

## HR Law Hotline

May 09, 2025

### WHEN TITLES DON'T MATTER: HOW SUPERVISORY ROLES DETERMINE LIABILITY UNDER THE EMPLOYEES STATE INSURANCE ACT

- Liability under the Employees' State Insurance Act, 1948 ("**ESI Act**") is determined by the actual supervisory and control responsibilities of an individual, rather than their official job title.
- Designation of a person is immaterial if such person is otherwise is an agent of the owner/occupier or supervises and controls the establishment in question.
- Failure to deposit employee contributions deducted under the ESI Act constitutes a serious economic offence and the liability was fastened on the Technical Coordinator cum General Manager of the company who qualified as a 'Managing Agent' as per the ESI Act.

#### I. INTRODUCTION

The role of a 'Principal Employer' under the ESI Act is critical in ensuring compliance with the social security obligations. Liability under the ESI Act is not determined solely by formal designation, but by the actual supervisory and control functions exercised by an individual. A recent decision of the Supreme Court ("**SC**") examined whether an individual, who operated in the capacity of a 'Technical Coordinator' at the employing company, could be held liable as a Principal Employer based on the nature of his responsibilities.

The case, **Ajay Raj Shetty v. Director and Anr.**<sup>1</sup> ("**Ajay Raj Shetty Case**"), involved the conviction of an individual for failing to deposit employee contributions deducted under the ESI Act. The appellant challenged his conviction on the ground that he did not hold a managerial position and that financial distress faced by the company, classified as a sick unit, should mitigate his liability. The SC, however, reaffirmed that functional responsibility, rather than formal title, determines liability under the ESI Act. It also emphasized that statutory obligations relating to employee welfare cannot be disregarded due to the employer's financial condition, thereby strengthening the protective framework envisaged under the ESI Act.

#### II. AJAY RAJ SHETTY CASE

##### a. Factual Background

Ajay Raj Shetty, the Appellant ("**Appellant**") was employed with M/s Electriex (India) Limited ("**Company**") which was declared a sick industry by the Board for Industrial and Financial Reconstruction ("**BIFR**") on October 31, 2001. On September 24, 2002, the BIFR ordered for a change in the management of the Company. The Company filed an appeal against the order of BIFR before the Appellate Authority for Industrial and Financial Reconstruction ("**AAIFR**") which was dismissed via order dated January 15, 2003. Following this, the Company filed a writ petition before the Karnataka High Court ("**HC**") and the Employees' State Insurance Corporation ("**ESIC**") was also a party to the said writ petition. By its order dated March 03, 2008, the HC remanded the matter to the BIFR for fresh consideration and quashed the orders of the BIFR and AAIFR.

Subsequently, on July 01, 2010, BIFR directed the Company to settle the dues with the secured creditors. On February 01, 2011, the ESIC officials visited the factory premises of the Company to inspect the Company's compliance as regards the statutory contributions under the ESI Act for the period from February 01, 2010, to December 31, 2010. The inspection report revealed that INR 8,26,696 had been deducted from employees' wages during this period but had not been deposited with the ESIC. The Appellant was identified as the 'General Manager' and 'Principal Employer' in the report.

On the basis of the aforesaid report, a private complaint was filed by the ESIC for offence(s) under Section 85(a) of ESI Act against the Appellant and the Company before the Special Court for Economic Offences, Bangalore ("**Trial Court**") which convicted the Appellant under Section 85(i)(b) of the ESI Act and sentenced him with imprisonment for 6 months along with a fine of INR 5000.

The Appellant and the Company filed an appeal before the Principal City Civil and Sessions Judge, Bangalore which was subsequently transferred to the Fast Track Court VI, Bangalore ("**First Appellate Court**") which upheld the Trial Court's verdict and hence, the Appellant and the Company filed a Revision Petition before the HC which was also dismissed. The HC held that the evidence on record conclusively established Appellant's role as a General Manager and Principal Employer of the Company and it was also established that a contribution of INR 8,26,696 was deducted during the specified period from the employees of the Company, but not remitted to the ESIC. Aggrieved by the decision of the HC, the Appellant approached the SC assailing the dismissal order.

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Whether the Appellant could be held liable as the 'Principal Employer' under Section 2(17) of the ESI Act, based on the nature of his role and responsibilities, despite his claim of being appointed and functioning in the role of a 'Technical Coordinator'.

### c. Arguments advanced

- The Appellant argued that he was appointed only as a Technical Coordinator and not as a General Manager or Principal Employer within the meaning of Section 2(17) of the ESI Act. It was submitted that the burden lay on the prosecution to establish his designation as General Manager, which had not been discharged adequately, as the only evidence relied upon was the ESIC inspection report. The Appellant contended that the report could not be relied upon as the officer who prepared it was neither examined nor subjected to cross examination, and no supporting appointment documents were produced.
- It was further contended that since the Company was a sick industrial unit under BIFR, the ESIC ought to have proceeded with civil recovery instead of initiating criminal prosecution. The Appellant relied on the decision in **ESI Corporation v. A K Abdul Samad**<sup>2</sup> to urge that leniency be exercised, especially as he had deposited the entire outstanding amount after the HC judgment.
- The ESIC on the other hand maintained that the Appellant had been clearly identified as the General Manager and Principal Employer in the Company records during the relevant period of non-remittance. It was further submitted that the Appellant failed to produce any evidence to rebut this finding or to identify who else was responsible for supervision and control of the establishment.
- The ESIC contended that a company's status as a sick unit under the BIFR does not insulate its officers from criminal prosecution. Despite sufficient evidence against the Appellant, he was convicted under Section 85(i)(b), a less serious offence compared to Section 85(i)(a) of the ESI Act. Accordingly, the ESIC sought dismissal of the appeal.

### d. Findings of the Court

For examining whether the Appellant, who was identified as the General Manager and Principal Employer in the ESIC inspection report, could be held criminally liable under Section 85 of the ESI Act for failure to remit the deducted employee contributions to the ESIC. The SC analysed Section 2(17) of the ESI Act to determine whether the Appellant's designation or functional role placed him within the scope of 'Principal Employer' as defined under the ESI Act.

The SC referred to the definition of "Principal Employer" under Section 2(17) of the ESI Act which reads as:

(17) "principal employer" means—

- *in a factory, the owner or occupier of the factory and includes the managing agent of such owner or occupier, the legal representative of a deceased owner or occupier, and where a person has been named as the manager of the factory under the Factories Act, 1948 (63 of 1948), the person so named;*
- *in any establishment under the control of any department of any Government in India, the authority appointed by such Government in this behalf or where no authority is so appointed, the head of the department;*
- *in any other establishment, any person responsible for the supervision and control of the establishment;'*

The SC held that this definition captures not only those formally designated as managers or owners but also any person who is functionally responsible for the supervision and control of the establishment. It emphasized that the Appellant failed to rebut the finding that he held such a role during the relevant period. No evidence was produced to substantiate his claim of being merely a Technical Coordinator, nor was any effort made to identify the person who actually held the post of General Manager.

Accordingly, SC, affirming the findings of the Trial Court, the First Appellate Court, and the HC, concluded that the Appellant fell within the ambit of clause (iii) of Section 2(17) of the ESI Act, as a person responsible for supervision and control, and hence was treated as the Principal Employer for the purposes of liability under the ESI Act. The Court rejected the Appellant's contention that ESIC should have pursued civil recovery measures in view of the Company's status as a sick industrial unit under BIFR. Referring to the statutory scheme of the ESI Act and the nature of the offence under Section 85(a) of the ESI Act, the SC held that non remittance of deducted contributions constitutes a serious economic offence.

The SC further noted that although the Appellant had subsequently deposited the outstanding dues with the ESIC, such post facto compliance does not negate the commission of the offence under the ESI Act. It found that the Trial Court had already taken a lenient view by convicting the Appellant under Section 85(i)(b) of the ESI Act, which carries a lower minimum sentence than Section 85(i)(a) of the ESI Act, even though the offence involved employee contributions actually deducted but not deposited.

## III. ANALYSIS AND CONCLUSION

In reaffirming that liability under the ESI Act is determined by the functional role performed by an individual, and not merely by their formal designation or title within the organization, the SC provides an important clarification on the interpretation of 'Principal Employer' under the ESI Act.

In the present case, the Appellant failed to produce any documentary evidence to support his claim and identify any other individual who was actually responsible for supervision and control during the relevant period. This omission led the SC to conclude that the Appellant exercised the requisite degree of control to be treated as the 'Principal Employer'. The burden to rebut the ESIC inspection findings lay squarely with the Appellant, and in the absence of any contrary evidence, the SC found no reason to interfere with the conclusions recorded in the lower court judgments.

The SC also dismissed the argument that the Company's financial distress and classification as a sick unit under the BIFR could excuse the failure to deposit statutory contributions. It emphasized that amounts deducted from

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employees' wages are held in a fiduciary capacity, and non-remittance strikes directly at the legislative intent of securing employee welfare through social security measures. The status of being a sick industrial company does not absolve officers of their personal liability for such statutory violations.

An important takeaway from this decision is the necessity for companies to clearly define and document the roles, designations, and responsibilities of individuals holding supervisory or managerial positions. In the absence of clear documentation, individuals exercising control over the establishment may be exposed to personal liability for statutory violations, even if they do not hold formal managerial titles. This judgment highlights the stringent obligations placed on people exercising control over establishments and signals a strong judicial approach to protecting employee rights under welfare legislation.

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<sup>1</sup>2025 SCC OnLine SC 810.

<sup>2</sup>(2016) 4 SCC 785.

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