The Contractor's Gamble: Disclose the Defect or Hope It Never Fails?

Strategic Disclosure, Risk Allocation and Dispute Prevention in Construction Projects

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Introduction

In modern construction projects, the timely identification and disclosure of emerging risks is central to effective project risk management. Standard forms such as the FIDIC Conditions of Contract incorporate notification and early warning mechanisms designed to encourage transparency and collaborative problem-solving between contracting parties. When properly implemented, these mechanisms enable project participants to identify and mitigate technical, operational, and commercial risks before they escalate into delays, safety incidents, or costly disputes.

Yet the effectiveness of these mechanisms ultimately depends on a difficult practical reality: parties must be willing to disclose problems even when doing so may conflict with their immediate commercial interests. Few situations illustrate this tension more clearly than the discovery of a latent defect after project handover. At that moment, the contractor is confronted with a stark strategic dilemma—disclose the defect immediately and risk exposure to remedial costs, delay claims, and reputational harm, or remain silent and hope the defect never manifests into an operational failure.

Legal doctrine typically frames this issue in terms of contractual compliance and professional duty. In practice, however, the decision is often more complex. Disclosure may undermine the contractor's short-term commercial position, particularly where the project has already reached completion and entered operational use. Silence, on the other hand, can expose the contractor—and other project stakeholders—to potentially catastrophic downstream consequences if the defect later results in system failure, property damage, or safety risks.

This article examines the strategic implications of early warning obligations in the context of defect discovery, particularly after project handover. Using a real-world data centre expansion project as a case study, it explores the legal and commercial consequences of non-disclosure and analyses how early warning mechanisms shape risk allocation and dispute prevention in construction projects. The article concludes with practical guidance for contractors, employers, and in-house counsel managing post-completion defect scenarios.

The Early Warning Framework under FIDIC

A central philosophy underpinning the FIDIC contracts is that risk should be managed proactively rather than litigated retrospectively. This approach aligns with broader developments in construction contract administration, particularly the emphasis on collaborative risk management.

Under the FIDIC 2017 Conditions, this philosophy is reflected in ***Sub-Clause 8.4 (Advance Warning)***, which requires each party to notify the other of any matter that could adversely affect the works, delay completion, or impair the performance of the completed project. The provision is expressly preventative in nature. Its objective is not to allocate blame, but to create an opportunity for the parties to jointly assess emerging risks and implement mitigation measures before those risks crystallise into formal disputes. The advance warning mechanism also interacts with the contractual claims regime under ***Sub-Clause 20.2 (Claims for Payment and/or Extension of Time)***. Early notification of risk events can influence how subsequent claims are evaluated, as it demonstrates that the notifying party acted transparently and allowed the other party an opportunity to mitigate potential impacts.

The ***FIDIC 1999 editions***, by contrast, do not contain a dedicated early warning clause. Nevertheless, similar obligations are frequently introduced through ***Particular Conditions of Contract (PCC)*** drafted by employers. These bespoke provisions often broaden notification duties and may impose obligations to notify any circumstance that could affect the future performance or safety of the works.

For contractors operating under such contractual arrangements, the practical implication is significant. Once a contractor becomes aware of a risk that could affect the performance of the completed works, the obligation to notify may arise immediately even where the technical consequences of that risk remain uncertain.

Case Study: Latent Defect in a Data Centre Fire Suppression System

The practical implications of early warning obligations can be illustrated through a data centre expansion project governed by the ***FIDIC 1999 Red Book***.

The contract incorporated a ***Particular Condition*** requiring the contractor to notify the Engineer upon becoming aware of any circumstance that could "impair the performance of the works in use." This obligation was replicated in the subcontract agreement on a back-to-back basis, thereby binding the mechanical, electrical and plumbing (MEP) subcontractor to the same notification duty.

Following the issuance of the ***Taking-Over Certificate***, the facility entered operational use. Shortly thereafter, the mechanical subcontractor identified a potential installation defect in a section of the fire suppression system pipework. Although the system had passed commissioning tests and remained operational, the review revealed that certain pipe joints had been installed outside the manufacturer's recommended tolerance range. Under high-pressure activation conditions, there was a risk that the joint could fail, potentially compromising the suppression system during an actual fire event.

The contractor therefore faced a difficult strategic decision: should the defect be disclosed immediately to the Engineer and Employer, or ***should the contractor remain silent in the hope that the defect would never manifest in an actual failure?***

From a purely technical perspective, the probability of failure appeared remote. From a contractual perspective, however, the position was less ambiguous. Once the contractor became aware of a circumstance capable of impairing the performance of the works, the contractual duty to notify was arguably triggered. The situation therefore illustrates the tension between commercial incentives and contractual risk allocation that lies at the heart of early warning regimes.

Legal and Commercial Consequences of Non-Disclosure

Failure to disclose a known defect, particularly one affecting safety-critical systems, can expose contractors to severe legal and commercial consequences.

Breach of Contractual Duty

Where an early warning or risk notification obligation exists, silence may constitute a breach of contract. Such provisions are designed to allow the Employer and Engineer to mitigate potential risks before they escalate.

If a contractor conceals a known defect and the risk subsequently materialises, liability may extend beyond the cost of remedial work. The contractor may also become responsible for consequential losses, including operational disruption, delay-related losses, or additional remedial measures that could have been avoided through earlier intervention.

In effect, the contractor may become responsible for losses that would not have occurred had the defect been disclosed promptly.

Loss of Liability Cap Protection

Many FIDIC-based contracts include an aggregate cap on the contractor's liability. However, these caps frequently exclude liability arising from fraud, wilful misconduct, or reckless default. The deliberate concealment of a known defect, particularly one affecting a safety-critical system, may be characterised as reckless disregard for the employer's interests. If a tribunal or court adopts that characterisation, the contractor may lose the protection of the contractual liability cap entirely. For major infrastructure projects, the financial implications can be catastrophic.

Exposure to Third-Party Liability

The risks of non-disclosure extend beyond the contractual relationship between the employer and contractor.

If a life-safety system such as a fire suppression installation fails during an emergency because of an undisclosed defect, the contractor may face claims from building occupants, insurers, equipment owners, or neighbouring property interests. Such claims may include property damage, business interruption losses, or personal injury claims. In facilities such as data centres, where even short periods of operational downtime can generate substantial financial losses, third-party claims may significantly exceed the original construction contract value.

Reputational and Commercial Risk

In specialised sectors such as data centre construction, reputation and trust are critical commercial assets. Employers rely heavily on contractors' technical expertise and professional judgment in delivering mission-critical infrastructure. If a defect is later discovered to have been knowingly concealed, the reputational damage may include exclusion from future tenders, strained relationships with consultants and engineers, and diminished credibility within a highly specialised industry.

For contractors operating in competitive markets, this loss of trust may ultimately prove more damaging than the immediate financial liability associated with rectifying the defect.

Strategic Disclosure as a Risk Management Strategy

Although disclosure may initially appear to expose the contractor to liability, proactive notification can in fact operate as an effective risk management strategy. Early disclosure allows the contractor to preserve contractual protections, demonstrate good faith, and retain influence over how the issue is framed and resolved. In the data centre case study, the subcontractor presented the discovery as part of a post-completion quality assurance review, allowing the parties to address the issue collaboratively without immediately escalating into a formal dispute.

Decision Framework for Contractors and In-House Counsel

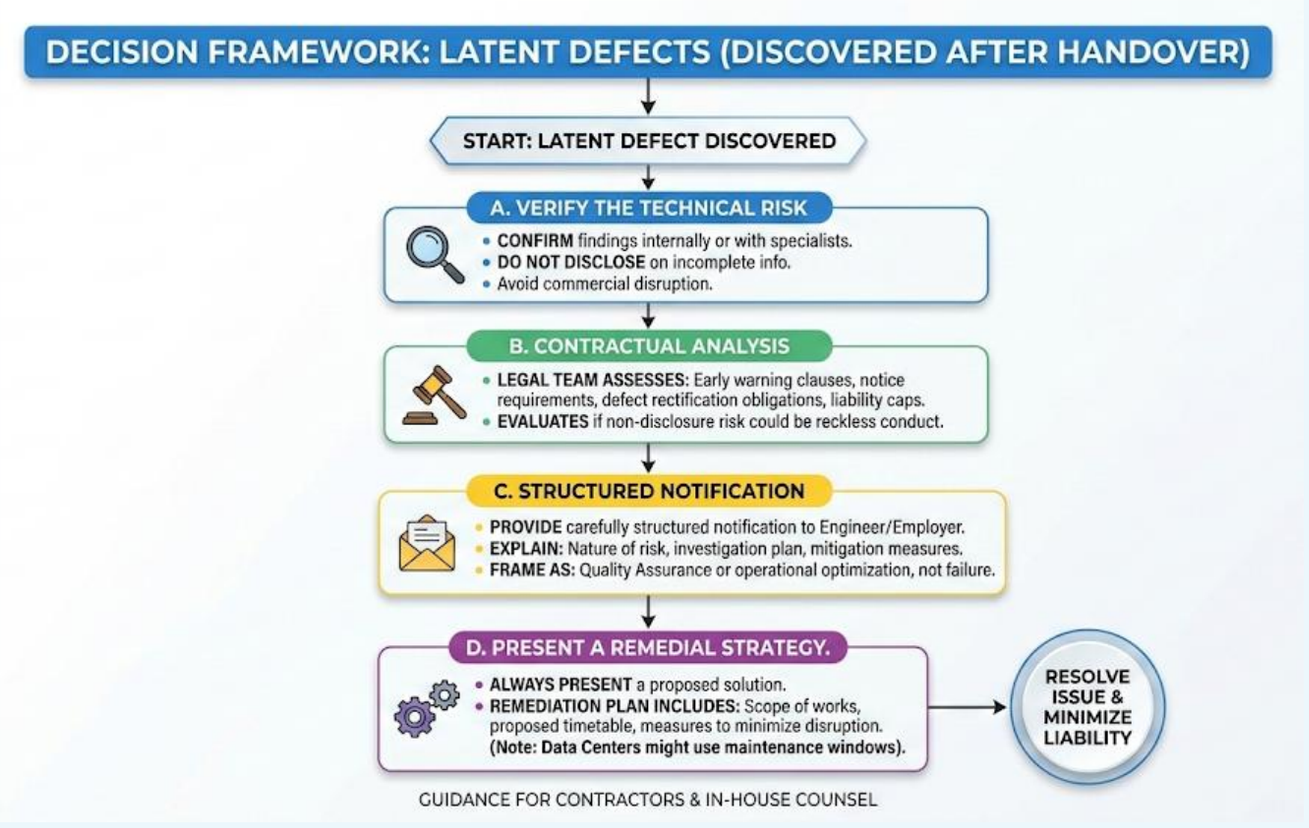
When a latent defect is discovered after handover, contractors should adopt a structured decision-making process.

a. Verify the Technical Risk: Before disclosure, the contractor should verify the accuracy and significance of the technical findings through internal review or specialist advice. Premature disclosure based on incomplete information may create unnecessary commercial disruption.

b. Conduct Contractual Analysis: Legal teams should review the relevant contract provisions, including early warning clauses, notice requirements, and defect rectification obligation and liability cap provisions. The analysis should assess whether non-disclosure could be characterised as a breach of contract or reckless conduct.

c. Provide Structured Notification: If notification is required, the contractor should provide a carefully structured notice to the Engineer or Employer describing the issue, the potential risk, and the proposed investigation.

d. Present a Remedial Strategy: A disclosure should never present a problem without a proposed solution. Contractors should present a clear remediation plan outlining the scope of corrective works, a timetable for implementation, and measures designed to minimise operational disruption. In operational facilities such as data centres, remediation may need to occur during scheduled maintenance windows or off-peak hours.



Implication for Employers and Project Teams

Employers and their legal teams also play a critical role in managing early defect disclosure. When notified of a potential defect, employers should assess: (i) whether the issue creates operational risk, (ii) whether insurers need to be notified, (iii) whether further testing is required, and (iv) how remedial works can be implemented with minimal operational disruption.

Importantly, employers should recognise that proactive disclosure often reflects responsible contractor behaviour rather than contractual failure. Encouraging transparency can ultimately prevent disputes and preserve long-term project relationships.

Conclusion

Early warning obligations under the FIDIC Conditions of Contract are not merely procedural requirements; they are essential tools for managing technical and commercial risk in complex infrastructure projects. The discovery of a latent defect following project handover presents contractors with a strategic choice: conceal the issue and hope the risk never materialises or disclose it and manage the consequences collaboratively.

While concealment may appear commercially attractive in the short term, it carries substantial legal and financial risks. Failure to disclose a known defect may constitute a breach of contract, expose the contractor to uncapped liability, and damage long-term commercial relationships. Transparent disclosure, by contrast, allows the parties to address emerging risks before they escalate into major disputes. By facilitating early intervention

and collaborative problem-solving, early warning mechanisms transform potentially catastrophic risks into manageable technical issues.

In complex infrastructure projects where operational reliability and safety are paramount, early warning is not merely a contractual obligation. It is a critical component of responsible project delivery.

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