Hall/Mega Arbitration Jan.11, 1988

July 6, 1987 Denial of breach of contract and counterclaim against Dr. H. Tracy Hall. Demands repayment of most of royalties Megadiamond has paid to Hall. Reason stated is that royalties have been erroneously paid.

Rebuttal: How could royalties have possibly been erroneously paid over a period extending from 1969 through 1986 (17 years)? Certainly, bookkeepers, accountants, comptrollers, auditors and other officials and representatives of the company would have picked up such an "error".

There was no error! Actually, the precedent of continuous payment of royalties on all PCDs sold by Mega over this long period of time establishes the original intent as well as the intent of the "Patent Sales Agreement" (PSA); namely, royalties are due on any and all polycrystalline diamond products (PCDs) sold by Mega.

Another claim was that "no products within the scope of the inventions of the PSA have been sold by Mega in recent years".

Rebuttal: Mr. Seibel is putting words into the PSA that do not exist in an attempt to limit its meaning. Within the scope of the inventions is a phrase that would do this, but such a phrase simply does not appear in the language of the PSA. The PSA does not put limiting conditions on the subject Inventions; it expands them. This is achieved by use of a number of modifying phrases that clearly indicate that royalties are to be paid on any and all products that Mega manufactures and sells.
The PSA requires that royalties are to be paid on:

(a) improvements appertaining thereto (of said inventions)
(b) improvements (on said inventions)
(c) future improvements (on said inventions)
(d) on any and all products manufactured and sold by Megadiamond

Royalties are also due under the following circumstances:
(e) if the subject inventions are used in any way in the manufacturing processes
(f) if Mega uses the said Invention in the manufacture of any of its products
(g) if Mega shall use said Invention in any way whatsoever.
(h) if thereunto relating or in any way pertaining (to the Inventions of the PSA)

Furthermore, other documents indicate that royalty must be paid on all PCD products that Mega sells. When a company reorganization takes place such as a sale, merger or other action that requires ratification by the stockholders, the company has a responsibility to inform the shareholders of such things as its assets, liabilities, commitments, obligations, etc. The Smith-Mega Merger Agreement does that and states the following concerning Tracy's royalties.

(a) Page 61: " Megadiamond has purchased certain technology and inventions from H. Tracy Hall, Sr., pursuant to a patent sales agreement (PSA) dated December 2, 1970. The patent sales agreement provides that Megadiamond is obligated to pay Mr. Hall a royalty of two percent of the net sales of all products sold by Megadiamond **relating to** the patents and technology that it purchased from Mr. Hall. Note the phrase "relating to the patents and technology purchased from Mr. Hall". It definitely does not say, falling within the scope of the two Inventions sold in the PSA"

(b) Page 111: "I. COMMITMENTS The company has an agreement with one of its stockholders (H. Tracy Hall) which requires a royalty payment of $1,500 per month through December 1986. The company has also agreed to pay this stockholder 2% on sales of certain types of products (on PCDs but not on diamond grit) in exchange for the use of patent applications and rights. This agreement expires December 2, 1990. The company paid royalties to this stockholder of approximately $35,000 and $26,000 during the years ended April 30, 1984 and 1983, respectively."

The $1,500 per month royalty came into being when Art Frigo became president of Mega in 1978. He and other company officials wanted Tracy to become an employee of Mega but Tracy declined. Mega was very desirous of obtaining Tracy's press technology (press design and construction were not a part of Mega's business). So Mega offered him an improved royalty position in exchange for use of his detailed press designs which included such features as "right and left hand threaded tie bars", "anvil guide retraction", and "inverted ram". The improved royalty position included a flat $1500.00 per month royalty in addition to the 2% royalty on sales already in place. Additionally, the 2% royalty would be paid monthly instead of biannually. Reassurance was also given that all PCDs were subject to the 2% royalty on sales.

(c) Page 124: "I. COMMITMENTS The Company has an ongoing agreement with one of its stockholders (H. Tracy Hall) which requires a royalty payment of 2% on sales of certain types of products (PCDs) in exchange for the use of patent applications and rights. The term of the agreement is 20 years, expiring December 2, 1990. The Company paid royalties to this stockholder of approximately $26,000 in each of the years ended April 30, 1983 and 1982.

Another document stating the fact that royalties are due on any and all PCDs sold by Mega is found in the Journal of David R. Hall, page 38 under date of January 16, 1984. At this time in Mega's history, talks with Smith International Inc. (SII) concerning a merger or "technology transfer" were beginning. Dr. M. Duane Horton was president of Mega and David R. Hall was vice president. Smith was aware of the 2% of sales royalty obligation to Tracy on all PCD sales.

David's Journal states the following: "Duane and I agreed to pay Dad on all of the polycrystalline products as we are required to under the royalty agreement until approximately 1990. We will also continue to pay the $1500 per month until the French start paying us the 5% monthly royalty at which time we pay him the 2% until 1990 on French sales of PCD product. The 2% on PCD products would be approximately 4,000 per month plus 1,500

equals $5,500 per month. He will make more from royalties than I make in salary.

If we are able to merge with a larger company who will use the products in high volume the royalties will be a growing amount and may be as high as 25,000 per month by 1990."

On October 30, 1978, certain Megadiamond mergers took place which required approval of the stockholders. Consequently, a document entitled "INFORMATION ABOUT MEGADIAMOND CORPORATION AND MEGADIAMOND INDUSTRIES, INC." was sent to the stockholders in advance of the meeting. This document invited stockholders to visit Mega's facilities and to visit with officers and the board of directors in advance of the meeting and also disclosed its financial condition and its commitments. The following commitment to Tracy appears on the first page of the document, paragraph four, third sentence and states: "Mega does have certain patents under which it has paid and will be required to pay to H. Tracy Hall the amount of 2% of the net sales of all sintered diamond products manufactured and sold by Mega". Note the words all sintered diamond products. Also note that this document was written about eight years after the PSA. This is additional evidence of what Duane, Bill, and Tracy had always understood since April of 1969. Royalty is due on all PCD sales.

Testimony:
(a) Dr. Bill J. Pope, a founder and former president of Mega, will testify that a 2% royalty is due Tracy on any and all sales of PCD products irrespective of type, style, variety, or other considerations whatsoever.
(b) David R. Hall, former vice president of Mega will testify likewise.
(c) Dr. M. Duane Horton may testify contrariwise. He was the person who, as president of Mega, terminated Tracy's royalties without notice or explanation. It is possible that Duane's action was prompted by Tracy's efforts to have him replaced as president of Mega.

August 26, 1987 Raises issue of Tracy's rights in technology and inventions he conveyed to Megadiamond. He alleges that Tracy does not own the inventions conveyed to Mega because of "his fiduciary responsibilities" to Mega. Tracy served as president of Mega in name only.

Bill J. Pope and M. Duane Horton were responsible for the company's management. Tracy's name as president was used to promote the company's interest in view of his international reputation.

Mega did not have any resources or equipment for Tracy to use. Tracy used his own time and personal HP/HT machines and other resources to develop PCD technology. Tracy worked for Mega at least 2000 hours in its early formative years without any compensation whatever. As a matter of fact, he did many unselfish things to keep Mega alive. For example, he sold 26.5% of Mega's outstanding stock, which he owned, for $1.00. That block of stock is worth $2 million today. He invented and gave Mega its first saleable product, a nickel-manganese (Ni-Mn) catalyzed diamond grit. He loaned Mega his personally owned 200 ton Tetrahedral Press and also his 200 ton Cubic Press until Mega could acquire its own. Mega had access to all of Tracy's work in the field of High Pressure/High Temperature (HP/HT) including the material accumulated in his research notebooks from 1955 until 1986.

A letter from attorney Brad Leaheey to Duane concerning Tracy's "Leached Diamond" invention confirms this. On the first page, beginning at (a) Leaheey says, "Tracy Hall developed an invention and filed an application therefor; (b) Hall made an improvement on the invention and reduced to practice the new invention but did not file an application; (c) Megadiamond purchased the rights to all of Hall's work including patents.

Mr. Seibel also suggests that Tracy's PCD inventions belong to BYU or to Research Corporation. Two waivers from BYU officials prove that this is not the case. The first letter is dated February 24, 1974 and the second is dated September 29, 1987.

Actually, the above waivers are unnecessary since the PSA in the second paragraph states, "Whereas, H. Tracy Hall <u>is the owner</u> of certain inventions listed below, etc.

Mr. Seibel also requests a plethora of documents. Lastly, in a counterclaim, he theorizes that Tracy owes Mega about $140,000 in unearned royalties.

September 11, 1987. Mr. Seibel again brings up his idea of the scope of the inventions. As previously mentioned, the word scope never appears in the PSA. It is to be expected that improvements and changes will be made on PCD materials downstream in time. The modifying phrases already given as items (a) through (h) beginning on page one of this document rebut Seibel's arguments.

Mr. Seibel makes a lot of the fact that the PSA products do not contain cobalt (Co) while Mega's current products do contain Co. This is irrelevant. The PSA inventions only have to be related to Mega's current technology or vice versa. Again, the "modifying phrases" previously discussed dictate that royalty must be paid on all PCDs sold by Mega.

Mr. Seibel again brings up the idea that some other entity may own Tracy's Inventions. He has not brought forth any evidence to support this.

Mr. Seibel theorizes that "advance royalties" were paid to Tracy. Tracy has given him copies of about 170 checks, check stubs, and bank deposit slips for all the royalties ever paid. The term advance royalty does not appear on a single document.

September 17, 1987. Mr. Seibel states that Mega destroyed the copies of Tracy's scientific journals after the US Synthetic litigation. Therefore, he wants Tracy to supply him with new copies.

September 28, 1987. Mr. Seibel supplied a list of 17 of Tracy's patents that Mega had allowed to lapse without consulting Tracy. The list was not complete inasmuch as it did not include the "Diamond Non-Diamond Carbon" patents. Note how this violates ¶ 6 of the PSA concerning good faith, diligence, best business judgement , etc.
He again raised the issue of Mega's current PCD products containing cobalt.

October 6, 1987. Mr. Seibel notes that Mega has made an offer to settle the dispute (The verbal offer consisted of a $20,000.00 per year payment to Tracy for the next four years plus return of ownership of the U.S. patents

"Method For Sintering Diamond Particles", "Diamond Compact", and "Diamond Non-Diamond Carbon Polycrystalline Composites". These are the three patents (Exhibit A) licensed to the French in the $4.8 million Mega-Cogema deal.
Mega will not return ownership of the corresponding foreign patents licensed to the French.

Mr. Seibel states that if there were any previous understandings that Tracy was to receive a royalty on all polycrystalline (PCD) products that ¶12 of the PSA would negate those understandings. The second sentence of ¶12 reads, "This agreement constitutes the entire agreement between the parties and replaces any prior agreements between them. This statement applies only to the matter at hand; namely, the sale of the two PSA patent applications to Mega. It only negates the "Agreement" respecting the same two patent applications that was signed by Duane and Tracy July 1, 1987. It cannot be stretched beyond that. As has already been shown, the PSA in and of itself supports the fact that royalty is due on all PCDs that are sold. It thus agrees with Tracy's previous understandings.

What Tracy sold to Mega, 20 months before the PSA was signed, was a Business Opportunity; a "Turnkey System" of inventions, technology, and know-how that enabled Mega to be the first in the world to manufacture and sell PCD. Mega made and sold PCDs almost immediately and was in the marketplace 3 years ahead of GE. In exchange for this Business Opportunity, Tracy was to receive a royalty of 2% on all PCD products that Mega would sell.
Mr. Seibel lectures (I suppose for the benefit of the arbitrators) concerning PCD manufacture.

He also describes the manufacture of "Leached Diamond" an important invention of Tracy's that Mega failed to recognize until GE's Bovenkerk re-invented and patented it about ten years later. This violated ¶6 of the PSA. We seek $5 million ~~in damages for this~~. for Tracy's loss of sales.

Mr. Seibel also speaks again on the fact that Mega's PCDs contain cobalt and the PSA Inventions do not.

He says that Mega got its technology from GE and not from Tracy. Tracy proposed the use of Co and other catalyst metals for sintering diamond many years before the advent of any of the GE patents. Mega learned the cobalt technology from Tracy.

He again rehearses his theory on "scope of the Inventions.". As stated previously these words are not found anywhere in the PSA. They are irrelevant and have no application to the PSA. The important words that are found in the PSA are the modifying phrases already listed from (a) to (h) above.

He brings up his " unearned, advance royalty" theory again and continues to seek a refund of $144,000. He also believes that Tracy should account for, and refund, royalties erroneously paid on cobalt catalyzed material.

He suggests a settlement but gives no specifics on same.