MERCK & CO. INC.

FORM 10-K
(Annual Report)

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14. Share-Based Compensation Plans

The Company has share-based compensation plans under which employees, non-employee directors and employees of certain of the Company's equity method investees may be granted options to purchase shares of Company common stock at the fair market value at the time of grant. In addition to stock options, the Company grants performance share units ("PSUs") and restricted stock units ("RSUs") to certain management level employees. These plans were approved by the Company's shareholders.

As a result of the Merger, the Schering-Plough 2006 Stock Incentive Plan ("Schering-Plough 2006 SIP") was amended and restated. Share-based compensation instruments remain available for future grant under the Schering-Plough 2006 SIP to New Merck employees who were employees of Schering-Plough prior to the Merger. As such, there are outstanding share-based compensation instruments, as well as share-based compensation instruments available for future grant, under Old Merck and New Merck incentive plans.

Also, as a result of the Merger, certain share-based compensation instruments previously granted under the Schering-Plough 2006 SIP and other legacy Schering-Plough incentive plans were exchanged for New Merck replacement awards. Other awards related to precombination services became payable in cash. In addition, certain stock options under Schering-Plough legacy incentive plans contain a "lock-in" feature whereby an award holder can elect to receive a cash payment for those stock options at a fixed amount based on the price of Schering-Plough's common stock 60 days prior to the Merger. The liability associated with this provision was $246.4 million at December 31, 2009. Upon expiration of the exercise period associated with the "lock-in" feature, the amount was reclassified from liabilities to equity. The fair value of replacement awards attributable to precombination service was $525.2 million and is included in the calculation of consideration transferred (see Note 3). A significant portion of the legacy Schering-Plough awards vested in the opening balance sheet at the time of the Merger. Those Schering-Plough share-based compensation instruments that did not immediately vest upon completion of the Merger were exchanged for New Merck replacement awards that generally vest on the same basis as the original grants made under the Schering-Plough legacy incentive plans and will immediately vest if the employee is terminated by the Company within two years of the Merger under certain circumstances. The fair value of New Merck replacement awards attributed to postcombination services is being recognized as compensation cost subsequent to the Merger over the requisite service period of the awards.

At December 31, 2009, 134.0 million shares collectively were authorized for future grants under the Company's share-based compensation plans. Prior to the Merger, employee share-based compensation awards were settled primarily with treasury shares. Subsequent to the Merger, these awards are being settled with newly issued shares.

Employee stock options are granted to purchase shares of Company stock at the fair market value at the time of grant. These awards generally vest one-third each year over a three-year period, with a contractual term of 7-10 years. RSUs are stock awards that are granted to employees and entitle the holder to shares of common stock as the awards vest, as well as non-forfeitable dividend equivalents. The fair value of the stock option and RSU awards is determined and fixed on the grant date based on the Company's stock price. PSUs are stock awards where the ultimate number of shares issued will be contingent on the Company's performance against a pre-set objective or set of objectives. The fair value of each PSU is determined on the date of grant based on the Company's stock price. The fair value of stock option, RSU and PSU replacement awards was determined and fixed at the time of the Merger. Over the PSU performance period, the number of shares of stock that are expected to be issued will be adjusted based on the probability of achievement of a performance target and final compensation expense will be recognized

based on the ultimate number of shares issued. RSU and PSU distributions will be in shares of Company stock after the end of the vesting or performance period, generally three years, subject to the terms applicable to such awards.

Total pretax share-based compensation cost recorded in 2009, 2008 and 2007 was $415.5 million, $348.0 million and $330.2 million, respectively, with related income tax benefits of $132.4 million, $107.5 million and $104.1 million, respectively.

The Company uses the Black-Scholes option pricing model for determining the fair value of option grants. In applying this model, the Company uses both historical data and current market data to estimate the fair value of its options. The Black-Scholes model requires several assumptions including expected dividend yield, risk-free interest rate, volatility, and term of the options. The expected dividend yield is based on historical patterns of dividend payments. The risk-free rate is based on the rate at grant date of zero-coupon U.S. Treasury Notes with a term equal to the expected term of the option. Expected volatility is estimated using a blend of historical and implied volatility. The historical component is based on historical monthly price changes. The implied volatility is obtained from market data on the Company's traded options. The expected life represents the expected amount of time that options granted are expected to be outstanding, based on historical and forecasted exercise behavior.

The weighted average fair value of options granted in 2009, 2008 and 2007 was $4.02, $9.80 and $9.51 per option, respectively, and were determined using the following assumptions:

Years Ended December 31	**2009**	2008	2007
Expected dividend yield	**6.3%**	3.5%	3.4%
Risk-free interest rate	**2.2%**	2.7%	4.4%
Expected volatility	**33.8%**	31.0%	24.6%
Expected life (years)	**6.1**	6.1	5.7

Summarized information relative to stock option plan activity (options in thousands) is as follows:

	Number of Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Balance as of January 1, 2009	247,651.3	$ 51.50		
Granted	**34,279.2**	**24.31**		
Replacement awards	**66,611.8**	**28.23**		
Exercised	**(8,548.1)**	**21.80**		
Forfeited	**(26,139.4)**	**68.10**		
Outstanding as of December 31, 2009	**313,854.8**	**$ 43.02**	**4.95**	**$ 1,102.7**
Exercisable as of December 31, 2009	**235,353.6**	**$ 46.48**	**3.90**	**$ 531.4**

Additional information pertaining to stock option plans is provided in the table below:

Years Ended December 31	**2009**	2008	2007
Total intrinsic value of stock options exercised	**$119.1**	$ 40.3	$301.2
Fair value of stock options vested [(1)]	**$311.2**	$259.0	$251.1
Cash received from the exercise of stock options	**$186.4**	$102.3	$898.6

[(1)] *The fair value of stock options vested excludes the fair value of options that vested as a result of the Merger attributable to precombination service.*

A summary of nonvested RSU and PSU activity (shares in thousands) is as follows:

	RSUs		PSUs	
	Number of Shares	Weighted Average Grant Date Fair Value	Number of Shares	Weighted Average Grant Date Fair Value
Nonvested as of January 1, 2009	6,292.2	$ 39.41	1,621.4	$ 41.86
Granted	**2,818.5**	**26.78**	**726.4**	**24.20**
Replacement awards	**8,105.6**	**30.67**	**2,049.9**	**30.67**
Vested	**(1,896.6)**	**34.18**	**(1,063.7)**	**32.10**
Forfeited	**(201.0)**	**36.81**	**(1,011.4)**	**31.46**
Nonvested at December 31, 2009	**15,118.7**	**$ 33.06**	**2,322.6**	**$ 35.46**

At December 31, 2009, there was $521.8 million of total pretax unrecognized compensation expense related to nonvested stock options, RSU and PSU awards which will be recognized over a weighted average period of 1.5 years. For segment reporting, share-based compensation costs are unallocated expenses.

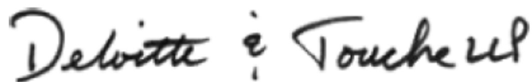
The Partners of the Merck/Schering-Plough Cholesterol Partnership

We have audited the accompanying combined balance sheet of the Merck/Schering-Plough Cholesterol Partnership (the "Partnership") as of December 31, 2008, as described in Note 1, and the related combined statements of net sales and contractual expenses, partners' capital (deficit) and cash flows, as described in Note 1, for each of the two years in the period ended December 31, 2008. These financial statements are the responsibility of the management of the Partnership, Merck & Co., Inc., and Schering-Plough Corporation. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards as established by the Auditing Standards Board (United States) and in accordance with the auditing standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Partnership is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Partnership's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

The accompanying statements were prepared for the purpose of complying with certain rules and regulations of the Securities and Exchange Commission and, as described in Note 1, are not intended to be a complete presentation of the financial position, results of operations or cash flows of all the activities of a stand-alone pharmaceutical company involved in the discovery, development, manufacture, distribution and marketing of pharmaceutical products.

In our opinion, the financial statements referred to above present fairly, in all material respects, the combined financial position of the Merck/Schering-Plough Cholesterol Partnership, as described in Note 1, as of December 31, 2008, and the combined results of its net sales and contractual expenses and its combined cash flows, as described in Note 1, for each of the two years in the period ended December 31, 2008, in conformity with accounting principles generally accepted in the United States of America.



Deloitte & Touche LLP
Parsippany, New Jersey
February 26, 2009