

April 29, 1989

Dear Family:

I do not know all the ramifications of this proposed suit. You will note that "only those who participate will enjoy the benefits and "risks" of such a suit. This means that if the suit is "settled" we will probably get less than the agreed amount because the "settlement" usually results in an "agreement" which is usually mutually beneficial and detrimental. If we would lose the suit all of us would have to help pay for the costs of the suit, because Dad and I cannot afford to bear the cost alone.

There is also the problem that Dad is worried about, that if he is involved, Mega will cut off his royalty payment and he would have to go after them about that. Barry's answer to this is "good". Then we'll really go after them and get what he has coming."

The advantage of the suit is that we will get the money either in a lump sum or at least paid out yearly until finished. Hopefully, also, we could stick Mega for legal costs.

We can wait and get the payments starting in 1996 until it is paid off. That might be faster if Mega increases in sales and productivity. The danger is that who knows if Mega is even going to be in existence by 1996 and on.

Each of you will have to decide for yourself if you want to go in on this suit. They want to know as soon as possible so they can get going. Duane wants to confine the suit to ~~xxxxx~~ one clause in question and thinks it would only cost 50,000. Barry says if it goes to trial it will cost twice that. Barry thinks we should even enlarge the suit to include the limitation Mega put on outside sales, which prevents us from getting another milestone.

Several of the stockholders have already given their go ahead. Dick stratford's family has not committed. Dick has become not so acute as he used to be, so that family will have to have an OK from some one besides the father.

David says there is no doubt that the clause is ambiguous to say the least. Duane admits it. But says that the clear intent is that there would be a yearly payment. He says that one of the stock holders has another "previous" ^{document} to the final agreement, which shows that that was the intent, and the lawyer who drew up the agreement will testify that that was the intent. Larry Holman.

If Dad does not want to go along with this, I will not push him. Duane suggests that we have a family spokesman. Since Barry's firm is going to be representing us, maybe Barry would not mind being the spokesman for our family. But that is up to all of you to decide.

Barry thinks that the "little stockholders against the Big bad wolf Corporation" would make a jury lean towards us. Especially when they see all 33 grandchildren and 7 children and spouses lined up in the audience with mission and school funds in jeopardy. for all those innercent little lambs.

Mom

To: **The former shareholders of Megadiamond**

You recently received a letter from Gene Myers in which he gave Smith's interpretation of one payment clause in the acquisition agreement. According to this interpretation no payments are due this year. In fact, as the attached schedule shows, the next payment would not be made until about 1995.

However, the above is an incorrect interpretation of the agreement. As, negotiated, the agreement called for a payment to be made every year until all obligations are paid off.

Some of the shareholders feel so strongly on this issue that they have selected an attorney to help in further discussions with Smith. The attorney has requested a meeting with Smith for further discussion of the issue but it is anticipated that Smith will not respond. Therefore, it is highly probable that a suit will be brought within a few weeks. Utah law covers the agreement, a federal court will have jurisdiction and a jury trial will be appropriate. If suit is filed, costs are expected to be relatively small, being less than \$50,000. Only those who become plaintiffs of record and who share costs and risks will be included in any judgement or settlement.

The dispute would be resolved by the jury first examining paragraph "f" in the final agreement. If the clause were considered to be clear, no other evidence would be examined. If the jury found it unclear, other documents and testimony would be used to determine the intent of the clause. Earlier documents and the testimony of the participants would then become critical.

The number of related documents that have been unearthed thus far is relatively small and copies of the critical pages are enclosed. Only one of the original participants, who was a shareholder, has significant recollection and he does not support Smith's position.

You should evaluate the information presented in this document. Then, select a course of action for yourself and decide if you wish to become a plaintiff and act in concert with others. If so, it would probably be best for each family group to select a spokesman. Then, these spokesmen might jointly select someone who will be responsible for interacting with the lawyer and participating in negotiations. It would be very expensive and cumbersome for all shareholders to participate directly in the legal aspects and the negotiations. Those who are in active opposition to Smith's position intend to press forward vigorously with a minimum of delay. Therefore, you might want to respond promptly.

Percentage milestone payments to former shareholders and employees based on an estimated sales volume of \$ 10,000,000 per year from Megadiamond to Smith.

	As Negotiated	Smith Interpretation
1987	0	0
1988	\$ 500,000	0
1989	500,000	0
1990	500,000	0
1991	500,000	0
1992	500,000	0
1993	500,000	0
1994	500,000	0
1995	500,000	\$500,000
1996	0	500,000
1997	0	500,000
1998	0	500,000
1999	0	500,000
2000	0	500,000
2001	0	500,000
2002	0	500,000
Net	4,000,000	4,000,000
Present value based on 10% interest rate	2,850,000	1,360,000

CONFIDENTIAL

SMITH TOOL
Newport Beach, California

August 17, 1984

Dr. Duane Horton
President, Megadiamond Industries, Inc.
275 West 2230 North
Provo, Utah 84604

Re: LETTER OF INTENT BETWEEN SMITH TOOL, A DIVISION
OF SMITH INTERNATIONAL INC. AND MEGADIAMOND
CORPORATION

Dear Duane:

This letter confirms that Megadiamond Industries Inc. ("Seller") has reached a general understanding with Smith Tool a division of Smith International Inc. ("Buyer") as to the essential features of a proposed acquisition of Megadiamond Industries Inc. Whether the purchase is an entity or asset transaction, there is no asset or liability to be excluded. This would include all patents and all rock drilling technology discussed with the Buyer. Subject to the preparation, execution and performance of a definitive written agreement containing such mutual covenants in agreements of both parties and such other terms, conditions, covenants, representations and warranties that either party in good faith may require, we have agreed in principle to the following general terms:

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I. Price and Terms.

1. Purchase. On the date to be agreed upon (the closing date) which we will attempt to have occur before October 22, 1984. The Buyer will purchase the Shares from the Seller and the Seller will sell and transfer the Shares to the Buyer.

2. Price.

a. The purchase price ("Purchase Price") of the Shares shall be established as up to \$11,000,000 assuming the company achieves the "Milestones" set forth in 2c below.

b. Method of payment will be cash or stock to be determined later. The Buyer recognizes the Seller's goal of achieving capital gains or a tax-free exchange.

c. Terms and Schedule:

(1) Three million dollars up front.

(2) The following milestones have been established:

Milestone #1: Two million dollars when diamond enhanced inserts are used in a standard product of Smith Tool or else when the cumulative sale of enhanced inserts to Smith Tool is \$1,000,000 with the inserts transferred at fair market price.

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Milestone #2: One million dollars when diamond hard facings are used on a standard Smith Tool Product or else when there is a cumulative sale of diamond, at fair market value, from Megadiamond to Smith Tool of \$100,000.

Milestone #3: One and one-half million dollars when diamond bearings are used in a standard Smith Tool Product or else when cumulative sales of diamond bearing blanks, transferred at fair market value, from Megadiamond to Smith Tool shall reach \$300,000.

Milestone #4: One and one-half million dollars when the sale of External Products by Megadiamond reaches yet to be specified goals, similar in difficulty of accomplishment, to those above.

Progress payments will be credited against Milestone payments based on all Megadiamond sales to all divisions of Smith International. Five percent of each annual years sales will be paid up to a cumulative amount of \$6,000,000. Based on mutual

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agreement of the two parties, substitute Milestones may be used in the future.

- (3) In addition, up to two million dollars in "Upside Performance Payment" will be paid based on a trigger yet to be identified but which is related to total sales on some other trigger point by the Seller.

3. SII/Smith Tool Commitments.

- (a) Buyer will commit the necessary personnel and funding to an agreed-upon Research and Development and Product Development Plan necessary to permit fair evaluation of the identified high proprietary projects defined under Milestones 1, 2, and 3 in 2c above.
- (b) Buyer will commit the necessary personnel and funding commitment to evaluate the business potential of the external markets. This would commitment include the necessary research and development, product development and feasibility studies to determine the market potential of Megagrit CBN and tooling Product Lines but would not include additional capital funding for presses. It is also recognized that Milestone 4 dealing with external markets could be adjusted

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as mutually agreed to by both parties once the External Products Business Plan has been developed.

4. Additional Terms.

The final purchase agreement will also be subject to the following:

- (a) The contents of the purchase agreement must be approved Boards of Directors of both companies. Accordingly this letter is not binding on either party and is subject to final negotiation.
- (b) Normal representations and warrants in the purchase document.
- (c) Successful negotiation of an agreement with Cogema.
- (d) The completion of a patent search by the Buyer.
- (e) Negotiation and a reaffirmation of the Tracy Hall Sr. Royalty Agreement with Megadiamond Industries Inc.

5. Organization.

- (a) The Buyer agrees to continue to operate Megadiamond as a separate entity during the time of the purchase program described above.
- (b) Employment agreements will be developed with key Megadiamond personnel.

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We look forward to successfully concluding this agreement
and to the mutual success of this venture.

Yours very truly,
SMITH TOOL COMPANY

Don Thomas
President

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SEMI-FINAL AGREEMENT

(ii) From and after the Effective Date of the Merger, each officer of Megadiamond immediately prior to the Effective Date of the Merger shall be an officer of the Surviving Corporation in the same capacity or capacities, until his successor is elected and qualified or until his earlier death, resignation or removal.

ARTICLE THREE

CONVEYANCE; CONSIDERATION THEREFOR AND RELATED MATTERS

3.1. At the Effective Date of the Merger, any shares of stock of Megadiamond issued and outstanding or held in the treasury of Megadiamond shall be cancelled. At the Effective Date of the Merger and thereafter, each holder of any certificate representing shares of stock outstanding immediately prior to the Merger shall surrender such certificate, duly endorsed, to SMI, and the holder thereof shall be entitled, upon such surrender and upon the completion and signature of a shareholder questionnaire to be furnished to each such holder and, where appropriate, acknowledgment of shareholder's purchaser representative, to receive the payments provided for in Section 3.2. The shareholder questionnaire and acknowledgment shall be in a form and substance satisfactory to Smith in its sole determination. Until surrendered in accordance with the provisions of this Section 3.1, the certificate or certificates which immediately prior to the Effective Date of the Merger represented issued and outstanding shares of stock of Megadiamond shall represent for all purposes the right to receive the payments provided for in Section 3.2.

3.2. Subject to the terms and conditions set forth in this agreement, Smith and SMI agree to pay the shareholders of Megadiamond the sum of \$10,175,000 at the times, in the manner, and subject to the conditions as follows:

(i) On the Closing Date, pro rata to their respective share ownership of Megadiamond, the sum of \$2,793,750 subject to the provisions of Article Fourteen below.

(ii) Following the Closing Date, Smith shall pay, or cause to be paid to the shareholders of Megadiamond, the sum of \$7,400,000, at the times and subject to satisfaction of the conditions specified below (each separate condition being referred to as a "Milestone" and the payment with respect to a Milestone being referred to as a "Milestone Payment"):

(a) A Milestone Payment in the amount of \$1,850,000 shall be payable if either of the following two conditions, constituting one Milestone, is reached on or before December 31, 1990:

(1) When any production engineering order (hereinafter "EO") is issued by the manufacturing

department of Smith Tool Division, a Division of Smith ("Smith Tool"), incorporating any tungsten carbide insert which is enhanced by Megadiamond technology (the "TCI Enhanced Inserts") in a drill bit which has appeared as one of the top 20 drill bits in Smith Tool's most recent "Quarterly Top 50 Products" listing; or

paid?
(2) Megadiamond makes cumulative deliveries of 20,000 TCI Enhanced Inserts to Smith Tool.

(b) A Milestone Payment in the amount of \$925,000 shall be payable if either of the following two conditions, constituting one Milestone, is reached on or before December 31, 1990:

(1) When any EO is issued by the manufacturing department of Smith Tool incorporating any hardfacing material developed through Megadiamond technology into a premium "journal bearing" type drill bit which has appeared as one of the top 20 drill bits in Smith Tool's most recent "Quarterly Top 50 Products" listing; or

(2) Megadiamond makes cumulative gross sales, deliveries or transfers of \$100,000 worth of hardfacing material developed through Megadiamond technology ("Hardfacing Material") to Smith Tool. The foregoing shall be considered to be reached upon the delivery to Smith Tool of the Hardfacing Material resulting in the required volume of sales, deliveries or transfers.

(c) A Milestone Payment in the amount of \$1,850,000 shall be payable if either of the following two conditions, constituting one Milestone, is reached on or before December 31, 1990:

(1) When any EO is issued by the manufacturing department of Smith Tool incorporating any hardfacing bearing material developed through Megadiamond technology in the main bearing in a premium "journal bearing" type drill bit which has appeared as one of the top 20 drill bits in Smith Tool's most recent "Quarterly Top 50 Products Listing"; or

(2) Megadiamond makes cumulative gross sales, deliveries or transfers of \$300,000 worth of hardfacing bearing material developed through Megadiamond Technology ("Hardfacing Bearing Material")

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to Smith Tool. The foregoing shall be considered to be reached upon the delivery to Smith Tool of the Hardfacing Bearing Material resulting in the required volume of sales, deliveries or transfers.

(d) A Milestone Payment in the amount of \$925,000 shall be payable if, for any calendar year (ending on or before December 31, 1990) the contribution margin from Megadiamond's sales, excluding sales of products which are incorporated in any of the Smith drilling products, equals or exceeds the contribution margin for Megadiamond's fiscal year ending April 30, 1984, and sales by Megadiamond for such calendar year (including sales to entities related to the parties hereto but excluding sales of products which are incorporated in any of the Smith drilling products) exceed \$5,000,000. The contribution margin as of April 30, 1984 was 53% and any future contribution margin shall be determined by the same method as used in determining the contribution margin at April 30, 1984 as set forth in Exhibit 3.2(ii)(d). The foregoing shall be considered to be reached as of the last day of the applicable calendar year regardless of when the actual calculations are completed.

(e) A Milestone Payment in the amount of \$1,850,000 shall be payable if either of the following two conditions, constituting one Milestone, is reached:

(1) Any three of the above-described Milestones are reached within a period of five years after December 31, 1984; or

(2) Annual sales for a calendar year (including sales to entities related to the parties hereto) exceed \$10,000,000 for any of the five years following the year ending December 31, 1984.

(f) A milestone payment in the amount of up to \$5,550,000 shall be payable, such amount to be based upon 5% of Megadiamond's sales, deliveries and transfers to Smith Tool and the other divisions of Smith. The foregoing shall be payable for each calendar year (ending on or before December 31, 1990). The amounts payable under this Section 3.2(f) shall be reduced by any payments made under Sections 3.2(a) - (e) and further amounts that may become payable under Sections 3.2(a) - (e) after payments have been made under this Section 3.2(f) shall be reduced by the net amounts paid under this Section 3.2(f) such that the total amounts that may be payable under Sections 3.2(a) - (f) will not exceed \$7,400,000.

FINAL AGREEMENT

(ii) From and after the Effective Date of the Merger, each officer of Megadiamond immediately prior to the Effective Date of the Merger shall be an officer of the Surviving Corporation in the same capacity or capacities, until his successor is elected and qualified or until his earlier death, resignation or removal.

ARTICLE THREE

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3.1. At the Effective Date of the Merger, any shares of stock of Megadiamond issued and outstanding or held in the treasury of Megadiamond shall be cancelled. At the Effective Date of the Merger and thereafter, each holder of any certificate representing shares of stock outstanding immediately prior to the Merger shall surrender such certificate, duly endorsed, to SMI, and the holder thereof shall be entitled, upon such surrender and upon the completion and signature of a shareholder questionnaire to be furnished to each such holder and, where appropriate, acknowledgment of shareholder's purchaser representative, to receive the payments provided for in Section 3.2. The shareholder questionnaire and acknowledgment shall be in a form and substance satisfactory to Smith in its sole determination. Until surrendered in accordance with the provisions of this Section 3.1, the certificate or certificates which immediately prior to the Effective Date of the Merger represented issued and outstanding shares of stock of Megadiamond shall represent for all purposes the right to receive the payments provided for in Section 3.2.

3.2. Subject to the terms and conditions set forth in this agreement, Smith and SMI agree to pay the shareholders of Megadiamond the sum of \$10,204,100 at the times, in the manner, and subject to the conditions as follows:

(i) On the Closing Date, pro rata to their respective share ownership of Megadiamond, the sum of \$2,804,100 subject to the provisions of Article Fourteen below.

(ii) Following the Closing Date, Smith shall pay, or cause to be paid to the shareholders of Megadiamond, the sum of \$7,400,000, at the times and subject to satisfaction of the conditions specified below (each separate condition being referred to as a "Milestone" and the payment with respect to a Milestone being referred to as a "Milestone Payment"):

(a) A Milestone Payment in the amount of \$1,850,000 shall be payable if either of the following two conditions, constituting one Milestone, is reached on or before December 31, 1990:

(1) When any production engineering order (hereinafter "EO") is issued by the manufacturing

department of Smith Tool Division, a Division of Smith ("Smith Tool"), incorporating any tungsten carbide insert which is enhanced by Megadiamond technology (the "TCI Enhanced Inserts") in a drill bit which has appeared as one of the top 20 drill bits in Smith Tool's most recent "Quarterly Top 50 Products" listing; or

(2) Megadiamond makes cumulative deliveries of 20,000 TCI Enhanced Inserts to Smith Tool.

(b) A Milestone Payment in the amount of \$925,000 shall be payable if either of the following two conditions, constituting one Milestone, is reached on or before December 31, 1990:

(1) When any EO is issued by the manufacturing department of Smith Tool incorporating any hardfacing material developed through Megadiamond technology into a premium "journal bearing" type drill bit which has appeared as one of the top 20 drill bits in Smith Tool's most recent "Quarterly Top 50 Products" listing; or

(2) Megadiamond makes cumulative gross sales, deliveries or transfers of \$100,000 worth of hardfacing material developed through Megadiamond technology ("Hardfacing Material") to Smith Tool. The foregoing shall be considered to be reached upon the delivery to Smith Tool of the Hardfacing Material resulting in the required volume of sales, deliveries or transfers.

(c) A Milestone Payment in the amount of \$1,850,000 shall be payable if either of the following two conditions, constituting one Milestone, is reached on or before December 31, 1990:

(1) When any EO is issued by the manufacturing department of Smith Tool incorporating any hardfacing bearing material developed through Megadiamond technology in the main bearing in a premium "journal bearing" type drill bit which has appeared as one of the top 20 drill bits in Smith Tool's most recent "Quarterly Top 50 Products Listing"; or

(2) Megadiamond makes cumulative gross sales, deliveries or transfers of \$300,000 worth of hardfacing bearing material developed through Megadiamond Technology ("Hardfacing Bearing Material")

to Smith Tool. The foregoing shall be considered to be reached upon the delivery to Smith Tool of the Hardfacing Bearing Material resulting in the required volume of sales, deliveries or transfers.

(d) A Milestone Payment in the amount of \$925,000 shall be payable if, for any calendar year (ending on or before December 31, 1990) the contribution margin from Megadiamond's sales, excluding sales of products which are incorporated in any of the Smith drilling products, equals or exceeds the contribution margin for Megadiamond's fiscal year ending April 30, 1984, and sales by Megadiamond for such calendar year (including sales to entities related to the parties hereto but excluding sales of products which are incorporated in any of the Smith drilling products) exceed \$5,000,000. The contribution margin as of April 30, 1984 was 53% and any future contribution margin shall be determined by the same method as used in determining the contribution margin at April 30, 1984 as set forth in Exhibit 3.2(ii)(d). The foregoing shall be considered to be reached as of the last day of the applicable calendar year regardless of when the actual calculations are completed.

(e) A Milestone Payment in the amount of \$1,850,000 shall be payable if either of the following two conditions, constituting one Milestone, is reached:

(1) Any three of the above-described Milestones are reached within a period of five years after December 31, 1984; or

(2) Annual sales for a calendar year (including sales to entities related to the parties hereto) exceed \$10,000,000 for any of the five years following the year ending December 31, 1984.

(f) A Milestone Payment shall be payable for each calendar year ending on or after December 31, 1985, in an amount equal to 4.625% of Megadiamond's sales, deliveries and transfers to Smith and entities related to Smith, provided, however, that payments under this Section 3.2(ii)(f) shall not exceed in the aggregate \$5,550,000, and, provided further, that any amounts payable under this Section 3.2(ii)(f) for any calendar year shall not exceed an amount equal to the aggregate of amounts paid or payable under this Section 3.2(ii)(f) less the aggregate of amounts paid or payable under Sections 3.2(ii)(a) - (e).

(g) In computing the sales, deliveries or transfers from Megadiamond to Smith Tool and, with respect

to Section 3.2(ii)(f), to the other divisions of Smith, the transfer price shall be determined by multiplying the product cost by a mark-up factor of three. Such computation shall not include materials which are rejected by Smith Tool or any other division of Smith for failure to meet specifications. For purposes of the foregoing, the product cost shall in each case be determined by reference to the "cost of product sold," or other equivalent reference, as presently reflected in the statement of operations set forth in Megadiamond's financial statements.

(h) Any sums due to the shareholders under this Section 3.2 as a Milestone Payment, shall become due and payable 30 days after reaching the applicable Milestone, except the Milestone Payments under Sections 3.2(ii)(d) and 3.2(ii)(f) shall be due 90 days after reaching the applicable Milestones. Any Milestone Payments not paid within 60 days after the due date thereof shall bear interest from such payment due date at the rate of 12% per annum until paid.

(i) Notwithstanding anything elsewhere in this Section 3.2, the aggregate of amounts payable under Sections 3.2(ii)(a) - (f) shall not exceed \$7,400,000; and, provided further, any amounts otherwise payable under Sections 3.2(ii)(a) - (e) during any particular year shall not exceed an amount equal to the aggregate of amounts paid or payable under Sections 3.2(ii)(a) - (e) less the aggregate of amounts paid or payable under Section 3.2(ii)(f). *sum*

(j) Notwithstanding anything elsewhere in this Section 3.2, in the event any payment to be made under this agreement would otherwise be subject to the imputed interest rules of Section 483 of the Internal Revenue Code of 1954, as amended (the "Code"), or the original issue discount rules of Section 1274 of the Code, or any section of the Code that would otherwise be applicable with similar effect, a portion of such payment shall be treated as interest for federal income tax purposes. The amount to be so treated as interest shall be the minimum amount necessary to make Sections 483 or 1274 of the Code, or such other section of the Code which would require some portion of the payment be treated as interest for federal income tax purposes, not applicable to such payment. Nothing herein shall be construed to require an increase in any amount to be paid hereunder.

(iii) For purposes of this Section 3.2, Megadiamond shall include any successor division or entity of Smith or Smith Tool (presently contemplated to be SMI) maintained for the

purpose of carrying on the business of Megadiamond as conducted prior to the Closing Date.

(iv) All payments provided for in this Section 3.2 shall be made by certified or cashier's check, and, unless delivered in person to a shareholder, shall be delivered as provided for the giving of notices pursuant to Article Twenty.

ARTICLE FOUR CERTAIN EFFECTS OF MERGER

4.1. On and after the Effective Date of the Merger, the Surviving Corporation shall thereupon and thereafter possess all the rights and privileges, powers and franchises, of a public as well as of a private nature, and be subject to all the restrictions, disabilities and duties of each of Megadiamond and SMI; and all and singular, the rights, privileges, powers and franchises of each of Megadiamond and SMI, and all property, real, personal and mixed, and all debts due to either Megadiamond and SMI on whatever account, as well as all choses in action and all and every other interest of or belonging to or due to each of Megadiamond and SMI shall be vested in the Surviving Corporation and all property, rights, privileges, powers and franchises, and all and every other interest shall be thereafter the property of the Surviving Corporation as they were of Megadiamond or SMI and the title to any real estate vested by deed or otherwise, in either Megadiamond or SMI, shall not revert or be in any way impaired by reason of the Merger; but all rights of creditors and all liens upon any property of either of Megadiamond or SMI shall be preserved unimpaired, and all debts, liabilities and duties of Megadiamond or SMI shall thenceforth attach to the Surviving Corporation, and may be enforced against it to the same extent as if said debts, liabilities and duties had been incurred or contracted by it.

4.2. If at any time after the Effective Date of the Merger the Surviving Corporation shall consider or be advised that any further deeds, assignments or assurances in law or in any other things are necessary, desirable or proper to vest, perfect or confirm, of record or otherwise, in the Surviving Corporation, the title to any property or rights of Megadiamond acquired or to be acquired by reason of, or as a result of, the Merger, Megadiamond agrees to execute and deliver all such proper deeds, assignments and assurances in law and do all things necessary, desirable or proper to vest, perfect or confirm title to such property or rights in the Surviving Corporation and otherwise to carry out the purpose of this agreement, and that the proper officers and directors of Megadiamond and the proper officers and directors of the Surviving Corporation are fully authorized in the name of Megadiamond or otherwise to take any and all such action.