



INSURANCE

LABOUR

# Penalty Under the Employees Compensation Act Cannot be Passed on to Insurers

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## Overview

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In a significant ruling with wide implications for employer-employee relations and insurance liability, the Supreme Court of India has held that an insurance company cannot be made liable to pay the statutory penalty imposed under Section 4A(3)(b) of the Employees' Compensation Act, 1923. In *New India Assurance Co. Ltd. v. Rekha Chaudhary & Others*<sup>1</sup> The judgment, delivered on February 23, 2026, by a bench comprising Justice Aravind Kumar and Justice Prasanna B. Varale, draws a firm line between the contractual obligations of an insurer and the personal accountability of an employer for wilful delay in paying compensation.

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## The Facts of the Case

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The case arose from a tragic incident on February 13, 2017, when Sandeep, a commercial driver employed by one Manoj Kumar, collapsed while driving a Maruti Swift Dzire cab and was pronounced dead upon arrival at hospital. His legal heirs his widow and dependants filed a compensation claim before the Commissioner, Labour Department, Government of NCT of Delhi, under the Employees' Compensation Act, 1923.

The Commissioner found that an employer-employee relationship existed between Sandeep and Manoj Kumar, and that the death had occurred during the course of employment. Compensation of Rs. 7,36,680 was awarded along with interest at 12% per annum from the date of death. Since the vehicle was insured under a Commercial Vehicle Package Policy with New India Assurance Company Limited which was valid at the time of the incident the employer was entitled to claim indemnification from the insurer.

Separately, the Commissioner issued a show cause notice to the employer for failing to pay the compensation within the mandatory one-month period stipulated under Section 4A (3) of the Act. When the employer neither appeared nor responded, the Commissioner imposed a penalty of 35% of the compensation amount amounting to Rs. 2,57,838 under Section 4A(3)(b) of the Act.

## The High Court's Error

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Aggrieved by the original orders, the claimants appealed to the Delhi High Court seeking enhancement of the compensation amount and also challenged the finding that primary liability lay on the employer rather than the insurer. While the High Court declined to enhance the compensation, it redirected the entire liability including the penalty from the employer to the insurance company. It is this specific aspect of the High Court's order that New India Assurance challenged before the Supreme Court.

It is important to note that the insurance company did not dispute its liability to pay the compensation and interest components. The sole issue before the Supreme Court was whether the penalty imposed under Section 4A(3)(b) a consequence of the employer's personal default could lawfully be transferred to the insurer.

## The Legal Question: What Does Section 4A Say?

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Section 4A of the Employees' Compensation Act mandates that compensation must be paid as soon as it falls due. Where an employer fails to pay within one month of the due date, the Commissioner is required to direct payment of interest under clause (a) and, if no justifiable cause is shown for the delay, impose a further penalty not exceeding 50% of the compensation amount under clause (b). Crucially, no penalty order can be passed without giving the employer a reasonable opportunity to show cause.

The Supreme Court traced the legislative history of this provision in detail. Section 4A was originally introduced by the Workmen's Compensation (Amendment) Act, 1959, where all three components compensation, interest, and penalty formed a single, consolidated obligation under sub-section (3). The expression "together with" used in the 1959 provision bundled these liabilities together, which effectively allowed the entire financial burden, including penalty, to be passed on to insurers under an indemnity contract.

This changed fundamentally with the Workmen's Compensation (Amendment) Act, 1995. The substituted version of Section 4A deliberately split the earlier consolidated provision into two separate clauses clause (a) covering compensation and interest, and clause (b) addressing penalty alone. The Court read this structural separation as a conscious legislative choice to distinguish between obligations rooted in the employment relationship and those arising from the employer's personal default.

## The Supreme Court's Reasoning

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The Court held that the 1995 amendment was enacted precisely to address the problem that had emerged under the earlier law: employers were openly delaying payment of compensation because they knew the penalty would ultimately be absorbed by their insurer. With no personal financial consequence, the one-month payment deadline had become a dead letter. By severing the penalty clause and making it a distinct provision, Parliament intended to restore deterrence and ensure that employers had a real incentive to pay compensation promptly.

The Court also firmly rejected the respondents' argument that the insurance policy covered all financial liabilities including penalty. First, the claimants had not produced the actual insurance policy before the Court to substantiate this claim. Second, and more fundamentally, a statutory obligation such as the employer's duty to pay compensation within one month cannot be negated by a contractual arrangement. Allowing an indemnity contract to override the statutory timeline would directly undermine the legislative intent of Section 4A.

The respondents had also argued that Section 4A must be read as a whole, and that it was impermissible to carve out clause (b) as a special employer-only liability. The Court dismissed this contention, holding that reading the provision holistically in fact supports the conclusion that the 1995 amendment deliberately differentiated the penalty component from compensation and interest. The distinction is textual, structural, and purposive it cannot be wished away.

## Reliance on Precedent

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The ruling is firmly grounded in established precedent. The Court placed extensive reliance on the Division Bench decision in *Ved Prakash Garg v. Premi Devi*<sup>2</sup>, where it had been clearly held that while an insurance company is jointly liable with the employer to pay compensation and interest, the penalty under Section 4A(3)(b) is attributable to the personal fault and negligence of the employer and cannot be passed on to the insurer.

This principle was reaffirmed in *L.R. Ferro Alloys Ltd. v. Mahavir Mahto*<sup>3</sup>, and more recently in *Sheela Devi v. Oriental Insurance Company Limited*<sup>4</sup>, the decision had explicitly reiterated that statutory penalty under Section 4A(3)(b) is the employer's alone to bear.

## The Final Order

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The Supreme Court allowed the appeal and set aside the High Court's order to the extent it had fastened the penalty liability on the insurance company. The employer, Manoj Kumar (Respondent No. 4), was directed to pay the penalty of Rs. 2,57,838/- within eight weeks. The rest of the High Court's findings including the insurer's liability for compensation and interest were left undisturbed.

## Why This Judgment Matters

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This decision carries significance on multiple levels. For workers and their families, it reinforces the social welfare purpose of the Employees' Compensation Act by ensuring that the penalty mechanism designed to protect employees from delays in receiving compensation retains real teeth. If employers could simply pass on the penalty to their insurers, there would be no incentive to pay on time, and vulnerable claimants would routinely face protracted delays.

For insurers, the ruling offers welcome clarity. Insurance companies are liable to indemnify employers for the legitimate consequences of employment-related accidents that is, compensation and interest. They are not, however, underwriters of an

employer's wilful inaction or negligence. The judgment draws a principled boundary between risk that is legitimately insurable and liability that is a direct result of an employer's personal default.

For employers, the message is unambiguous: the obligation to pay compensation within one month of the due date is statutory and non-negotiable. Failure to do so without justifiable cause will result in a penalty that they alone must bear, regardless of whether they hold an insurance policy. The existence of an indemnity contract provides no refuge from a penalty that flows from personal fault.

At a broader level, this judgment is a reminder that social welfare legislation must be interpreted purposively, but that purposive interpretation cuts both ways. The protective intent of the Employees' Compensation Act is best served not by expanding insurer liability indefinitely, but by ensuring that the deterrent mechanisms built into the statute actually deter and that accountability rests with the party whose conduct triggers it.

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1. *Civil Appeal No. 174 of 2026* ??
  2. (1997) 8 SCC 1 ??
  3. (2002) 9 SCC 450 ??
  4. (2025 SCC OnLine SC 827) ??

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