

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

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:
ENCOMPASS AVIATION, LLC,
:
Plaintiff,
:
- against -
:
SURF AIR INC. (F/K/A SURF AIRLINES INC.)
:
Defendant.
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Index No. **18-cv-5530**

COMPLAINT

Plaintiff Encompass Aviation, LLC (“Encompass” or “Plaintiff”), by and through its undersigned counsel, Willkie Farr & Gallagher LLP, for its Complaint against Defendant Surf Air Inc. (f/k/a Surf Airlines Inc., “Surf”) alleges as follows:

NATURE OF THE ACTION

1. Since the very beginning of the commercial relationship between Surf and Encompass, Surf has acted in bad faith and has engaged in frequent and blatant violations of its contractual obligations to Encompass. Surf’s conduct has literally left Encompass holding the bag for millions of dollars in services that Encompass provided and that Surf has yet to pay for despite its contractual obligations to do so. Eager to shift blame and escape its liability, Surf found the perfect partner in Advanced Air LLC (“Advanced Air”). Together, the two have conspired to interfere with Encompass’ business and to deprive Encompass of its bargained-for contractual rights and legitimate business opportunities, while ultimately leaving Surf’s customers with inferior service, insufficient capacity, and fewer options.

2. Accordingly, Plaintiff Encompass, a provider of commuter and on-demand aircraft transportation services, brings this action against Defendant Surf, a financially distressed “all-you-

can-fly” membership organization that purports to arrange travel, transportation, and concierge services for its members. Encompass seeks to recover damages resulting, in part, from Surf’s blatant violations of its contracts with Encompass.

3. On May 15, 2017, Encompass and Surf entered into a series of transactions, memorialized in contemporaneously executed arms-length and thoroughly negotiated agreements, the net effect of which was that Encompass took ownership and control of Surf’s subsidiary Surf Airlines LLC, which held airline operating assets. As part of the deal, Surf committed to use Encompass as its exclusive California-based air transportation carrier going forward, subject to certain agreed-upon fees and the reimbursement of expenses and Surf’s promise that Encompass would have the first and last opportunities to bid on any air transportation services offered by Surf in California.

4. The impetus for these transactions was that Surf, facing uncertain future prospects and a federal agency investigation, determined that it was no longer able to provide air transportation services to its members. Under the terms of the deal, Encompass agreed to provide to Surf exclusive access to its fleet of “Pilatus PC-12 aircrafts” and maintain and operate an agreed-upon schedule of flights on select routes offered by Surf to its members. In turn, Surf agreed to make fixed and variable payments, based on the number of “block hours” of charter aircraft services provided by Encompass in accordance with the terms of the Amended Charter Agreement dated April 1, 2017, as amended as of May 15, 2017 (the “Charter Agreement”). Specifically, the payment schedule specified that Surf would make payments for flights two weeks in advance and then Encompass would operate the flights. Not only did Surf never pay in advance as required by the agreements, but it consistently was delinquent in paying following the provision of flight operations and maintenance. Soon after entering into the Charter Agreement, Surf defaulted on

its payment obligations to Encompass triggering an “Event of Default” under the Charter Agreement.

5. Indeed, not even a single month of operation had passed before Surf failed to pay the contractually agreed upon amounts due Encompass. In total, Surf now owes Encompass more than \$3.1 million in delinquent payments for services already rendered.

6. The Charter Agreement specifies that “upon any Event of Default [Encompass] shall have no obligation to continue to provide any flight services or satisfy any other of its obligations pursuant to this Agreement or the other agreements entered into in connection with this Agreement.” Despite this provision of the Charter Agreement, and notwithstanding Surf’s failure to pay, in good faith and in reliance upon the assurance of Surf’s Executive Chairman, Sudhin Shahani, Encompass reserved its rights under its contracts with Surf and agreed to continue providing flight operations to Surf’s membership in order to help Mr. Shahani keep Surf afloat.

7. Throughout the second half of 2017, Surf continued to demand full performance from Encompass in exchange for little to no payments to Encompass. Indeed, Surf pleaded with Encompass time and again beginning in mid-2017 to continue to provide flight operations and maintenance of the aircraft so that Surf’s business would not come to a screeching halt. Surf made and broke promises over and over again, and imposed on Encompass to be patient and allow, among other things, Surf to grow its cash balances to make its business seem more profitable.

8. Despite the fact that it was collecting revenue from its members, Surf chose to allocate such cash for anything and everything other than paying the contracted costs for flight operations, and related maintenance responsibilities, undertaken by Encompass. In short, not a single month went by when Surf satisfied its financial obligations under the agreements on time and in full.

9. But now, in an attempt to avoid paying what is rightfully owed to Encompass and living up to its agreements, Surf is trying a new tactic: moving all of Encompass' flight services to *another carrier*—Advanced Air. This attempt to sidestep and effectively replace Encompass, so Surf can continue to avoid its obligations to Encompass and suffer no consequences, is expressly foreclosed by the agreements that the parties signed on May 15, 2017. Specifically, Surf's engagement of another carrier violates Encompass' express rights of "first refusal" and "last offer" in the parties' Amended and Restated Capital Adjustment Agreement dated May 15, 2017 (the "Capital Adjustment Agreement").

10. Under Section 4 of the Capital Adjustment Agreement, "[Surf] hereby grants [Encompass] the rights of first refusal and last offer to have each such Additional Aircraft"—i.e., other aircraft or access to flight operations obtained "for air transportation services in the United States by [Surf's] . . . members"—to be made "subject to the Charter Agreement, subject to [Encompass] agreeing to substantially identical terms as any other party that has agreed in writing to such terms and is ready, willing and able to provide services to [Surf] of the type contemplated by the Charter Agreement." Furthermore, under Section 4 of the Capital Adjustment Agreement, Surf must "exercise the foregoing on commercially reasonable times and afford [Encompass] with reasonable time to consider and respond." Finally, Section 4 specifies that this grant is "irrevocable."

11. By secretly entering into its arrangements with Advanced Air without notifying Encompass, much less providing Encompass with an opportunity to bid on these services, Surf has materially breached every substantive requirement in Section 4 of the Capital Adjustment Agreement.

12. Surf's financial situation was exacerbated when Surf failed to comply with its purportedly secured multi-million dollar loan borrowed by Surf from a third party lender, which loan, upon information and belief, fully matured during the first half of 2017.

13. Surf's material breaches of the Charter Agreement and the Capital Adjustment Agreement, among others, were only compounded when Surf sent Encompass a letter late in the evening of Friday, June 15, 2018 (the "Surf Termination Letter"), purporting to terminate unilaterally the various contracts between Surf and Encompass. In its thinly-veiled attempt to avoid liability and shift blame to Encompass, Surf attempted to terminate so that it could immediately execute its new partnership with Advanced Air, which eagerly announced by press release the next day that it would become the operator of Surf's California flights.

14. Encompass seeks damages flowing from the bad faith conduct of Surf and Advanced Air, including the more than \$3.1 million that Surf owes it in overdue payments, as well as all damages resulting from Surf's numerous breaches of the Charter Agreement and the Capital Adjustment Agreement. These breaches include Surf's failure to provide Encompass with its bargained-for rights of first refusal and last offer within the Capital Adjustment Agreement and the purported termination of the relevant contracts.

PARTIES

15. Encompass Aviation, LLC is a Nevada limited liability company organized and existing under the laws of the State of Nevada, and having its principal place of business at 3507 Jack Northrop Avenue, Hawthorne, CA 90250. All members of the limited liability company are citizens of Pennsylvania. Encompass is engaged in the business of providing U.S. FAA Part 135 intrastate air transportation.

16. Surf Air Inc. is a Delaware corporation organized and existing under the laws of the State of Delaware, and having its principal place of business at 1408 Third Street Promenade, Suite 300, Santa Monica, CA 90401. Surf is a membership organization which arranges travel, transportation and concierge services for its members.

JURISDICTION AND VENUE

17. This Court has subject matter jurisdiction pursuant to 28 U.S.C. § 1332 because the parties are of diverse citizenship and the amount in controversy, exclusive of interest and costs, exceeds \$75,000. Plaintiff Encompass is a Nevada limited liability company. Encompass has four members: Steven E. Harfst, Lauren M. Harfst, the Revocable Deed of Trust of Steven E. Harfst, and the Revocable Deed of Trust of Lauren M. Harfst. Steven E. Harfst is a citizen of Pennsylvania. Lauren M. Harfst is a citizen of Pennsylvania. The trustee for the Revocable Deed of Trust of Steven E. Harfst is Steven E. Harfst, who is a citizen of Pennsylvania. The trustee for the Revocable Deed of Trust of Lauren M. Harfst is Lauren M. Harfst, who is a citizen of Pennsylvania. Defendant Surf is a Delaware corporation with its principal place of business in California. Accordingly, complete diversity exists between the parties.

18. This Court has personal jurisdiction over Surf because Surf expressly consented to the jurisdiction of this Court in an Amended and Restated Membership Interest Purchase Agreement (“MIPA”), executed on May 15, 2017.

19. Specifically, Section 8.4(b) of the MIPA states: “Any legal suit, action or proceeding arising out of or based upon this Agreement, the other Transaction Documents or the transactions contemplated hereby or thereby may be instituted in the federal courts of the United States of America or the courts of the state of New York in each case located in the city of New

York, and each party irrevocably submits to the exclusive jurisdiction of such courts in any such suit, action or proceeding” (all caps removed).

20. “Transaction Documents” is defined in Section 1.1 of the MIPA to include the Charter Agreement and the Capital Adjustment Agreement. Accordingly, because this action arises out of and is based upon Surf’s breaches of the Charter Agreement and the Capital Adjustment Agreement, Surf has irrevocably consented to the jurisdiction of this Court.

21. Venue in this Court is proper because the MIPA includes a forum-selection clause specifying a New York choice of forum.

22. Specifically, Section 8.4(b) of the MIPA states: “The parties irrevocably and unconditionally waive any objection to the laying of venue of any suit, action or any proceeding in such courts and irrevocably waive and agree not to plead or claim in any such court that any such suit, action or proceeding brought in any such court has been brought in an inconvenient forum” (all caps removed).

FACTUAL ALLEGATIONS

23. Surf’s business is providing travel, transportation and concierge services for its members including private air transportation services. In May 2017, upon information and belief, Surf was facing uncertain financial prospects and pending federal government investigations concerning its possible illegal activities. The Federal Aviation Administration was investigating Surf’s provision, through Advanced Air, of cross-border flight operations.

24. Upon information and belief, Surf determined that it could no longer provide air transportation services to its members. Accordingly, Surf entered into a series of transactions with Encompass whereby the parties agreed that Encompass would operate flights exclusively for Surf’s members using Encompass’ aircraft.

25. The Charter Agreement and the Capital Adjustment Agreement were among the agreements entered into between Surf and Encompass to effectuate this transaction. The other agreements between the parties included: (a) the Amended and Restated Membership Interest Purchase Agreement dated as of May 15, 2017 (the “MIPA”), by and among Surf, Surf Air Global Limited (the “Parent”) and Encompass; (b) those certain Sublease Agreements (collectively, the “Sublease Agreements”), by and among Surf and Encompass, each relating to the aircraft specified therein and, collectively, relating to the remaining eight (8) aircraft (collectively, the “Encompass Fleet”); and (c) Sudhin Shahani’s email as of February 5, 2018 (the “February 5th Email Agreement”), discussed further below.

**I. SURF FAILS TO MAKE PAYMENTS
REQUIRED BY THE CHARTER AGREEMENT.**

26. For nearly one year, Surf has engaged in a pattern of flagrant violations of its contractual obligations pursuant to the contracts it entered into with Encompass on May 15, 2017, stringing along Encompass with false promises, using questionable business practices, and taking advantage of Encompass’ willingness to be a good business partner trying to help Surf avoid the grounding of all aircraft servicing Surf’s members (a right which Encompass has had since the very first default committed by Surf but has chosen never to exercise).

27. Notwithstanding Surf’s failure to make the payments it was required to under the contract, in good faith and in reliance upon representations by Surf’s Executive Chairman, Mr. Sudhin Shahani, that such payments would be forthcoming, Encompass reserved its rights under its various contracts with Surf and agreed to continue to provide exclusive flight operations to Surf’s members in order to help Mr. Shahani keep his company operating. All at great financial risk to Encompass and its owner.

28. Throughout the second half of 2017, Surf continued its failure to make its contractual payments pursuant to the Charter Agreement, even though Surf expected Encompass to continue to run a complete flight schedule for Surf's members—at Encompass' own expense—for the benefit of Surf and its members.

29. By the end of 2017, mere months after Surf and Encompass executed the Charter Agreement, Surf was behind in payments to Encompass to the tune of \$2 million. These overdue payments were in exchange for flight services and aircraft maintenance that Encompass already provided for Surf's benefit, and for the benefit of Surf's members, whose monthly payments Surf was collecting. Surf's pattern of non-compliance and non-payment has continued throughout the relationship between Encompass and Surf.

30. However, in the spirit of being a cooperative business partner and in reliance on Surf's repeated representations that its payments were forthcoming, Encompass kept flying for Surf. Encompass maintained the operational safety and performance of its subleased aircraft to the best of its financial abilities, which were severely constrained solely because of Surf's decision not to keep Encompass current on contractually obligated payments.

31. Encompass continued repeatedly to chase Mr. Shahani for Surf's contractually-owed payments while it continued to provide flight operations exclusively to Surf's membership in good faith. Importantly, not once did Surf ever reject or question in any way any invoices from Encompass for services rendered in accordance with the parties' contracts. In fact, during the "Interim Period," as defined in the Charter Agreement, Surf and Encompass worked through all of the transition payment reconciliations, which were all agreed to by Surf.

32. Pursuant to the February 5th Email Agreement, Mr. Shahani acknowledged on behalf of Surf that significant amounts owing to Encompass were past due. Mr. Shahani agreed,

among other things, to the following terms: (i) to make a payment of \$1,250,00.00, representing certain amounts then overdue through January 31, 2018; (ii) to remit to Encompass 25% of any new capital raised on account of additional overdue amounts; (iii) to make monthly payments of \$600,000.00 to Encompass, representing partial payment for each month of flying beginning February 1, 2018; (iv) to compensate Encompass for all monthly expenses Encompass incurred above the partial payment of \$600,000.00 as of February 1, 2018; and (v) to grant Encompass a warrant for equity in Surf equal to \$3,000,000.00.

33. In good faith, Encompass continued to reserve its rights and agreed to provide the requested meaningful economic concessions on the terms offered. Encompass continued to provide exclusive flight operations to Surf's members at Encompass' own financial risk and to the best of its severely constrained financial ability.

34. Less than a month later, Surf violated its promises memorialized in the February 5th Email Agreement and fell further behind on its payment obligations to Encompass.

35. In written correspondence to Encompass, Mr. Shahani again pleaded with Encompass' CEO to agree to accept payments only after February 28, 2018 (even though he had just agreed to such payment date) because Surf wanted to show a higher cash balance on its books because it would be "[v]ery helpful to my [aircraft lessor] negotiations to end [February] with as much cash on hand as possible."

36. Put differently, Mr. Shahani sought to use Encompass' cash to create a fiction for another creditor seeking overdue payments from Surf.

37. After giving effect to the payments, including late payments, made through and including June 14, 2018, Surf still owes Encompass more than \$3.1 million for flight services provided by Encompass (the "Overdue Amount").

38. Surf's failure to pay the Overdue Amount constituted Events of Default under Section 12.1 of the Charter Agreement and a material breach. These defaults are continuing as of the date of this complaint.

II. SURF PARTNERS WITH ADVANCED AIR IN VIOLATION OF THE CAPITAL ADJUSTMENT AGREEMENT.

39. Not only is Surf in violation of the Charter Agreement, but it also has blatantly violated the Capital Adjustment Agreement.

40. In the Capital Adjustment Agreement, as a material inducement for the transactions entered into between the parties, Surf irrevocably granted Encompass a right of first refusal and right of last offer.

41. Section 4 of the Capital Adjustment Agreement states: "From time to time, Seller or its Affiliates may determine to acquire (whether by purchase, lease, sublease *or other arrangement permitting Seller or their Affiliates to access space and time on aircraft*) additional aircraft, including aircraft of a different type, to be used for air transportation services in the United States by Seller's (or its Affiliates') members (the 'Additional Aircraft'). Seller hereby grants Buyer the rights of first refusal and last offer to have each such Additional Aircraft added as an additional aircraft subject to the Charter Agreement, subject to Buyer agreeing to substantially identical terms as any other party that has agreed in writing to such terms and is ready, willing and able to provide services to Seller of the type contemplated by the Charter Agreement. Seller shall exercise the foregoing on commercially reasonable times and afford Buyer with reasonable time to consider and respond. The foregoing grant is coupled with an interest and is irrevocable." (emphasis added).

42. Without any notice to Encompass, on June 16, 2018 Surf publicly announced that it was unilaterally acting to replace Encompass with Advanced Air as its operator for all of its

flights within the State of California. Surf's press release "announced the expansion of its partnership with operator Advanced Air." It stated that "Surf Air will transition more flights to Advanced Air, including San Francisco and Los Angeles area flights, as well as, San Diego, Santa Barbara, Las Vegas, Monterey and Napa flights."

43. This replacement was a material breach of the Capital Adjustment Agreement and in direct violation of Encompass' rights of first refusal and last offer within Section 4 of the Capital Adjustment Agreement.

44. Advanced Air is only furthering the bad faith conduct of its new business partner. Indeed, Advanced Air spent the weekend days of June 16 and June 17, 2018 soliciting Encompass pilots to fly for them.

III. SURF AIR ISSUED AN IMPROPER TERMINATION LETTER TO ENCOMPASS.

45. Part and parcel of their scheme to dodge liability, simultaneous with Surf's announcement that it was replacing Encompass with Advanced Air, it issued an improper termination letter to Encompass declaring that it was "immediately terminat[ing]" Encompass' right to provide exclusive flight operations in California for Surf. The Surf Termination Letter claimed that Encompass has provided "unreliable and substandard service quality," has "fail[ed] to properly maintain aircraft," and has provided "overall poor management of the flight operations and Surf Air relationship, all of which has occurred on an extended and unacceptable basis."

46. The Surf Termination Letter purported to give a rationale for the termination, but did not allege any specific breaches of contractual obligations by Encompass. Rather, Surf's "rationale" consisted of a host of service issues such as "[h]igh turnover of pilots/employees [that] has impacted Surf Air's schedule dramatically"; "[p]oor maintenance practices"; and

“[u]nacceptable completion factor, poor on-time performance and service disruptions,” each of which were either fabricated or significantly overblown.

47. It is important to note that the agreements between Surf and Encompass have no objective service quality requirements to which Surf can point. And, if Surf is alleging that one or more of its grievances constitutes a breach of any agreement, Surf did not give Encompass proper notice and opportunity to cure, in violation of Section 12.1 of the Charter Agreement.

48. In sum, the Surf Termination Letter is Surf’s latest attempt to use smoke and mirrors as a way to avoid paying the Overdue Amount and justify its own bad faith actions and membership attrition.

49. The Surf Termination Letter itself also constitutes a material breach by Surf. The letter proclaims that immediate termination of the contractual relationship is warranted, even though Section 12.1 of the Charter Agreement does not provide any unilateral right by Surf to terminate the applicable contracts without adequate notice and opportunity to cure.

50. Rather, Section 12.1 provides that a non-defaulting party can terminate the Charter Agreement based on a breach that is “not cured within ten (10) calendar days of having received notice from [Surf]” or a breach of the Sublease Agreement(s) “that is not cured within the applicable cure period (if any) set forth in the applicable agreement.” Yet, the Surf Termination Letter merely makes one general allusion to an “indication that Encompass has failed to keep maintenance logs in accordance with regulatory requirements, a serious breach of our Charter Agreement and the Subleases” but makes no mention of giving prior notice or opportunity to cure such alleged breach, because Surf did not do that.

51. Instead of giving Encompass notice and an opportunity to cure whatever breaches Surf is baselessly alleging, Surf improperly and wrongfully terminated the contracts, effective “immediately.”

52. In light of Surf’s improper termination of the contracts and multiple material breaches thereof, Encompass sent Surf a cease and desist letter on June 18, 2018 identifying Surf’s multiple defaults under the contracts and demanding immediate payment of all obligations owed to Encompass by Surf.

FIRST CAUSE OF ACTION – Breach of Contract By Surf

53. Plaintiff repeats and re-alleges each of the foregoing paragraphs as if fully set forth herein.

54. Plaintiff and Surf are parties to binding and enforceable agreements, including the Charter Agreement and the Capital Adjustment Agreement, which are supported by adequate consideration.

55. Surf materially breached its agreements with Encompass. In particular, Surf breached Section 4 of the Charter Agreement by failing to make payments owed to Encompass. Surf also breached Section 12.1 of the Charter Agreement by unilaterally terminating the contracts without adequate notice and opportunity to cure. Moreover, Surf breached Section 4 of the Capital Adjustment Agreement, which grants Plaintiff the right of “first refusal” and “last offer,” when it negotiated offers for Additional Aircraft without first notifying Plaintiff and soliciting and obtaining Plaintiff’s first and final offers.

56. Plaintiff has fully performed its obligations under the agreements with Surf, including the Charter Agreement and the Capital Adjustment Agreement.

57. As a direct and proximate result of Surf's numerous breaches, including the breaches identified in Paragraph 50 above, Plaintiff has been damaged in an amount to be determined at trial. By way of example, as a result of Surf's breach of Section 4 of the Charter Agreement by failing to make timely payments, Surf continues to owe Encompass more than \$3,100,000.00 to date in overdue payments. Plaintiff has also been damaged by having been deprived of the unique and valuable opportunity to serve as exclusive carrier for Surf.

SECOND CAUSE OF ACTION – Declaratory Relief Against Surf

58. Plaintiff repeats and re-alleges each of the foregoing paragraphs as if fully set forth herein.

59. Plaintiff's rights under the Capital Adjustment Agreement are being infringed upon by Surf's breach of contract.

60. Plaintiff has a legally protected interest as it will be directly and substantially harmed by Surf's breach.

61. Plaintiff contends that Surf is obligated under the Capital Adjustment Agreement to offer Plaintiff a right of first refusal and right of last offer regarding Additional Aircraft sought by Surf for its members in the United States. By virtue of its new arrangement with Advanced Air, Surf contends that it is free and clear to grant third parties the opportunity to provide Additional Aircraft for its members in the United States without offering Plaintiff a right of first refusal or right of last offer. Accordingly, a justiciable controversy exists as to the rights and obligations of the parties under the Capital Adjustment Agreement, including whether Surf is required to give Plaintiff a right of first refusal or right of last offer.

62. Additionally, Plaintiff contends that Surf is obligated under the Charter Agreement to provide adequate notice and an opportunity to cure any alleged defaults by Plaintiff that may

trigger Surf's right to terminate the contracts. Surf has unilaterally issued a termination letter without following the requirements of Section 12.1. Accordingly, a justiciable controversy exists as to the rights and obligations of the parties under the Charter Agreement, including whether Surf is required to provide notice and an opportunity to cure before unilaterally terminating the parties' agreements.

63. An award of declaratory relief is therefore proper under 28 U.S.C. § 2201.

DEMAND FOR RELIEF

WHEREFORE, Plaintiff demands judgment of the Defendant as follows:

- a) Declaring Surf to be in breach of Section 4 of the Capital Adjustment Agreement;
- b) Declaring Surf to be in breach of Section 4 and Section 12.1 of the Charter Agreement;
- c) Specifically enforcing Plaintiff's rights under Section 4 of the Capital Adjustment Agreement;
- d) Awarding Plaintiff compensatory and any and all other damages available by law in an amount to be determined at trial, with interest, at the maximum amount permitted by law;
- e) Awarding Plaintiff its costs and disbursements in prosecuting this action to the extent permitted by law; and
- f) Awarding Plaintiff such other and further relief as the Court deems just and proper.

Dated: June 19, 2018
New York, New York

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