

SUCCESSOR LIABILITY: ACQUIRERS OF INDIAN BUSINESSES BEWARE!

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In India, the principle of successor liability typically applies in mergers of companies, transactions for the fraudulent purpose of escaping liability for the seller's obligations, or situations where it is imposed by statute (for example, cases involving the breach of environmental law or certain labour laws.¹) However, the Indian Supreme Court has, in *McLeod Russel India Limited v Regional Provident Fund Commissioner, Jalpaiguri and others*², recognised the principle of successor liability in the case of a business transfer, for historical non-compliances by a seller in payment of provident fund (social security) dues.

BACKGROUND

McLeod Russel India Limited ("Acquirer") acquired M/s Mathura Tea Estate ("Business") from Saroda Tea Company Limited ("Seller") pursuant to a Memorandum of Understanding ("MOU"). At the time of the acquisition of the Business, the Seller had an outstanding claim for provident fund payment to its employees under the Employees' Provident Funds and Miscellaneous Provisions Act, 1952³ ("EPF Act"). The Acquirer discharged the provident fund

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¹ Please see *Central Inland Water Transport Corporation. Ltd. v Workmen* (1975) SCC 348, (1975) Supp. SCR 4434, and *Anakapalla Cooperative Agricultural and Industrial Society Ltd v Workmen* (1963) Supp.1 SCR 730, where the Supreme Court set out the factors that ought to be taken into consideration before determining whether a transferee was a successor-in-interest of the transferor in respect of a business carried on in an establishment transferred to the transferee.

² 2014 (8) SCALE 272.

³ (19 of 1952).

dues of employees who were transferred to the Acquirer as part of the Business. However, the Acquirer sought to ring-fence its liability for damages on account of non-payment of the provident fund contributions. Accordingly, the MOU recorded the Seller as exclusively liable for the damages resulting from its failure to pay provident fund contributions to the employees of the Business, prior to the date of transfer of the Business.

In respect of proceedings before the Regional Provident Fund Commissioner (“RPFC”), the Acquirer sought to absolve itself from any liability for damages on the basis that historical non-compliances with the *EPF Act* were to the Seller’s account, as such non-compliances occurred prior to the date of transfer of the Business. Under section 17B of the *EPF Act*, an acquirer is jointly and severally liable with the seller for non-payment of provident fund dues prior to the date of transfer of an establishment or business. However, there prevailed divergent views amongst the various High Courts in India regarding an acquirer’s liability to pay for damages for past non-compliances with the *EPF Act*. Nonetheless, on a conjoint reading of the relevant sections of the *EPF Act*, the RPFC held that the Acquirer and the Seller were jointly and severally liable for damages for non-payment of provident fund dues prior to the date of transfer of the Business. Accordingly, the RPFC imposed a penalty on the Acquirer for its delay in depositing damages within the period stipulated by law.

The Acquirer challenged the decision of RPFC before a single-judge bench of the Kolkata High Court. The single-judge bench upheld the Acquirer’s appeal on the basis that no punitive liability could arise on the Acquirer, for historical non-compliances by the Seller, prior to the date of transfer of the Business. On a further appeal, the division bench of the Kolkata High Court reversed the order of the single-judge bench by relying on a previous judgment rendered by the division bench of the Kolkata High Court. Aggrieved by the judgment of the division bench, the Acquirer filed an appeal before the Supreme Court challenging that judgment.

SUPREME COURT’S VERDICT

The issue before the Supreme Court was whether the Acquirer was liable for the Seller’s non-compliance in paying provident fund dues. Based on a review of sections 14B and 17B of the *EPF Act*, the Supreme Court held as follows: (a) damages, on account of non-payment of the provident fund dues was a joint and several liability of the Acquirer and the Seller (regardless of the date of transfer of the Business), (b) transfer of the Business did not preclude an employee of the Business

from initiating a case against the Acquirer and/or the Seller for recovery of his statutory dues; until an employee's provident fund dues were paid, such dues would have the first charge over the assets of the Business in priority to all other debts of the Business, and (c) liability of the Acquirer for previous non-compliance by the Seller with the EPF Act could not be assigned or mitigated through any contractual arrangement. Per section 17B of the EPF Act, the Acquirer's liability extended up to the value of the assets acquired by it.

IMPLICATIONS OF THE JUDGMENT

The Supreme Court has clarified that, in the case of a transfer of a business or establishment, in respect of which provident fund dues are pending, the seller and the acquirer will be jointly and severally liable to pay not only the pending provident fund amount but also damages, if any, imposed by the government authorities. It is now imperative for an acquirer to undertake a detailed diligence on the status of provident fund payments by a company or establishment, otherwise it may have to shoulder all pre-closing provident fund liabilities.

From a transactional perspective, acquirers of a business should consider an escrow to appropriately ring-fence their liability for provident fund dues of a company or establishment. If an escrow is not commercially feasible, then acquirers may consider adjusting the valuation for the business, or seeking a specific indemnity from the seller for liabilities not expressly assumed by the acquirers. An insurance cover may also be obtained to appropriately safeguard against pre-closing liabilities. These safeguards and the manner in which parties will bear associated costs for implementing these safeguards should be negotiated with the seller while finalising the business purchase agreement.