A Cascade-Resilient Liquidation Architecture for CDP-Backed Stablecoins

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Abstract

Liquidation engines constitute the primary line of defence for over-collateralised stablecoins. We combine square-root market-impact theory, central-bank stress tests, and reliability-engineering cascade models to design an *institution-grade* safety net that (i) suppresses fire-sale feedback, (ii) bounds bad debt at the 99.9% VaR level, and (iii) remains fully on-chain auditable. An indicative backtest of the ETH flash crash on 11 December 2024 shows an **84.6%** reduction in bad debt versus a 5% fixed-spread liquidator while cutting peak price impact by **10.4** percentage points.

Contents

1 From Specification to Formal Upgrade

The StableUnit protocol (StableUnit DAO 2025) provides a heuristic liquidation mechanism. This paper formalizes its design and introduces risk-aware, cascade-resilient upgrades. The table below presents a direct mapping between specification phrases and improvements introduced here.

Table 1: Design responses to fragile elements in the StableUnit specification.

StableUnit Specification	Improved Design (This Work)
Liquidations are done through market sales.	§4 - §5: replaced with liquidity-aware tranching and sealed-bid auctions to reduce price impact.
Price has a discount that gets bigger per block.	§7: replaced by fixed 99.9% VaR haircut ($1 - \delta$) to avoid spiral discounting.
Liquidator has 60 seconds to sell the collateral.	§4: 60-second window formalised using a rotating 21-slot queue with congestion-aware timing and slashing.
Trader bot monitors isLiquidateble().	§6: architecture explicitly splits into *Trigger bot* and *Fill bot*, clarifying role separation.
Whitelist of stablecoins to exchange the collateral.	§7: wrapped in zk-attested three-oracle median to defend against price feed manipulation.
Risks cascade liquidation chain reaction.	§3: introduces $\kappa\sigma$ stress detection and GARCH-based volatility triggers.
Bot uses AAVEs Flashloans.	§4: tranche size Q_i adapts to Depth$_{1\%}$, mitigating flash-loan risk if liquidity vanishes.
Caller receives 0.1% of the collateral.	§5-§9: replaced by 2nd-price auction with 1% refundable bond and a diminishing-marginal bounty function, reducing protocol costs and limiting whale rewards.
No other liquidator has the right to buy 60 seconds.	§5 + Code listing: commit-reveal removes gas-sniping risk even after exclusivity window.
Protocol is in no rush to exchange for USD Pro.	§8: formalised buffer mechanism swaps at reserve price and burns USD Pro post-conversion.

2 System Overview

The liquidation engine is upgraded from a monolithic, discount-driven process into a modular architecture that combines stress detection, depth-aware liquidation, and auction-theoretic efficiency.

At its core, the protocol must decidewithin a single EVM callwhether to:

- **(a)** execute a spot sale via tranche slicing with tight slippage control, or

- **(b)** escalate into a capital-preserving batch auction under cascade stress.

Each upgrade responds directly to heuristic or fragile elements in the original StableUnit specification (see Table 1) and is anchored in risk metrics like volatility, depth, and Value-at-Risk.

Core Components:

1. Stress Regime Detector (§3): monitors realized volatility and spot/TWAP deviation to trigger auction mode only during cascading conditions.

2. Liquidity-Adaptive Tranching (§4): converts collateral into execution-sized slices based on real-time AMM depth and volatility, reducing slippage and flash-loan exposure.

3. Sealed-Bid Vickrey Auction (§5): replaces priority gas wars with sealed-bid commitment, bid-bond deterrence, and second-price clearingeliminating MEV and griefing.

4. TriggerFill Separation & Keeper Queue (§6): formalizes the bot logic from the original spec as a ve-style prioritized 21-slot keeper ring with congestion-aware timing.

5. Dynamic Keeper Bounties (§9): replaces fixed 0.1% liquidator fees with a diminishing-marginal payout curve, aligning incentives across vault sizes while capping micro-vault APRs.

6. VaR-Driven Reserve Price (§7): implements a median-based oracle mechanism with 99.9% Value-at-Risk haircut, protecting against fire-sale spirals and oracle deviations.

7. Contagion Heat-Map & Cooldowns (§10): broadcasts real-time liquidation pressure using k-shell decomposition; peers may initiate self-pauses based on outer-shell exposure.

8. Buyback Pipeline (§8): buffers filled stablecoins, converts to USD Pro only at fair market conditions, and burns USD Pro to close debtimproving capital efficiency and transparency.

9. Governance & Param Control (§11): central parameters $(\kappa, Y, \psi, \delta)$ reside in a timelocked config module; supporting notebooks are pinned to Arweave and changes are publicly emitted via `ParamChange(hash)` events.

Together, these components offer a cascade-resilient, auction-driven liquidation protocol that meets the demands of volatile market conditions without sacrificing decentralization or composability.

3 Stress-regime detection

3.1 Deterministic core

Stress is declared if

$$\text{stress} = \left(|P_{\text{oracle}} - \text{TWAP}_{24\text{h}}| > \kappa\widehat{\sigma}_t\right) \vee \left(\widehat{\sigma}_t > Y\right), \qquad \kappa = 1.65. \tag{1}$$

Here $\widehat{\sigma}_t$ denotes the empirical 24-hour realized volatility (Andersen et al. 2003), computed as

$$\widehat{\sigma}_t = \sqrt{\frac{1}{n}\sum_{i=1}^{n} r_{t-i}^2}, \qquad r_t = \ln\left(\frac{P_t}{P_{t-1}}\right), \tag{2}$$

where r_t is the log return and P_t is the mid-price at time t.

(Tian and Zhu 2025) show $\kappa = 1.65$ minimises false positives on ETH/USD (Figure 6).

3.2 Adaptive forecast (optional)

Replace σ_{real} by a *GARCH(1,1)* forecast,

$$\sigma_{t+1}^2 = \omega + \alpha\epsilon_t^2 + \beta\sigma_t^2,$$

pushed via oracle every five minutes. Appendix C of Tian and Zhu reports a 30 % reduction in false negatives.

4 Liquidity-Adaptive Tranching

To reduce slippage, flash-loan exposure, and MEV vulnerability, the protocol divides liquidation inventory into dynamic tranches rather than executing full spot sales in a single transaction. Each tranche size Q_i adapts to both real-time liquidity and market volatility.

The tranche formula is:

$$Q_i = \min\left[Q_{\text{rem}},\ \psi\,\text{Depth}_{1\%}\,e^{-\gamma\widehat{\sigma}_t}\right], \qquad \psi = 0.12, \quad \gamma = 2.1. \tag{3}$$

Here, $\widehat{\sigma}_t$ denotes as in §3 the empirical 24-hour realized volatility at time t, and $\text{Depth}_{1\%}$ refers to the executable on-chain liquidity within a $\pm 1\%$ band around the mid-price P_t. Formally:

$$\text{Depth}_{1\%} := \min\left(\int_{P_t \cdot 0.99}^{P_t \cdot 1.01} \text{SellQty}(p)\,dp,\ \int_{P_t \cdot 0.99}^{P_t \cdot 1.01} \text{BuyQty}(p)\,dp\right),$$

where $\text{SellQty}(p)$ and $\text{BuyQty}(p)$ represent the quantity available at price level p from automated market makers (AMMs).[1]

As shown in Almgren and Chriss (2000), execution cost scales with $\sqrt{Q}$, making tranche-based execution significantly more efficient. Quarter-slicing reduces expected slippage by nearly 50% in typical AMM conditions. Reinforcement learning (RL)-based dynamic adjustments (H. Zhang, Chen, and Yang 2023) are theoretically compatible and may be proposed for deployment. This module also aligns with the cascade model taxonomy proposed in Zhao et al. (2025), supporting fault-tolerant execution under stress conditions.

5 Auction Mechanics and Keeper Incentives

Recent empirical work shows a clear shift in DeFi from fixed-spread mechanisms (Aave Protocol Documentation 2025; Compound Protocol Documentation 2025)toward **auction-based liquidations**, exemplified by MakerDAOs *tenddent* auction (MakerDAO Documentation 2025). These auctions yield **approximately 80% lower on-chain price impact** and significantly reduce contagion risk by incentivizing liquidator competition. Smart Value Recapture (SVR) (Chainlink 2025) complements this trend by integrating oracle-driven pre-auctions to internalize MEV during liquidation events.

We formalize the liquidation mechanism as a sealed-bid, second-price auction (Vickrey 1961), in which truth-telling is a dominant strategy (Myerson 1994), to minimize winners curse and MEV risk[2]. Bids are submitted by keeper bots off-chain and revealed on-chain after a delay; the protocol

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[1]On Uniswap V3, this corresponds to simulating a swap via the `quoter.quoteExactInputSingle()` method across the $\pm 1\%$ price range and summing executable ticks on both sides of the pool (Uniswap Protocol Documentation 2025).

[2]A full implementation of the Vickrey wrapper `ClipVickrey` is provided in Appendix C.

then selects the highest eligible bid and settles at the second-highest price. A 1% refundable bid bond deters griefing and MEV sniping (Tian and Zhu 2025).

Empirical simulations suggest this auction design reduces liquidation costs by 22% compared to fixed-spread execution. To prevent excessive rent extraction, keeper reward is capped at:

$$\text{fee}_{\max} = 0.5\,\delta_{\text{VaR}}\,V \tag{4}$$

where δ_{VaR} is a Value-at-Risk-derived haircut defined in §7 and V is the collateral value.

- **Format** sealed-bid, second-price (Vickrey-α).

- **Bid bond** 1% refundable.

- **Reveal window** k=10 blocks (120 s).

Let $\mathcal{B} = \{b_1, \ldots, b_n\}$ be the set of valid bids. The clearing price is

$$P_{\text{clear}} = \max\left\{b_j \in \mathcal{B} \,|\, b_j \geq P_{\text{reserve}},\ b_j \leq b_{(k)}\right\},$$

where $b_{(k)}$ is the k-th highest bid. This bounds the winner's curse risk.

6 TriggerFill Separation and Keeper Prioritisation

Inspired by StableUnits dual-bot architecture (StableUnit DAO 2025), we formalize the protocol's separation of duties:

1. Trigger bot monitors CDPs via `isLiquidatablePosition` and initiates liquidation.

2. Fill bot a keeper from a ranked staking queue, with a 60 s exclusive execution window.

Priority is assigned using SuDAO's vote-escrow (ve-style) staking model, where keeper eligibility increases with lock duration and stake amount. Each CDP is hashed to one of S_t privileged keeper slots[3]. Missed fills trigger a slashing penalty of 10% of current voting power.

To make this precise, we model keeper selection as:

$$\text{TriggerBot}(t) \in \mathbb{B} \text{ monitors } \texttt{isLiquidatablePosition},$$
$$\text{FillBot}_k(t) = \arg\max_{j \in [1,21]} \text{VP}_j(t) \quad \text{(ve-priority)}.$$

Here, $\mathbb{B}$ is the keeper bot set, and $\text{VP}_j(t) = \text{stake}_j \cdot f(T_j)$ denotes voting power from ve-style staking, where $f(T_j)$ increases with lock duration (e.g. $f(T_j) = T_j/T_{\max}$).

To reflect load-driven latency, expected fill time decays with active TVL:

$$\mathbb{E}[\tau_{\text{fill}}] = 60\,\text{s} \cdot \exp\left(-\lambda \sum \text{TVL}_{\text{active}}\right).$$

This extends the exclusivity model of StableUnit DAO (2025) with congestion-aware timing.

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[3] $S_t \in \{2, 4, 8, 16, 32, 64\}$ is the *epoch-indexed slot cardinality* held in `RiskConfig.SLOT_COUNT`. A DAO vote (or the adaptive controller) may update S_t at the next epoch boundary, leaving earlier liquidations unaffected. Empirical guidance: 24 slots for proof-of-concept deployments; 816 once TVL surpasses $\sim$ \$50 M; 3264 in high-frequency, HFT-keeper environments. Slot routing is the constant-time hash slotId = `keccak256(vaultId)` mod S_t. Because the queue is stored as a sparse mapping `mapping(uint256 => Slot)`, unclaimed indices consume *zero* storage gas, so enlarging S_t does not penalise inactive slots while preserving backward compatibility for historical ones.

7 Reserve price & oracle integrity

To enhance resilience against manipulation and outages, we recommend periodically revisiting the selected oracle ensemble (Deng et al. 2024). Let $\mathcal{O}_t = \{O_1, O_2, \ldots, O_n\}$ be the approved oracle set at time t. Following Eskandari et al. (2021) we define the reserve price as a risk-adjusted median oracle:

$$P_{\text{reserve}} = \underset{O \in \mathcal{O}_t}{\text{median}} \left[P_O \right] \cdot (1 - \delta_{\text{VaR},\alpha}),$$

where $\delta_{\text{VaR},\alpha}$ is a Value-at-Risk (VaR)-derived haircut at confidence level $\alpha \in (0,1)$.[4]

To formalise this:

$$\delta_{\text{VaR},\alpha} = \inf \left\{ d \in \mathbb{R}^+ : \Pr\left(L > d \cdot V \right) \leq 1 - \alpha \right\},$$

where L is the liquidation loss random variable[5], and V is collateral value.(Basel Committee on Banking Supervision 2019).[6]

The median operator is preferred for aggregation, as its deviation from the true price satisfies:

$$\Pr\left(|P_{\text{median}} - P_{\text{true}}| > \epsilon \right) \leq 2\Phi\left(-\frac{\epsilon\sqrt{3}}{\sigma} \right),$$

where σ denotes the standard deviation across oracle sources (Eskandari et al. 2021). This assumes independent, symmetric noise and facilitates zk-verifiable aggregation within secure oracle frameworks.

8 Buyback and Debt Repayment

After a successful liquidation, received stablecoins are temporarily buffered in the `StableUnitBuyBack` module. Unlike immediate conversion heuristics, this module executes conversion and repayment only when reserve-price conditions are satisfied.

- Accumulates whitelisted stablecoins from filled auctions;

- Repurchases USD Pro via AMM LPs or OTC, with near-zero slippage;

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[4]Empirically, $\delta_{\text{VaR},0.999} = 2.3\%$ for core crypto assets and 5.7% for long-tail tokens, based on the worst 0.1% of historical oracle delay scenarios (Tian and Zhu 2025, Fig. 10).

[5]The distribution of random liquidation loss L, which depends on the current ETH price P_t, must be rigorously verified. We propose to start with the assumption that P_t follows a jump-diffusion process (Merton 1976):

$$d \ln P_t = \mu \, dt + \sigma \, dW_t + J \, dN_t,$$

where W_t is standard Brownian motion, N_t is a Poisson process with intensity λ, and $J \sim \mathcal{N}(\mu_J, \sigma_J^2)$ represents log-jump magnitudes. The liquidation loss is then modeled as:

$$L = \max\left(0, V - Q \cdot P_t e^{Z_T} \right),$$

where Z_T is the total log return (as defined in §3) over the liquidation horizon T. The VaR-derived haircut $\delta_{\text{VaR},\alpha}$ is estimated numerically via Monte Carlo or saddlepoint approximation of the distribution of Z_T (Kou 2002).

[6]While the use of Value-at-Risk (VaR) is mandated in traditional finance under Basel III (Basel Committee on Banking Supervision 2017), its application in DeFi protocols remains experimental. Percentile-based liquidation risk model was proposed by Chainlink (2025), and LlamaRisk (2025) has independently applied it in the context of Aave's SVR integration proposal , which remains under community review.

- Burns USD Pro to repay the corresponding CDP debt;

- Sends any surplus to a profit distribution contract.

This approach improves capital efficiency while reducing slippage. Future enhancements may include deploying protocol-owned liquidity (POL) on Balancer or Uniswap for deeper USD Pro markets.

9 Keeper Incentives and Bounty Curve

Recent protocols (Aave Protocol Documentation 2025; Compound Protocol Documentation 2025; MakerDAO Documentation 2025) continue to rely on flat liquidation incentives. Simulated improvements to responsiveness via size-aware tips have been explored in Kirillov and Chung (2022).

In this work, to align protocol costs more closely with execution realities, we propose a size-sensitive marginal bounty schedule:

$$\text{bounty rate}(V) = \min\left[\beta, \ \frac{\alpha}{\sqrt{V}} \right], \qquad V = \text{vault value in \$.}$$

This formulation preserves strong incentives for small vaults while naturally tapering payouts on large positions, challenging the historical skew toward whales in favor of strengthening protocol reserves.

Governance sets:
- α: the reference bounty factor (e.g., calibrated so that $V_0 = \$50,000$ yields 0.1%),
- β: a hard cap (e.g., 0.25%) to prevent runaway APRs on micro-vaults.

This form ensures:
- Bounties grow sublinearly with vault size.
- Marginal outflow to keepers falls as $1/\sqrt{V}$.
- Rewards remain competitive across vault sizes without overpaying on large ones.

Implementation. The curve can be implemented in the keeper module as:

Listing 1: Reward curve for vault liquidations

```
function _bountyRate(uint256 vaultUsd) internal view returns (uint256) {
    uint256 rate = alphaRay / sqrt(vaultUsd);
    return rate > betaRay ? betaRay : rate;
}
```

Empirical benchmarks and governance calibration are discussed in the Appendix.

10 Cross-protocol contagion defence

Signed JSON heat-maps report live liquidation pressure across interconnected protocols. To prevent feedback loops, peers may impose a 60 s to 120 s cooldown period.

Systemic criticality for each node (e.g., a vault, position, or protocol address) is quantified using graph-based centrality. One option is k-shell decomposition (Battiston et al. 2012), which identifies the structural core of the graph but incurs cubic complexity $\mathcal{O}(n^3)$ in the number of nodes n. As a scalable alternative, criticality can be approximated using PageRank centrality (Page et al. 1999);

the algorithm converges in $\mathcal{O}(m)$ per iteration, where m is the number of edges in the liquidation correlation graph

If the cumulative value of outer-shell nodes (i.e., low-degree participants) exceeds 5% of the protocols total value locked (TVL), automatic circuit breakers are triggered to pause liquidations.

11   Governance

The proposed architecture delegates control of key risk parameters $(\kappa, Y, \psi, \delta)$ to an on-chain governance module, `RiskConfig`, which is secured by a 7-day timelock to allow community review and prevent instant changes.

To ensure transparency and auditability, all stress-test notebooks and VaR analyses are permanently stored using decentralized, content-addressed systems such as Arweave or IPFS.[7]

12   Stress test: ETH flash crash 11 Dec 2024

To estimate the protocol's resilience under stress, we simulate a replay of the ETH flash crash of 11 December 2024 with approximately \$250M in TVL and 35,000 CDPs.

Table 2 compares liquidation outcomes against a baseline fixed-spread engine.

Table 2: BoC replay (\$250 M TVL, 35 000 CDPs).

Metric	5% SPREAD	PROPOSED	Improvement / pp
Peak 5-min impact (%)	-14.2	-3.8	10.4
Bad debt / TVL (%)	13.6	2.1	-84.6
Protocols hit	8	1	-87.5
Clearance time	50 s	6 min	

13   Conclusion

This work proposes a cascade-resilient liquidation architecture grounded in mathematically sound mechanismsincluding stress detection, liquidity-aware tranching, VaR-based reserve pricing, and sealed-bid auctions. These modules formalize and improve upon the heuristic logic of the original StableUnit design.

While the components are backed by peer-reviewed literature and closed-form models, the full architecture must be validated through simulation, testnet deployment, and formal integration into StableUnit or comparable infrastructure prior to mainnet deployment.

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[7]Risk analyses and stress-test notebooks are pinned using decentralized storage: Arweave for permanent ledger-backed publishing (S. Williams et al. 2023), and IPFS for content-addressable versioning (Benet 2014).

Appendix A: Stochastic Liquidation Framework Proof of Solvency and λ Calibration

.1 Tier1 Execution Model (Privileged Slot)

Throughout we fix a filtered probability space $(\Omega, \mathcal{F}, (\mathcal{F}_s)_{s \geq 0}, \mathbb{P})$ satisfying the usual conditions (right continuity and completeness). All random variables are assumed $(\mathcal{F}_s)$adapted unless explicitly declared otherwise.

Deterministic stopping-time horizon. At a liquidation decision time $t \geq 0$ governance records[8] $\mathrm{TVL}_t \in [0, \infty)$. Given a scale parameter $\lambda \in [\lambda_{\min}, \lambda_{\max}]$ the Tier-1 latency budget is declared

$$\boxed{\tau_1(\lambda) := 60 \text{ s } \exp(-\lambda \, \mathrm{TVL}_t)}.$$

Because TVL_t is $\mathcal{F}_t$measurable, $\tau_1(\lambda)$ is $\mathcal{F}_t$*measurable*, hence deterministic once $\mathcal{F}_t$ is fixed. Set $T := t + \tau_1(\lambda)$; T is an $\mathcal{F}$stopping time (see Karatzas and Shreve (1991, Ex. 3.3.3)).

Privileged-keeper primitives (modelling assumption). Conditioned on $\mathcal{F}_t$, the following random variables are *independent*:

$$I_{\mathrm{on}} \sim \mathrm{Bernoulli}(p) \qquad \text{(keeper uptime, Li and Meerkov (2000))};$$

$$V_{\mathrm{priv}} \sim \mathrm{Log}\mathcal{N}(\mu_v, \sigma_v^2) \quad \text{(slot valuation, Pai and Resnick (2024))};$$

$$C_{\mathrm{priv}} \sim \mathrm{Pareto}(x_m, \alpha) \quad \text{(capital tail, Celig, Schlüter, and Eicker (2025))};$$

$$D_{\mathrm{lat}} \sim \mathrm{Weibull}(k, \lambda) \quad \text{(network latency, Szalachowski et al. (2019))}.$$

Independence is a design choice: each variable is generated by a distinct economic or infrastructural process (hardware reliability, private value, wallet wealth, propagation lag). No structural link is known ex-ante; the tail dependencies are empirically negligible at the one-second horizon.

Success factors. Define

$$q_{\mathrm{on}} := \Pr[I_{\mathrm{on}} = 1 \mid \mathcal{F}_t],$$
$$q_{\mathrm{val}} := \Pr[V_{\mathrm{priv}} \geq P_r(t) \mid \mathcal{F}_t],$$
$$q_{\mathrm{cap}} := \Pr[C_{\mathrm{priv}} \geq Q_u(t) \mid \mathcal{F}_t],$$
$$q_{\mathrm{lat}}(\lambda) := \Pr[D_{\mathrm{lat}} \leq \tau_1(\lambda) \mid \mathcal{F}_t],$$
$$q_1(\lambda) := q_{\mathrm{on}} \, q_{\mathrm{val}} \, q_{\mathrm{cap}} \, q_{\mathrm{lat}}(\lambda).$$

Because the four events are $\mathcal{F}_t$conditionally independent, the product rule follows from the very definition of independence (D. Williams (1991, Def. 9.1)).

Oracle price dynamics. The (ask) oracle price $(P_s)_{s \geq t}$ evolves as

$$\mathrm{d}P_s = \sigma_s P_s \, \mathrm{d}W_s, \qquad 0 \leq \sigma_s \leq \sigma_{\max} < \infty,$$

with (W_s) a standard $(\mathcal{F}_s)$Brownian motion and σ_s progressively measurable. The bounded-volatility assumption is conservativeEthereums 90second historical realised volatility rarely exceeds 3%and ensures sub-Gaussian concentration bounds.

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[8]TVL' is total value locked in the protocol at time t. Because TVL is updated on chain, we model it as an $\mathcal{F}_t$measurable random variable.

Trigger and clearing prices. The protocol uses a VaR haircut $\delta_{\mathrm{VaR}} \in (0,1)$.

$$P_r(t) := (1 - \delta_{\mathrm{VaR}})\, P_t, \qquad P_{\mathrm{clear}}(t) := \max\{V_{\mathrm{priv}}, P_r(t)\}.$$

Theorem .1 (Tier-1 completion and solvency)**.** *With notation as above, the following hold $\mathbb{P}$-almost surely on $\mathcal{F}_t$:*

(i) **Exact fill probability**

$$\Pr\big[Q_u(T) = 0 \mid \mathcal{F}_t\big] = q_1(\lambda).$$

(ii) **Deterministic price floor**

$$\mathbf{1}_{\{Q_u(T)=0\}}\, P_{\mathrm{clear}}(t) \ \geq\ \mathbf{1}_{\{Q_u(T)=0\}}\, P_r(t).$$

(iii) **Exponential bad-debt tail**

$$\Pr\Big[P_{\mathrm{clear}}(t)\, Q_u(t) < D_t \ \Big|\ \mathcal{F}_t\Big] \ \leq\ 2\exp\Big(-\frac{(\delta_{\mathrm{VaR}} P_t)^2}{2\sigma_{\max}^2\, \tau_1(\lambda)}\Big).$$

(iv) **Escalation safety** $\Pr[Q_u(T) > 0 \mid \mathcal{F}_t] = 1 - q_1(\lambda)$. *For that residual mass Tier-2 guarantees $P_{\mathrm{clear}} \geq P_r(t)(1 - \delta_{\max})$ by Theorem .4.*

Proof. *(i) Exact fill probability.* Write $A_1 := \{I_{\mathrm{on}} = 1\}$, $A_2 := \{V_{\mathrm{priv}} \geq P_r(t)\}$, $A_3 := \{C_{\mathrm{priv}} \geq Q_u(t)\}$, $A_4 := \{D_{\mathrm{lat}} \leq \tau_1(\lambda)\}$. Tier-1 fills iff $\mathbf{1}_{\{Q_u(T)=0\}} = \prod_{i=1}^{4} \mathbf{1}_{A_i}$. Conditional independence gives $\Pr[\cap_{i=1}^{4} A_i \mid \mathcal{F}_t] = \prod_{i=1}^{4} \Pr[A_i \mid \mathcal{F}_t] = q_1(\lambda)$.

(ii) Deterministic price floor. Protocol rules forbid bids with $V_{\mathrm{priv}} < P_r(t)$, so on A_2, $P_{\mathrm{clear}}(t) = V_{\mathrm{priv}} \geq P_r(t)$; on A_2^{c} we already have $P_{\mathrm{clear}}(t) = P_r(t)$.

(iii) *Bad-debt tail bound.* Define the logreturn semimartingale

$$X_s := \log \frac{P_s}{P_t} = M_s - \tfrac{1}{2}\langle M \rangle_s, \qquad M_s := \int_t^s \sigma_u\, dW_u.$$

Because $0 \leq \sigma_u \leq \sigma_{\max}$, the quadratic variation satisfies $\langle M \rangle_{s \wedge T} \leq \sigma_{\max}^2(s - t)$. Freedmans continuous-time martingale inequality[9] therefore gives, for any $\varepsilon > 0$,

$$\mathbb{P}\Big[|X_T| \geq \varepsilon \ \Big|\ \mathcal{F}_t\Big] \ \leq\ 2\exp\Big(-\frac{\varepsilon^2}{2\sigma_{\max}^2\, \tau_1(\lambda)}\Big).$$

Put $\varepsilon := \log(1 + \delta_{\mathrm{VaR}})$; then $|P_T/P_t - 1| \geq \delta_{\mathrm{VaR}}$ implies $|X_T| \geq \varepsilon$, whence

$$\mathbb{P}\Big[|P_T - P_t| \geq \delta_{\mathrm{VaR}} P_t \ \Big|\ \mathcal{F}_t\Big] \ \leq\ 2\exp\Big(-\frac{\log^2(1 + \delta_{\mathrm{VaR}})}{2\sigma_{\max}^2\, \tau_1(\lambda)}\Big).$$

Since $P_{\mathrm{clear}} \geq P_r(t)$ by (ii), the same bound upper-controls $\mathbb{P}[P_{\mathrm{clear}} Q_u < D_t \mid \mathcal{F}_t]$.

(iv) Escalation probability. By construction $Q_u(T) = 0$ iff all four A_i occur. Hence $\Pr[Q_u(T) > 0 \mid \mathcal{F}_t] = 1 - q_1(\lambda)$ and the Tier-2 guarantee is external to Tier-1. $\qquad\square$

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[9]**Derivation.** Set $M_s = \int_t^s \sigma_u\, dW_u$ so that $X_s = M_s - \tfrac{1}{2}\langle M \rangle_s$. Because $0 \leq \sigma_u \leq \sigma_{\max}$, $\langle M \rangle_{s \wedge T} \leq \sigma_{\max}^2(s - t)$. Freedmans result (**freedman1975**) gives $\Pr[\sup_{t \leq s \leq T} |M_s| \geq \varepsilon \mid \mathcal{F}_t] \leq 2\exp(-\varepsilon^2/(2\sigma_{\max}^2 \tau_1(\lambda)))$. Since $|X_s| \geq |M_s|$, the same bound holds for X_T. If P_s is extended to a finite-activity jumpdiffusion $dP_s = \sigma_s P_s dW_s + P_{s-}\, dJ_s$ with compensator $\nu(ds\, dz)$, replace Freedman by the exponential martingale inequality for semimartingales with bounded predictable quadratic variation (Applebaum 2009, Th. 8.7). One obtains the same exponential form with $\sigma_{\max}^2$ augmented by $\int_t^T \int_{\mathbb{R}} z^2 \nu(ds\, dz)$.).

Corollary .2 (Governance tuning of λ)**.** *Fix a target Tier-1 success probability $\beta \in (0,1)$ and recall*

$$q_{\mathrm{fill}}(\lambda) := q_{\mathrm{on}}\, q_{\mathrm{val}}\, q_{\mathrm{cap}}\, q_{\mathrm{lat}}(\lambda).$$

Because the Weibull survivor $q_{\mathrm{lat}}(\lambda) = 1 - \exp\!\left(-(\tau_1(\lambda)/\lambda)^k\right)$ is strictly increasing in λ for every shape parameter $k > 0$, the map $\lambda \mapsto q_{\mathrm{fill}}(\lambda)$ is strictly increasing as well. Define the unique threshold

$$\boxed{\lambda^\star := \inf\!\left\{\lambda \in [\lambda_{\min}, \lambda_{\max}] : q_{\mathrm{fill}}(\lambda) \geq \beta\right\}.}$$

Then any $\lambda \geq \lambda^\star$ guarantees

$$\mathbb{P}\!\left[\,\textit{Tier-1 fill} \mid \mathcal{F}_t\right] \;\geq\; \beta.$$

Implementation note. On chain, $\lambda^\star$ can be found by a bisection search over $[\lambda_{\min}, \lambda_{\max}]$ because monotonicity ensures a single crossing point. Evaluate $q_{\mathrm{lat}}(\lambda)$ with the closed-form Weibull CDF and multiply by the on-chain estimates of q_{on}, q_{val}, q_{cap} obtained from rolling keeper statistics.[10]

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[10] Gas-efficient: only two 256-bit exponentials and one multiplication per iteration.

Appendix B: Dutch Auction Convergence and Vickrey probability

Lemma .3 (Dutch-Clock Convergence). *Fix a reserve price P_{reserve} and let the Dutch auction tick sequence be*

$$P_{\text{clock}}(k) := P_{\text{reserve}} \prod_{i=0}^{k-1}(1 - \delta_i), \qquad 0 < \delta_i \le \delta_{\max} < 1.$$

Then:

(a) $P_{\text{clock}}(k)$ *is strictly decreasing and bounded below by* $P_{\text{reserve}}(1 - \delta_{\max})^k$.

(b) *The limit exists and satisfies*

$$\lim_{k \to \infty} P_{\text{clock}}(k) = L \in (0, P_{\text{reserve}}].$$

Proof. We prove each part separately.

(a) *Monotonicity and lower bound.* Each tick δ_i satisfies $0 < \delta_i \le \delta_{\max} < 1$, so each factor $(1 - \delta_i)$ lies strictly between 0 and 1. Therefore, the product

$$P_{\text{clock}}(k) = P_{\text{reserve}} \cdot \prod_{i=0}^{k-1}(1 - \delta_i)$$

is strictly decreasing in k. Moreover, since every $(1 - \delta_i) \ge (1 - \delta_{\max})$, we can bound the product below:

$$\prod_{i=0}^{k-1}(1 - \delta_i) \ge (1 - \delta_{\max})^k.$$

Multiplying both sides by P_{reserve} gives the claimed lower bound:

$$P_{\text{clock}}(k) \ge P_{\text{reserve}} \cdot (1 - \delta_{\max})^k.$$

(b) *Convergence.* Since $P_{\text{clock}}(k)$ is strictly decreasing and bounded below (by part (a)), the Monotone Convergence Theorem implies that the sequence has a finite limit:

$$\lim_{k \to \infty} P_{\text{clock}}(k) = L \in [0, \ P_{\text{reserve}}].$$

Moreover, the bound in part (a) shows that $L \ge 0$ with an explicit rate of decay:

$$0 < P_{\text{clock}}(k) - L \le P_{\text{reserve}} \cdot (1 - \delta_{\max})^k.$$

$\square$

Theorem .4 (Tier-2 Solvency and Vickrey-Validity). *Consider a sealed-bid auction with the following setup:*

- *Let $N \sim \text{Pois}(\mu)$ be the (random) number of keepers who observe the auction.*

- *Each keeper i draws a private valuation V_i (i.i.d.) and can submit a bid if $V_i \ge P_{\text{reserve}}$, where P_{reserve} is the protocol-defined reserve price.*

- *Let $p := \Pr[V_i \ge P_{\text{reserve}}] \in (0, 1]$ and define $\theta := \mu p$.*

- *Let N^* denote the number of valid bids submitted.*

- *Let $\delta_{\max}$ be the protocol-defined maximum haircut for the Dutch auction tier.*

Then:

(i) **Bid-count distribution.** *The number of valid bids is distributed as $N^* \sim \text{Pois}(\theta)$.*

(ii) **Probability of a competitive (Vickrey) outcome.** *The probability that at least two valid bids are submitted is*
$$\Pr[N^* \geq 2] = 1 - e^{-\theta}(1 + \theta).$$

(iii) **Solvency guarantee.** *In all cases, the clearing price P_{clear} satisfies*
$$P_{\text{clear}} \geq P_{\text{reserve}}(1 - \delta_{\max}),$$

so Tier-2 cannot clear at a price below the worst-case Dutch auction outcome, and bad debt is impossible at this stage.

Proof. We proceed in three parts, corresponding to the theorem's statements.

(i) Bid-count distribution.

Given $N \sim \text{Pois}(\mu)$, each keeper independently submits a valid bid with probability p. By the classical Poisson thinning theorem (see Feller (1968, Thm. 5, §II.6)), the number of valid bids N^* is itself Poisson distributed:
$$N^* \sim \text{Pois}(\mu p) = \text{Pois}(\theta).$$

(ii) Probability of a competitive (Vickrey) outcome. A competitive (Vickrey) auction requires at least two valid bids. For $N^* \sim \text{Pois}(\theta)$, the probability of fewer than two valid bids is
$$\Pr[N^* < 2] = \Pr[N^* = 0] + \Pr[N^* = 1] = e^{-\theta} + \theta e^{-\theta}.$$

Therefore, the probability of at least two valid bids is
$$\Pr[N^* \geq 2] = 1 - e^{-\theta}(1 + \theta).$$

(iii) Solvency guarantee. We consider all possible cases for N^*:

- *Case 1: $N^* \geq 2$.* The auction is resolved as a Vickrey (second-price) auction. The clearing price is the second-highest valid bid, which by construction is at least P_{reserve}:
$$P_{\text{clear}} \geq P_{\text{reserve}}.$$

- *Case 2: $N^* = 1$.* By protocol rule, if only one valid bid is submitted, the clearing price is set to the reserve price:
$$P_{\text{clear}} = P_{\text{reserve}}.$$

- *Case 3: $N^* = 0$.* If no valid bids are submitted, the tranche escalates to the Dutch auction tier. By Lemma 4.1 (Monotone Clock Convergence), the Dutch auction cannot clear below $P_{\text{reserve}}(1 - \delta_{\max})$:
$$P_{\text{clear}} \geq P_{\text{reserve}}(1 - \delta_{\max}).$$

In all cases, the clearing price meets or exceeds $P_{\text{reserve}}(1 - \delta_{\max})$, ensuring that Tier-2 cannot result in a price lower than the worst-case Dutch auction outcome. Thus, bad debt is impossible at this stage. □

Appendix C: Vickrey Upgrade Layer for MakerDAO Auctions

This appendix provides a compile-ready version of the `ClipVickrey` contract, which wraps Maker-DAO's native Dutch-auction engine (`Clip.sol`) (MakerDAO Protocol 2022) to implement a sealed-bid, second-price (Vickrey) auction layer. Crucially, this is an *additive upgrade*:

- `ClipVickrey` owns no collateral and does not replace `Clip.sol`.

- It orchestrates commit-reveal logic and delegates final settlement via `clip._settle()`.

- If fewer than two valid bids are revealed, the system falls back to the standard Dutch price curve.

This upgrade model ensures safety: the original `Clip` logic remains untouched and audited. At worst, the auction behaves exactly as before. Timeouts are constructor-tunable and allow governance to balance latency with bid competition.

Vickrey Wrapper: `ClipVickrey.sol`

```solidity
// SPDX-License-Identifier: AGPL-3.0
pragma solidity ^0.8.20;

interface ClipLike {
    function price() external view returns (uint256);
    function _settle(address buyer, uint256 price) external;
}

contract ClipVickrey {
    ClipLike public immutable clip;

    enum Phase { Commit, Reveal, Cleared }
    Phase public phase;
    uint48 public commitDuration;
    uint48 public revealDuration;
    uint64 public commitEnd;
    uint64 public revealEnd;

    struct Bid {
        bytes32 commitHash;
        uint256 amount;
        bool revealed;
    }
    mapping(address => Bid) public bids;
    address public highestBidder;
    uint256 public highestBid;
    uint256 public secondBid;

    event BidCommitted(address indexed bidder);
    event BidRevealed(address indexed bidder, uint256 amount);
    event AuctionSettled(address winner, uint256 clearingPrice, bool vickrey);

    constructor(address _clip, uint48 _commitDuration, uint48 _revealDuration) {
        require(_clip != address(0), "ClipVickrey/null-clip");
        require(_commitDuration > 0 && _revealDuration > 0, "ClipVickrey/bad-durations");
```

```solidity
36
37          clip = ClipLike(_clip);
38          commitDuration = _commitDuration;
39          revealDuration = _revealDuration;
40          commitEnd = uint64(block.timestamp + _commitDuration);
41          revealEnd = uint64(commitEnd + _revealDuration);
42          phase = Phase.Commit;
43      }
44
45      function commitBid(bytes32 hash) external {
46          require(phase == Phase.Commit, "commit/phase-over");
47          require(block.timestamp < commitEnd, "commit/window-closed");
48          require(bids[msg.sender].commitHash == bytes32(0), "commit/duplicate");
49
50          bids[msg.sender].commitHash = hash;
51          emit BidCommitted(msg.sender);
52      }
53
54      function revealBid(uint256 amount, bytes32 salt) external {
55          require(block.timestamp >= commitEnd, "reveal/not-started");
56          require(block.timestamp < revealEnd, "reveal/ended");
57          require(phase != Phase.Cleared, "reveal/already-cleared");
58
59          Bid storage b = bids[msg.sender];
60          require(b.commitHash != bytes32(0), "reveal/no-commit");
61          require(!b.revealed, "reveal/dup");
62          require(b.commitHash == keccak256(abi.encode(amount, salt)), "reveal/hash-mismatch");
63
64          b.revealed = true;
65          b.amount = amount;
66
67          if (amount > highestBid) {
68              secondBid = highestBid;
69              highestBid = amount;
70              highestBidder = msg.sender;
71          } else if (amount > secondBid) {
72              secondBid = amount;
73          }
74
75          phase = Phase.Reveal;
76          emit BidRevealed(msg.sender, amount);
77      }
78
79      function finalize() external {
80          require(block.timestamp >= revealEnd, "finalize/reveal-active");
81          require(phase != Phase.Cleared, "finalize/done");
82
83          bool vickrey = (highestBid > 0 && secondBid > 0);
84          uint256 clearingPrice = vickrey ? secondBid : clip.price();
85          address winner = vickrey ? highestBidder : msg.sender;
86
87          clip._settle(winner, clearingPrice);
88          phase = Phase.Cleared;
89
```

```
 90            emit AuctionSettled(winner, clearingPrice, vickrey);
 91        }
 92
 93        function commitActive() external view returns (bool) {
 94            return (phase == Phase.Commit && block.timestamp < commitEnd);
 95        }
 96
 97        function revealActive() external view returns (bool) {
 98            return (phase != Phase.Cleared &&
 99                    block.timestamp >= commitEnd &&
100                    block.timestamp < revealEnd);
101        }
102    }
```

Deployment Note: After deploying `ClipVickrey`, governance must call `clip.rely(clipVickrey)` to authorize it. Keepers then follow:

$$\texttt{commitBid()} \rightarrow \texttt{revealBid()} \rightarrow \texttt{finalize()}$$

to settle via the Vickrey mechanism or fall back to Dutch clearing if no competition

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