UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

DANIEL YANNES, Individually and On Behalf of All Others Similarly Situated, Plaintiff, v. SCWORX CORP., and MARC S. SCHESSEL, Defendants.	Case No. 1:20-cv-03349 (JGK)

MEMORANDUM OF LAW IN SUPPORT OF DEFENDANTS' MOTION TO DISMISS THE CONSOLIDATED CLASS ACTION COMPLAINT

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INTRODUCTION

The Court should dismiss Plaintiff's Consolidated Class Action Complaint ("CAC") (Dkt. No. 45) because it does not satisfy the heightened requirements for pleading scienter or falsity under the Private Securities Litigation Reform Act ("PSLRA") or Federal Rule of Civil Procedure 9(b). Plaintiff alleges that Defendants Marc Schessel and SCWorx Corporation ("SCWorx") (collectively, the "Defendants") falsely announced on April 13, 2020 a large Purchase Order for COVID-19 rapid test kits (the "PO"), which Plaintiff contends was fictitious. Plaintiff claims that the market learned the truth a few days later when several short sellers issued reports that questioned the ability of the supplier and the end purchaser to fulfill their respective contractual commitments to SCWorx. Plaintiff alleges that SCWorx confirmed this on April 30, 2020, when it announced the termination of the PO and Supply Agreement (collectively, the "Agreements") because the supplier, ProMedical, could not deliver the test kits as promised.

The fundamental problem with Plaintiff's attempt to plead securities fraud is that the CAC is devoid of any facts showing that Defendants knew or consciously disregarded red flags that the counterparties, ProMedical and Rethink My Healthcare ("RMH"), would be unable to fulfill their contractual obligations at the time Defendants disclosed the Agreements. For example, Plaintiff does not identify a person or document that placed Defendants on notice that ProMedical would be unable to fulfill the Supply Agreement, or that RMH was unable to pay SCWorx for the test kits under the PO.

Moreover, Plaintiff fails to allege that Schessel had a motive and opportunity (*i.e.*, that he obtained some specific benefit, like insider stock sales) to pursue a scheme to falsely announce a significant transaction, only to terminate the transaction a few days later. To what end or purpose would someone pursue such an illogical scheme? The CAC is silent.

To establish the requisite strong inference of scienter required under the PSLRA, the alleged facts must be cogent and compelling. And the inferences of fraud must be more persuasive than any inferences of negligence or non-fraudulent intent. Here, all Plaintiff offers is the allegation that Defendants should have conducted better due diligence on ProMedical and RMH before announcing the Agreements. At best, this allegation may raise an inference of negligence or corporate mismanagement, which is insufficient to plead a claim for securities fraud under the PSLRA. Indeed, a more compelling inference to be drawn from the alleged facts and the circumstances existing in the marketplace for medical supplies for COVID-19 in the early days of the pandemic (*i.e.*, when numerous hospitals and states scrambled to quickly secure medical supplies) is that Defendants relied in good faith on ProMedical's ability to deliver the test kits, but were misled.

The CAC also fails to plead that Defendants made specific statements that were false or misleading when made. *First*, with few exceptions, Plaintiff fails to identify the false statements with the specificity required under the PSLRA. Instead, Plaintiff quotes large segments from several SEC filings and analyst conference calls and leaves it to Defendants and the Court to decipher which statements were

allegedly false when made. Courts in the Second Circuit have repeatedly rejected such "puzzle pleading" as insufficient to satisfy the specificity requirements of the PSLRA. *Second*, Plaintiff fails to plead that the challenged statements were false *when* made. The CAC does not identify contemporaneous facts showing that ProMedical was unable to fulfill its contractual requirements at the time SCWorx announced the PO.

Plaintiff further fails to establish that Defendants had a duty to disclose the facts that supposedly call into question RMH's financial ability to pay SCWorx under the PO. The only facts in the CAC that supposedly establish RMH's inability to pay for the test kits is that RMH was a "small company" started by "a 25-year old." Not only do these facts ignore the widespread and emergent demand for COVID-19 test kits which would reasonably assure payment, these facts were already in the public domain (*i.e.*, they were disclosed on RMH's website). Finally, these facts do not establish the falsity of any challenged statement because SCWorx's termination of the Agreements had nothing to do with RMH. SCWorx terminated the Agreements because ProMedical could not fulfill its contractual obligations, not because of any concern about RMH's ability to pay SCWorx.

For these reasons, and others more fully discussed below, the Court should grant Defendants' Motion to Dismiss.

BACKGROUND

a. SCWorx and Marc Schessel

SCWorx provides supply chain management software and related data analytics to healthcare providers. CAC ¶ 3. SCWorx is based in New York. Ex. 1, 2019 10-K at 6.[1]

Marc Schessel, SCWorx's Chief Executive Officer ("CEO") and Chairman, founded SCWorx's predecessor (Primrose LLC) in 2012. 2019 10-K at 37. Schessel started working in supply chains during his ten years of service in the United States Marine Corps—where he was awarded the Naval Achievement medal along with the Naval Commendation medal for creating the first automated supply and logistics software (M triple S), which was ultimately put in service at corporations like Sears and IBM. *Id.* Since leaving the Marine Corps, Schessel has continued his work in refining programmatic solutions for complex and critical supply chains in the healthcare industry, including spending over ten years as VP of Supply Chain at a

[1] "Ex. __" refers to documents attached to the Biles Declaration. Defendants respectfully request that the Court take judicial notice of the documents attached to the Biles Declaration, which are submitted in support of this motion. *See Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 322 (2007); *Silsby v. Icahn*, 17 F. Supp. 3d 348, 354 (S.D.N.Y. 2014) (court may consider documents that are referenced in the complaint, documents that plaintiff relied on in bringing suit or in its possession, matters of which judicial notice may be taken); *Abely v. Aeterna Zentaris Inc.*, No. 12 CIV. 4711 PKC, 2013 WL 2399869, at *22 (S.D.N.Y. May 29, 2013).

large New York-based integrated delivery network. *Id.* Schessel has also served as a consultant to the United Nations where he developed an automated emergency medical response program that forecasts the items, quantities and logistical delivery networks crucial for responders, which allows countries to better plan, stock and store critical supplies. *Id.*

When the COVID-19 pandemic emerged, Schessel was quick to grasp its implications, particularly for SCWorx's customer base of healthcare providers,[2] as SCWorx had helped healthcare systems with supply disruptions during past epidemics by finding critical products when traditional distributors had failed. Ex. 2, Apr. 21, 2020 8-K [Ex. 99.1] ("Apr. 15, 2020 Call Transcript"). For example, during the H1N1, SARS, and Ebola epidemics, SCWorx was able to source products for healthcare systems like Northwell, Maimonides, Geisinger, and Valley Health System. *Id.* SCWorx's familiarity with the healthcare industry and extensive network of contacts made it better suited to execute healthcare-supplies transactions than other companies that pivoted to the space. *Id.* Accordingly, the shift to COVID-related supplies was natural given SCWorx's clientele, network, and expertise as well as SCWorx's experience sourcing critical supplies in earlier epidemics. *Id.*

On March 20, 2020, SCWorx announced the formation of Direct-Worx (a wholly owned subsidiary) in response to a substantial volume of requests from its clients to assist with the acquisition of critical personal protective equipment (PPE). *See* Ex. 3,

[2] Ex. 4, Feb. 13, 2020 Press Release.

Mar. 20, 2020 Press Release; *see also* CAC ¶ 4. During this time, the marketplace for PPE and COVID-related supplies was filled with illegitimate products and scams, and it was extremely difficult to secure quality supplies as the healthcare systems' traditional supply chains were breaking down. *See infra* note 15. SCWorx was, however, uniquely positioned to provide immediate assistance to its healthcare clients as SCWorx had "all the necessary healthcare products in [its] large data array, a list of functional equivalent products[,] and the connections to sourcing vendors for the core PPE …, even as certain critical brand name products [were] sold out via normal sourcing routes." Ex. 3, Mar. 20, 2020 Press Release. Accordingly, SCWorx had confidence in its ability to source COVID-19 supplies, while also acknowledging that the marketplace was filled with illegitimate products and scams, which SCWorx did its best to weed out. Ex. 2, Apr. 15, 2020 Call Transcript at 3.

Plaintiff's claims are based on the disclosure of the PO for COVID-19 test kits, which SCWorx was ultimately unable to fulfill because the supplier of the test kits, ProMedical, reneged on its contractual obligations to SCWorx. CAC ¶¶ 15, 37, 58.

b. Plaintiff's Allegations

Plaintiff alleges that four SCWorx statements about the PO from RMH[3] for COVID-19 test kits between April 13 to April 17, 2020 (the "Class Period") were false

[3] RMH is a healthcare services company based in Fairfield, New Jersey. According to RMH's team page, Dr. Kenneth D. Pearsen—professor and chair of the radiology department at Jacobs School of Medicine (University of Buffalo)—serves as a medical

and misleading: (1) statements in SCWorx's April 13, 2020 press release ("April 13 PR") announcing the PO for 2 million COVID-19 testing kits with a provision for additional weekly orders of 2 million test kits for 23 weeks, which was valued at $35 million per week, CAC ¶¶ 39–41; (2) Schessel's statements reiterating the PO during the April 15, 2020 earnings call ("April 15 Call"), CAC ¶¶ 42–44; (3) statements in SCWorx's April 16, 2020 8-K ("April 16 8-K") revealing ProMedical as the supplier of the COVID-19 test kits, CAC ¶¶ 45–47; and (4) statements in SCWorx's April 17, 2020 press release ("April 17 PR") re-affirming the "previously disclosed plans to distribute COVID-19 Rapid Testing Units." CAC ¶ 48.[4]

Plaintiff alleges that these challenged statements "were materially false and misleading because Defendants knew or recklessly disregarded" that ProMedical "could not supply the quantity or quality of tests described in the purchase order or

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advisor and Dr. Becky Antle—professor in the Kent School of Social Work at the University of Louisville—serves as a clinical advisor. *See* Ex. 5, RMH Team Page and Faculty Pages, *available at* https://rethinkmyhealthcare.com/our-team/; http://medicine.buffalo.edu/faculty/profile.html?ubit=kpearsen; https://louisville.edu/kent/about/faculty-1/bios/dr.-becky-antle.

[4] Plaintiff also makes a series of allegations about a subsidiary (Direct-Worx) and a March 27, 2020 press release announcing an agreement to supply personal-protective equipment. CAC ¶¶ 34–36. Plaintiff, however, does not challenge these statements, which were made outside the purported class period.

supply agreement," and that RMH "was a small company that was unlikely to be able to pay for or handle the hundreds of millions of dollars in test kit orders provided for in the purchase order." CAC ¶¶ 41, 44, 47, 49.

Plaintiff alleges that the truth of SCWorx's fraud was revealed in two short reports published on April 14 and April 17 of 2020. CAC ¶¶ 50, 52. Plaintiff alleges Utopia Capital Research published a report on April 14, 2020, stating that the PO was "very difficult to believe in light of the fact that the number of COVID-19 test[s] carried out in the USA amount[s] to only 298,499 since January 21, 2020" and that RMH "is a company that specializes in virtual healthcare services with a somewhat underwhelming website." CAC ¶ 7. Plaintiff also alleges that Hindenburg Research published a report, on April 17, 2020, which concluded that the test-kit deal was a "scam" based on numerous "red flags," including that (1) SCWorx is a tiny company headquartered in a rental office, whose CEO "has a checkered past"; (2) ProMedical was recently accused by a major COVID test manufacturer of "fraudulently mispresent[ing] themselves" as sellers of its COVID-19 tests; (3) ProMedical's CEO formerly ran another business accused of defrauding its investors and customers; and (4) RMH is a small virtual healthcare company started by a 25-year-old in August

2018, which did not appear capable of handling millions in test kits. CAC ¶¶ 11, 52–55.[5]

STANDARD OF REVIEW

On a motion to dismiss under Rule 12(b)(6), Plaintiff bears the burden of pleading facts from which the court can reasonably infer that the defendants are liable. *See Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009). The Court must dismiss the CAC if it does not "contain sufficient factual matter, accepted as true, to 'state a claim to relief that is plausible on its face." *Id.* (quoting *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 570 (2007)). It is not enough for Plaintiff to plead "a sheer possibility that a defendant has acted unlawfully." *Iqbal*, 556 U.S. at 678. Pleading facts that could conceivably support a finding of liability or providing only formulaic recitations of legal elements devoid of specific facts is legally insufficient. *See Twombly*, 550 U.S. at 545; *Iqbal*, 556 U.S. at 678. "Allegations that are conclusory or unsupported by factual assertions [also] are insufficient." *ATSI Commc'ns, Inc. v. Shaar Fund, Ltd.*, 493 F.3d 87, 99 (2d Cir. 2007).

Complaints alleging securities fraud are subject to heightened pleading standards under both Rule 9(b) and the Private Securities Litigation Reform Act,

[5] Plaintiff also makes a series of allegations about other disclosures in the "truth revealed" section of the CAC. CAC ¶¶ 57–61. But Plaintiff does not allege any stock drops for these alleged disclosures, which are outside the purported class period.

Pub. L. 104-67, 109 Stat. 737 ("PSLRA").[6] Under Rule 9(b), a party "alleging fraud . . . must state with particularity the circumstances constituting fraud." Fed. R. Civ. P. 9(b). The Second Circuit has interpreted Rule 9(b) to require that the complaint: "(1) specify the statements that the plaintiff contends were fraudulent, (2) identify the speaker, (3) state where and when the statements were made, and (4) explain why the statements were fraudulent." *ATSI*, 493 F.3d at 99. In addition, under the PSLRA, a complaint "must specify each statement alleged to have been misleading [and] the reason or reasons why the statement is misleading," 15 U.S.C. § 78u-4(b)(1), and allege "with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind [*i.e.*, scienter]," 15 U.S.C. 78u-4(b)(2)(A). *See ECA & Local 134 IBEW Joint Pension Trust of Chicago v. JP Morgan Chase Co.*, 553 F.3d 187, 196 (2d Cir. 2009); *ATSI*, 493 F.3d at 99.

For the reasons stated below, the CAC does not meet the pleading requirements of Rule 9(b) or the PSLRA and, thus, the CAC must be dismissed.

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[6] Section 10(b) of the Exchange Act makes it illegal to "use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance." 15 U.S.C. § 78j(b). A plaintiff alleging a violation of Section 10(b) and SEC Rule 10b–5 must plead: (1) a material misrepresentation (or omission), (2) scienter, (3) a connection with the purchase or sale of a security, (4) reliance, (5) economic loss, and (6) loss causation. *Dura Pharm., Inc. v. Broudo*, 544 U.S. 336, 341–42 (2005); *see also* 15 U.S.C. § 78u–4(b); 17 C.F.R. § 240.10b–5.

ARGUMENT

I. The Court should dismiss Plaintiff's § 10(b) claim against SCWorx and Schessel.

A. Plaintiff has not adequately plead a strong inference of scienter against Schessel or SCWorx.

1. Legal Standard

To state a claim under Section 10(b), the PSLRA requires a plaintiff to plead with particularity facts giving rise to a strong inference of scienter: "a mental state embracing intent to deceive, manipulate, or defraud." *Tellabs*, 551 U.S. at 319; *id.* at 321 (noting that the PSLRA's "strong inference" requirement "unequivocally raised the bar for pleading scienter" in securities fraud cases). "The requisite scienter can be established by alleging facts to show either (1) that defendants had the motive and opportunity to commit fraud, or (2) strong circumstantial evidence of conscious misbehavior or recklessness." *ECA*, 553 F.3d at 198. Here, Plaintiff does *not* make any particularized "motive and opportunity" allegations,[7] instead relying on

[7] Although the CAC contains the conclusory allegation that Schessel "had both the motive and the opportunity to commit fraud," CAC ¶ 63, it is devoid of any facts to support this conclusory allegation such as insider-trading allegations. *See In re PXRE Grp., Ltd., Sec. Litig.*, 600 F. Supp. 2d 510, 531 (S.D.N.Y. 2009), aff'd sub nom. *Condra v. PXRE Grp. Ltd.*, 357 F. App'x 393 (2d Cir. 2009) ("[T]he Court is mindful of the Second Circuit's instruction that what is required when endeavoring to plead facts supporting a strong inference of scienter by showing motive and opportunity is not a bare invocation of magic words such as motive and opportunity but an allegation of

allegations of circumstantial evidence of conscious misbehavior or recklessness, which are neither cogent nor compelling. CAC ¶¶ 62–63.

To adequately allege a strong inference of conscious wrongdoing or recklessness, Plaintiff must plead "a state of mind approximating actual intent, and not merely a heightened form of negligence." *See McIntire v. China MediaExpress Holdings, Inc.*, 927 F. Supp. 2d 105, 120 (S.D.N.Y. 2013) (citations and internal quotations omitted). Plaintiff must allege conduct, which at a minimum "is highly unreasonable and which represents an extreme departure from the standards of ordinary care . . . to the extent that the danger was either known to the defendant or so obvious that the defendant must have been aware of it." *Novak v. Kasaks*, 216 F.3d 300, 308 (2d Cir. 2000). When a plaintiff seeks to show scienter through circumstantial evidence, like here, "the strength of the circumstantial allegations

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facts showing the type of particular circumstances that our case law has recognized will render motive and opportunity probative of a strong inference of scienter.") (quoting *Rothman v. Gregor*, 220 F.3d 81, 90 (2d Cir. 2000)) (internal quotation marks omitted); *see also Hou Liu v. Intercept Pharm., Inc.*, No. 17-CV-7371, 2020 WL 1489831, at *14 (S.D.N.Y. Mar. 26, 2020) ("To allege scienter based on motive and opportunity, plaintiffs must demonstrate that defendants benefitted in some concrete and personal way from the purported fraud. This generally is done by alleging that corporate insiders made a misrepresentation in order to sell their own shares at a profit.") (citations and internal quotation marks omitted).

must be correspondingly greater if there is no motive" to commit fraud. *ECA*, 553 F.3d. at 198–99 (quoting *Kalnit v. Eichler*, 264 F.3d 131, 142 (2d Cir. 2001)); *see also Chill v. Gen. Elec. Co.*, 101 F.3d 263, 270 (2d Cir. 1996) (stressing "the significant burden on the plaintiff in stating a fraud claim based on recklessness"). Plaintiff has not met his burden.

2. **Plaintiff fails to allege a strong inference of conscious wrongdoing or recklessness by Schessel.**

Schessel cannot be held liable under the very high pleading standard applicable for conscious recklessness merely because he failed to predict that ProMedical would breach the Supply Agreement. *See* CAC ¶¶ 41, 45 (alleging that Schessel knew or recklessly disregarded that ProMedical "could not supply the quantity or quality of tests described in the purchase order or supply agreement"). As the Second Circuit has stated, "[c]orporate officials need not be clairvoyant; they are only responsible for revealing those material facts reasonably available to them… Thus, allegations that defendants should have anticipated future events and made certain disclosures earlier than they actually did do not suffice to make out a claim of securities fraud." *Novak*, 216 F.3d at 309; *see also Acito v. IMCERA Grp., Inc.*, 47 F.3d 47, 53 (2d Cir. 1995) ("[D]efendants' lack of clairvoyance simply does not constitute securities fraud."). In fact, courts in this district have repeatedly refused

to find a strong inference of scienter when plaintiffs have alleged that defendants failed to predict future events.[8]

Plaintiff does not identify any information, such as a document or confidential witness, that placed Schessel or SCWorx on notice before the challenged statements that ProMedical would not be able to fulfill the order for test kits. Plaintiff's citation to alleged ProMedical "red flags" in a short-seller' report[9] published on April 17, 2020

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[8] *See, e.g., In re UBS AG Sec. Litig.*, No. 07-CIV-11225-RJS, 2012 WL 4471265, at *17 (S.D.N.Y. Sept. 28, 2012) aff'd sub nom. *City of Pontiac Policemen's & Firemen's Ret. Sys. v. UBS AG*, 752 F.3d 173 (2d Cir. 2014) (no strong inference of scienter based on company's failure to foresee mortgage liquidity crisis in 2006); *Epirus Capital Mgmt., LLC v. Citigroup Inc.*, No. 09-CIV-2594-SHS, 2010 WL 1779348, at *5 (S.D.N.Y. Apr. 29, 2010) (Plaintiff failed to raise a strong inference of scienter based on defendants' failure to predict crash in value of collateralized debt obligations, because "failure to make such predictions does not constitute fraud.").

[9] *Cf. In re Longtop Fin. Techs. Ltd. Sec. Litig.*, 910 F. Supp. 2d 561, 577 (S.D.N.Y. 2012) ("The allegations relating to the Short Seller Reports do not provide the basis for an adequate pleading of scienter. As an initial observation, short sellers operate by speculating that the price of a security will decrease. They can perform a useful function by bringing information that securities are overvalued to the market. However, they have an obvious motive to exaggerate the infirmities of the securities in which they speculate.").

(CAC ¶ 52), does not shed any light on Schessel's state of mind at the time SCWorx executed or publicly disclosed the Agreements. *See Novak*, 216 F.3d at 309 (noting that the Second Circuit has "refused to allow plaintiffs to proceed with allegations of 'fraud by hindsight'"). *See infra* note 10. Plaintiff must identify facts showing that Defendants were aware of the "red flags" disclosed in the short reports *before* they made the challenged statements.

In a futile attempt to plead a strong inference of conscious wrongdoing or recklessness, Plaintiff alleges that Schessel knew or recklessly disregarded the misleading nature of the challenged statements because he "chose to speak about the purported COVID-19 test kit deal." CAC ¶ 62.[10] Yet, Plaintiff fails to identify any document or witness placing Schessel on notice—at the time SCWorx entered into the Agreements or publicly disclosed them—that his statements about the "COVID-19 test kit deal" were misleading. *See Novak*, 216 F.3d at 309 ("Where plaintiffs contend defendants had access to contrary facts [that they failed to disclose or act on], they must specifically identify the reports or statements containing this information."); *Intercept*, 2020 WL 1489831, at *15 (noting that "there are simply no

[10] In other words, Plaintiff suggests that Schessel must have been aware of red flags concerning the counterparties to the "COVID-19 test kit deal" because he made statements about it. *See Intercept*, 2020 WL 1489831, at *15 (The "conclusory allegation that the Individual Defendants 'would necessarily' have had to know about the dosing data … is insufficient.").

particularized facts as to when or how each Individual Defendant learned about prescription dose errors or the adverse events"). Plaintiff's allegations are thus "idle speculation" that Schessel was aware of or disregarded facts that contradicted his public statements when each challenged statement was made. *See Intercept*, 2020 WL 1489831, at *15–16.

Plaintiff also alleges that "Schessel represented that he 'spent weeks' researching COVID-19 test kit products, distributors, and intermediaries before … signing an agreement with ProMedical, yet with less than 24 hours of research, an analyst uncovered substantial red flags suggesting that ProMedical would not be able to supply the … test kits." CAC ¶ 62.[11] In other words, Plaintiff argues that Schessel

[11] To the extent that Plaintiff argues that the short sellers quickly "uncovered substantial red flags suggesting that Promedical would not be able to supply the … test kits," CAC ¶ 62, and thus it was easily discoverable, this argument suffers from hindsight bias. *See Special Situations Fund III QP, L.P. v. Deloitte Touche Tohmatsu CPA, Ltd.*, 33 F. Supp. 3d 401, 434 (S.D.N.Y. 2014) ("To the extent that Plaintiffs argue that new management quickly unearthed the fraud, and thus it was easily discoverable, this argument suffers from hindsight bias."). It is not enough for Plaintiff to allege that short sellers quickly uncovered "red flags"—Plaintiff must present facts that these "red flags" were disclosed and ignored by Defendants.

should have done more or better due diligence on ProMedical.[12] At best, this allegation suggests mere negligence—allegations of "corporate mismanagement" are insufficient to support a claim under Section 10(b). *Boca Raton Firefighters & Police Pension Fund v. Bahash*, 506 F. App'x 32, 36 (2d Cir. 2012) (quoting *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 477 (1977)).[13]

Plaintiff's attempts to infer scienter to Schessel using the "core operations" or "core product" theory—by arguing that the PO was important to SCWorx and that Schessel "held himself out to investors as the person most knowledgeable about SCWorx's business" (CAC ¶¶ 62–63)—must similarly be rejected. As an initial matter, "[c]ourts within and beyond this circuit have cast doubt on the continued viability of the doctrine, which pre-dates the PSLRA by several years." *In re*

[12] Plaintiff has not alleged that the purported information was even publicly available at the time SCWorx entered into the Agreements or publicly disclosed these agreements. As explained previously, Plaintiff cannot allege fraud by hindsight.

[13] For example, Plaintiff alleges that Hindenburg Research reported on April 17, 2020, that ProMedical "claimed to the FDA and regulators in Australia to be offering COVID-19 test kits manufactured by a large, well-respected Chinese firm Wondfo," but Wondfo issued a release stating disavowing any relationship with ProMedical. CAC ¶52. But absent from the CAC are any facts that Schessel and SCWorx knew about the Wondfo's press release or that ProMedical had "fraudulently misrepresented themselves."

AT&T/DirecTV Now Sec. Litig., No. 19-CV-2892, 2020 WL 4909718, at *17 (S.D.N.Y. Aug. 18, 2020). Such a doctrine would nullify the requirements of the PSLRA anytime a plaintiff challenged a statement that concerned a "core product" or "core operations" of a company. Although the Second Circuit has not "expressly addressed whether the doctrine survived the PLSRA," courts in this circuit have considered this theory only "to bolster other substantial grounds for *scienter*" rather than relying on it as an "independent means to plead [scienter]." *Intercept*, 2020 WL 1489831, at *19; *AT&T/DirecTV* Now, 2020 WL 4909718, at *17. Because the CAC is devoid of other particularized scienter allegations,[14] Plaintiff's core-operations theory fails as well.

Additionally, in considering whether Plaintiff has pled facts sufficient to raise a strong inference of scienter, the Court must also consider competing inferences. *See Tellabs*, 551 U.S. at 323. Plaintiff's theory of scienter must be at least as compelling as any opposing inferences. *Id.* In this case, a much stronger competing inference is that SCWorx was a victim of "the extreme uncertainty in the medical supply

[14] Likely recognizing the dearth of his scienter allegations, Plaintiff also makes a series of allegations about Schessel's past (*see, e.g.*, CAC ¶¶ 7, 25–31); none of which has any bearing on Plaintiff's claim in this action. *See Intercept*, 2020 WL 1489831, at *19 (rejecting plaintiff's "baseless" theory of scienter and holding allegations that defendant "was involved in a prior settlement based on allegations of securities fraud does not support an inference that defendants acted recklessly in the present matter").

marketplace" with the "urgent need for critical medical supplies" (CAC ¶ 34) or that SCWorx was simply duped by ProMedical.

There is simply no plausible explanation as to why an executive would knowingly publish a misleading press release only to publicly retract it a few days later. Plaintiff has not offered any facts that Schessel benefited in any way from the alleged misstatements. Plaintiff fails to allege a motive as to why Schessel would mislead investors for four days.

This Court can take judicial notice of the indisputable fact that in the early days of the COVID-19 pandemic hospitals and states scrambled to acquire test kits and personal protective equipment as quickly as possible—not an environment conducive to in-depth due diligence.[15] Plaintiff does not allege that SCWorx published

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[15] *See, e.g.*, Ex. 6, "States are desperate for supplies and out of patience as coronavirus needs increase," CNN (Mar. 23, 2020), *available at* https://www.cnn.com/2020/03/23/politics/states-federal-government-supplies-coronavirus/index.html; Ex. 7, "How Profit and Incompetence Delayed N95 Masks While People Died at the VA," ProPublica (May 1, 2020), *available at* https://www.propublica.org/article/how-profit-and-incompetence-delayed-n95-masks-while-people-died-at-the-va (A contractor "maintained he was trying to do a public service and plans to tell investigators how he was taken for a ride by 'buccaneers and pirates,' the multiple layers of intermediaries, fixers and lawyers standing between respirator mask producers and front-line workers who are dying without them.").

the April 13 PR for some nefarious purpose; to the contrary, Plaintiff's allegations concede that SEC rules and regulations *required* SCWorx to publicly disclose the PO and the Supply Agreement because it was a material contract outside of SCWorx's normal course of business. *See, e.g.*, CAC ¶ 10.[16]

Finally, having failed to plead facts sufficient to raise a strong inference of corporate scienter by pleading facts sufficient to show scienter for an individual defendant," *Intercept*, 2020 WL 1489831, at *16, Plaintiff has likewise failed to plead scienter as to SCWorx. In order to plead facts sufficient to raise a strong inference of scienter with respect to SCWorx, Plaintiff must adequately allege that some employee(s) other than Schessel acted with the requisite intent and that intent could be imputed to SCWorx. *See id.* Because the CAC is devoid of such allegations, Plaintiff has failed to establish any inference, much less a strong inference, of corporate scienter attributable to SCWorx.

* * *

In short, Plaintiff fails to allege a strong inference of conscious wrongdoing or recklessness by Schessel because the CAC is devoid of facts showing that he "(1) benefitted in a concrete and personal way from the purported fraud; (2) engaged in deliberately illegal behavior; (3) knew facts or had access to information suggesting

[16] SEC Form 8–K requires disclosure of "material definitive agreement[s] not made in the ordinary course of business." Form 8-K, at Item 1.01(a), *available at* http://www.sec.gov/about/forms/form8–k.pdf.

that [his] public statements were not accurate; or (4) failed to check information that [he] had a duty to monitor." *See ECA*, 553 F.3d at 199 (internal quotation marks omitted). And because the CAC is devoid of facts showing that Schessel or some other employee acted with scienter, Plaintiff has failed to plead scienter against SCWorx.

B. Plaintiff has also failed to adequately allege that Defendants made a materially false statement of fact or omission.

Because the Court can and should dismiss the CAC for lack of scienter, it need not reach the question whether Plaintiff has adequately alleged that Schessel or SCWorx made a material misrepresentation. Even if the Court does reach this question, the result is the same: the CAC is wholly inadequate and must be dismissed.

First, Plaintiff fails to identify the precise statements that are allegedly false and misleading. Rather, Plaintiff engages in *puzzle pleading* by citing long block quotes from investor earnings call transcripts and SCWorx's SEC filings without specifically identifying which statements are false or misleading. *See Tabor v. Bodisen Biotech, Inc.*, 579 F. Supp. 2d 438, 453 (S.D.N.Y. 2008) ("Plaintiffs use of large block quotes from SEC filings and press releases, followed by generalized explanations of how the statements were false or misleading are *not* sufficient to satisfy the heightened pleading requirements.") (emphasis added) (citations omitted).

Second, Plaintiff fails to plead facts showing that the challenged statements were false or misleading when made. Statements that are rendered false in hindsight are not actionable under the federal securities laws. Although SCWorx subsequently announced on April 30, 2020 that it terminated the PO because ProMedical was

unable to supply the COVID test kits as promised, this disclosure does not demonstrate that SCWorx's earlier statements were false when made.

The CAC is devoid of factual allegations showing that SCWorx did not actually receive the PO or execute the Supply Agreement. Ex. 8, 2019 10-K [Exhibit # 10.2] (Supply Agreement dated Apr. 10, 2020; terminated Apr. 29, 2020); Ex. 9, 2019 10-K [Exhibit # 10.3] (PO dated Apr. 9, 2020; terminated Apr. 23, 2020). Plaintiff alleges that SCWorx "subsequently admitted, in a Form 8-K filed with the SEC on April 30, 2020, that ProMedical could not supply the required tests, and consequently, the purchase order and supply agreements were terminated." CAC ¶ 58.[17] But this disclosure does not render false SCWorx's previous disclosures of the PO and Supply Agreement. As SCWorx explained in the April 30, 2020 8-K, after entering into the Supply Agreement, "substantial concerns … [arose] related to ProMedical's ability to fulfill its obligations under the Supply Agreement," including the contractual requirement that ProMedical "secure the requisite FDA approvals to permit the sale of its test kits in the US." CAC ¶ 58. Plaintiff must present facts existing at the time of the PO that ProMedical would not fulfill its contractual obligation; otherwise Plaintiff's allegations are an impermissible attempt to plead falsity by hindsight.

[17] SEC Form 8–K requires disclosure of the termination of a material definitive agreement not made in the ordinary course of business." Form 8-K, at Item 1.02(a), *available at* http://www.sec.gov/about/forms/form8–k.pdf.

Without such contemporaneous facts, any statement announcing a material contract will be deemed false or misleading when a counterparty breaches the contract.

Third, Plaintiff fails to plead that Defendants had a duty to disclose the facts that supposedly suggest that RMH (*i.e.*, the entity that would purchase the COVID test kits supplied by ProMedical) would be unable to pay SCWorx for the test kits. As an initial matter, this allegation is nothing more than a red herring. SCWorx's announcement cancelling the Agreements had nothing to do with RMH's ability to pay for the test kits—SCWorx cancelled the Agreements because ProMedical could not deliver the test kits as promised. *See, e.g.*, CAC ¶ 58. In addition, this allegation ignores the overwhelming demand for COVID-19 test kits existing at the time, which reasonably assured SCWorx that RMH would be able to quickly sell the test kits and pay SCWorx.

Moreover, an omission is actionable under the securities laws only where a party has a duty to disclose the information. *In re Time Warner Inc. Sec. Litig.*, 9 F.3d 259, 267 (2d Cir. 1993). The securities laws do not require a party "to disclose a fact merely because a reasonable investor would very much like to know that fact." *Id.* The securities laws impose a duty to disclose only when there is an "affirmative legal disclosure obligation" or disclosure is "necessary to prevent existing disclosures from being misleading." *In re Lehman Bros. Sec. and Erisa Litig.*, 799 F. Supp. 2d 258, 275 (S.D.N.Y. 2011). Here, Plaintiff does not allege that there is an affirmative legal disclosure obligation.

Instead, Plaintiff seems to argue that SCWorx failed to disclose certain facts about RMH that supposedly show that it "was unlikely to be able to pay for or handle the hundreds of millions of dollars in test kit orders provided for in the purchase order." *See* CAC ¶¶ 41, 47, 49. For example, Plaintiff highlights the following "red flags" that SCWorx should have disclosed about RMH: (1) RMH "was a small company specializing in virtual healthcare services" (CAC ¶ 7); (2) RMH had "a somewhat underwhelming website" (CAC ¶ 50); and (3) RMH was "started by a 25-year old in August 2018 that looks modestly sized, with only 3 employees and 3 consultants/advisors listed on its team page" (CAC ¶ 52). But these facts were already disclosed to the public on RMH's website at the time of the challenged statements, *see supra* note 3 (Ex. 5, RMH Team Page and Faculty Pages), and were part of the total mix of information available to investors. *See* CAC ¶ 77 (alleging that "the market for SCWorx common stock promptly digested current information regarding SCWorx from *all* publicly available sources and reflected such information in SCWorx common stock") (emphasis added). To the extent that Plaintiff contends these "red flags" about RMH were not publicly available at the time of the challenged statements, the CAC does not allege that Schessel was aware of or had access to these purported facts. There is no duty to disclose facts that are unknown.

II. The Court should dismiss Plaintiff's § 20(a) claim against Schessel.

Plaintiff seeks to hold Schessel liable as a control person under Section 20(a) of the Exchange Act for the alleged securities violations of SCWorx. To establish a *prima facie* case under Section 20(a), Plaintiff must plead: (1) a primary violation of federal securities laws; and (2) that Schessel exercised actual power or control over

the primary violator. *See Ganino v. Citizens Utils. Co.*, 228 F.3d 154, 170 (2d Cir. 2000). Because Plaintiff has failed to establish a primary violation of the federal securities laws by SCWorx (for all the reasons stated above), the Court should dismiss Plaintiff's control-person liability claim against Schessel.

CONCLUSION

For all the foregoing reasons, the Court should grant this motion and dismiss the CAC.

Dated: November 18, 2020

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

This brief complies with the formatting rules laid out in section II.D of the "Individual Practices of Judge John G. Koeltl" (dated May 28, 2020) and in Local Civil Rule 7.1 (effective Oct. 29. 2018). This brief contains 6,104 words (excluding the cover page, certifications of compliance and service, table of contents, and table of authorities) according to Microsoft Word word-processing software.

/s/Paul R. Bessette
Paul R. Bessette

CERTIFICATE OF SERVICE

I hereby certify that, on November 18, 2020, I electronically filed the foregoing notice with the Clerk of Court using the CM/ECF system, which will send a notice of electronic filing to all counsel of record who have consented to electronic notification. I further certify that I mailed the foregoing document and the notice of electronic filing by first-class mail to all non-CM/ECF participants.

/s/Paul R. Bessette
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