, the Market Surveillance Committee (MSC) of the California ISO drafted a formal Opinion on the ISO's extended day-ahead market congestion revenue allocation proposal.¹ The Opinion was then adopted at a General Session meeting of the Market Surveillance Committee on June 16, 2025.² Subsequently, Dr. Scott Harvey, member of the MSC, gave an oral presentation summarizing the Opinion at the joint meeting of the ISO Board of Governors and Western Energy Markets Governing Body on June 19, 2025.

The ISO's proposal concerned an anticipated conflict between two of the fundamental objectives of the extended day-ahead market design. These two objectives include:

- (1) providing congestion revenues to the BAAs where congestion and its costs occur,
- (2) while at the same time allowing balancing area authorities to retain their systems of open-access transmission tariff-based firm transmission rights that help recover fixed network costs and provide hedges against transmission congestion costs.

The proposal addressed this conflict by proposing an interim and partial reallocation of parallel flow congestion revenues from balancing authorities experiencing congestion to authorities that have sold long-term rights under their open-access tariff to market parties whose schedules contribute to that congestion. In Year 1 of extended day-ahead market operation, the ISO proposed to arrange such a reallocation only for parallel congestion

¹ California Independent System Operator, *Final Proposal: EDAM Congestion Revenue Allocation*, June 6, 2025, stakeholdercenter.caiso.com/InitiativeDocuments/FinalProposal-EDAMCongestionRevenueAllocation-June62025.pdf.

² James Bushnell, Scott Harvey, and Benjamin F. Hobbs, *Final Opinion on Extended Day-Ahead Market (EDAM) Congestion Revenue Allocation*, Market Surveillance Committee of the CAISO, June 16, 2025, www.caiso.com/documents/market-surveillance-committee-opinion-extended-day-ahead-market-congestion-revenue-allocation-jun-13-2025.pdf.

revenues associated with monthly or longer term balanced firm point-to-point or Network Integration Transmission Service rights sold under a balancing authority's transmission tariff that (a) are pre-registered with the ISO (including submission of their contract reference number), and (b) involve self-schedules for the operation of the resources using that transmission. A transfer of congestion revenue would then occur in which the balancing area authority in which the sources and sinks are located would then receive the congestion revenue associated with the parallel flow and congestion in other balancing area authorities.

Although not part of the design that the Board and Governing Body were asked to consider approving at their June 2025 meeting, the proposal also suggests additional possible changes in congestion allocation designs for implementation in year 2 or later. In those possible changes, balanced transactions economically scheduled by the extended day-ahead market could also be eligible for such transfers of congestion revenues. The proposal did not describe a final market design to resolve the competing objectives of the extended day-ahead market design, but instead outlined a possible three-year transition process for the consideration and implementation of interim and final designs.

In our formal Opinion on the proposal, we discussed both the year 1 proposal that the Board and Governing Body considered at their June 2025 meeting, as well as the possibilities suggested by the proposal for year 2 and afterwards which were not being decided upon by the Board and Governing Body at this time. The Opinion defined four sets of issues concerning the proposal, and summarized our analyses of those issues. Several conclusions were made based on those analyses, and we recommend several additional analyses that are desirable. Four of those conclusions from the Opinion are summarized below:

- A well designed and implemented extended day-ahead market has the potential to bring large economic benefits in the form of more cost-effective dispatch across the West, as we described in our previous January 2023 Opinion.³ Moreover, the extended day-ahead market design necessarily has a number of unique elements that have not been tested in other markets. It is therefore important for the market to go live sooner rather than later so the process of adjustment and refinement of the market design and operating practices can begin. Nevertheless, the ISO should not initiate operations of the extended day-ahead market with known and potentially material problems for which it has not developed a resolution.
- We have significant reservations about the year 1 congestion cost allocation approach described in the proposal, especially about incentives it will likely

³ James Bushnell, Scott Harvey, and Benjamin F. Hobbs, *Final Opinion on Extended Day-Ahead Market*, Market Surveillance Committee of the CAISO, Jan 27, 2023, www.caiso.com/documents/mscfinalopiniononextendedday-aheadmarket.pdf.

provide to self-schedule. These incentives potentially reduce the benefits of coordinating unit commitment and dispatch across multiple balancing areas that the extended day-ahead market is intended to provide and potentially result in material unintended cost shifts. The potential negative consequences we describe may not be material, particularly in year 1 given the limited initial scope of the market, but we have not seen enough empirical evidence for us to conclude that this will definitely be the case.

- That said, we understand that there are other important considerations regarding the timing of this proposal and the implementation of the market. At the very least, prior to a decision to commence actual extended day-ahead market operations, there are important data and analyses, described in our Opinion, that are needed to increase confidence that negative consequences would not be substantial.
- The proposal describes a possible expansion of recovery of parallel flow congestion costs that could be considered for implementation in year 2 to include schedules resulting from flexibly bid units, but still linked to registered transmission rights. This expansion may reduce the incentive to self-schedule in some circumstances but will, in our opinion, incent more below-cost offers. Therefore, this alternative shares some of the incentive problems we see in the year 1 proposal. We have even more significant concerns about this proposed year 2 direction. However, we have been told this alternative would only be considered at a future time alongside other possible alternatives to modify the year 1 loop-flow congestion cost allocation design. We believe the time spent after year 1 towards modifying congestion cost recovery would be best utilized by focusing on alternative frameworks. In our Opinion, we describe one such possible framework, structured around the concept of financial flowgate rights.