FORM 10-K

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

(Mark One)

☒ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For fiscal year ended December 31, 1998

OR

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from __________ to __________

Commission File Number: 1-2346

SOUTHWESTERN BELL TELEPHONE COMPANY

Incorporated under the laws of the State of Missouri
I.R.S. Employer Identification Number 43-0529710

530 McCullough, San Antonio, Texas 78215
Telephone Number 210-821-4105

Securities registered pursuant to Section 12(b) of the Act: (See attached Schedule A)

Securities registered pursuant to Section 12(g) of the Act: None.

THE REGISTRANT, A WHOLLY-OWNED SUBSIDIARY OF SBC COMMUNICATIONS INC., MEETS THE CONDITIONS SET FORTH IN GENERAL INSTRUCTION I(1)(a) AND (b) OF FORM 10-K AND IS THEREFORE FILING THIS FORM WITH REDUCED DISCLOSURE FORMAT PURSUANT TO GENERAL INSTRUCTION I(2).

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes __X__ No _____

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [Not Applicable]

SCHEDULE A

Securities Registered Pursuant To Section 12(b) Of The Act:

Title of each Class	Name of each exchange on which registered
Seven Year 6 1/8% Notes, Due March 1, 2000	New York Stock Exchange
Eight Year 6 3/8% Notes, Due April 1, 2001	New York Stock Exchange
Twelve Year 6 5/8% Notes, Due April 1, 2005	New York Stock Exchange
Forty Year 6 7/8% Debentures, Due February 1, 2011	American Stock Exchange
Twenty-Two Year 7% Debentures, Due July 1, 2015	New York Stock Exchange
Thirty Year 7 5/8% Debentures, Due March 1, 2023	New York Stock Exchange
Thirty-Two Year 7 1/4% Debentures, Due July 15, 2025	New York Stock Exchange
Fifty Year 6 7/8% Debentures, Due March 31, 2048	New York Stock Exchange

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*Omitted pursuant to General Instruction I(2).

PART I

ITEM 1. BUSINESS

GENERAL

Southwestern Bell Telephone Company (SWBell) was incorporated in 1882 under the laws of the State of Missouri, and has its principal executive offices at 530 McCullough, San Antonio, Texas 78215 (telephone number 210-821-4105). SWBell is a wholly-owned subsidiary of SBC Communications Inc. (SBC). SWBell provides landline telecommunications services over 16 million access lines in Texas, Missouri, Oklahoma, Kansas and Arkansas (five-state area). SWBell provides local exchange services and is subject to regulation by the five state commissions and the Federal Communications Commission (FCC).

SBC was one of the original seven regional holding companies (RHCs) formed to hold AT&T Corp.'s (AT&T) local telephone companies. AT&T divested SBC, and its subsidiary SWBell, by means of a spin-off of stock to its shareowners on January 1, 1984 (divestiture). The divestiture was made pursuant to a consent decree, referred to as the Modification of Final Judgment (MFJ), issued by the United States District Court for the District of Columbia (District Court).

On February 8, 1996, the Federal Government enacted the Telecommunications Act of 1996 (Telecom Act), a major, wide-ranging amendment to the Communications Act of 1934.

By its specific terms, the Telecom Act supersedes the jurisdiction of the District Court with regard to activities occurring after the date of enactment. The FCC is given authority for all post-enactment conduct, with the District Court retaining jurisdiction of pre-enactment conduct for a five-year period. As a result of these provisions, on April 11, 1996 the District Court issued its Opinion and Order terminating the MFJ and dismissing all pending motions as moot, thereby effectively ending 13 years regulation of RHCs under the MFJ.

Additional information relating to the Telecom Act is contained in Item 7, Management's Discussion and Analysis of Results of Operations of this report under the heading "Regulatory Environment" beginning on page 13.

Business Combinations

With the completion of SBC's mergers with Pacific Telesis Group (PAC) in 1997 and with Southern New England Telecommunications Corporation in 1998, SBC began reviews of operations of SWBell, Pacific Bell, Nevada Bell and The Southern New England Telephone Company (collectively referred to as the Telephone Companies). As a result of the review and recommendations of merger teams, SBC is centralizing several key functions that will support the operations of the Telephone Companies, including network planning, strategic marketing and procurement. It is also consolidating a number of corporate-wide support activities, including research and development, information technology, financial transaction processing and real estate management. The Telephone Companies will continue as separate legal entities. These initiatives continue to result in the creation of some jobs and the elimination and realignment of others, with many of the affected employees changing job responsibilities and in some cases assuming positions in other locations. Additional information on this matter is contained in Note 2 of Notes to Financial Statements.

BUSINESS OPERATIONS

SWBell serves the nation's second most populous state, Texas, and sections of the nation's Midwest region, including 2 of the country's 10 largest metropolitan areas and 7 of the country's 50 largest metropolitan areas. SWBell offers customers an expansive range of services and products, varying by market, including: local exchange services, long distance, telecommunications equipment and enhanced services. These services and products are described more fully below.

SWBell's revenues are categorized for financial reporting purposes as local service, network access, long distance service and other.

The following table sets forth the percentage for SWBell of total operating revenues by any class of service which accounted for 10% or more of total operating revenues in any of the last three fiscal years.

	Percentage of Total Operating Revenues		
	1998	1997	1996
Local service	**50%**	50%	48%
Network access	**32%**	32%	34%

Local services involve the transport of wireline telecommunications traffic between telephones and other customer premises equipment (CPE) located within the same local service calling area. Local services include: basic local exchange service, certain extended area service, dedicated private line services for voice and special services, directory assistance and various vertical services, including custom calling services, call control options and Caller ID services.

Network access services connect a subscriber's telephone or other equipment to the transmission facilities of other carriers that provide long distance (principally interLATA) and other communications services. Network access services are either switched, which use a switched communications path between the carrier and the customer, or special, which use a direct nonswitched path.

Additionally, SWBell also provides long distance services that involve the transport of telecommunications traffic between local calling areas within the same LATA (intraLATA). Long distance services also include other services such as Wide Area Telecommunications Service (WATS or 800 services) and other special services.

SWBell provides its services over approximately 10.7 million residential and 5.6 million business access lines in the five-state area. During 1998, over two-thirds of SWBell's access line growth occurred in Texas.

Customer Premises Equipment and Other Equipment Sales

Equipment offerings at SWBell range from single-line and cordless telephones to sophisticated digital business exchange (PBX) systems, all of which can be offered with SWBell's central office based solutions. PBX is a private telephone switching system, usually located on a customer's premises, which provides intra-premise telephone services as well as access to the public switched network.

In December 1996, substantially all of the operations of Southwestern Bell Telecommunications, Inc., a wholly-owned subsidiary of SBC, which offered CPE, were moved into the operations of SWBell. The move did not and is not expected to have a significant impact on SWBell's results of operations.

New Products

As part of its continuing strategy to be among the leaders in the communications services industry, SWBell is constantly developing new services and products. It currently is introducing several new data products, including Asymmetrical Digital Subscriber Line (ADSL). ADSL enables customers to transfer over existing telephone lines, data, graphics, audio and video files at speeds up to 1.5 megabits per second. ADSL allows customers to simultaneously make a phone call and access information via the Internet or an office local area network. ADSL is the subject of a pending FCC review. Additional information relating to the pending FCC review of ADSL is contained in Item 7, Management's Discussion and Analysis of Results of Operations of this report under "Regulatory Environment" beginning on page 13.

During 1998, SWBell continued to expand its offering of vertical services throughout its operating areas. These services include, among other things, Caller ID, a feature which displays the telephone number of the person calling and the caller's name in certain markets; Caller ID Call Waiting, a feature which displays the telephone number and caller's name in certain markets when the customer is on a call; Call Return, a feature that redials the number of the last incoming call; and Call Blocker, a feature which allows customers to automatically reject calls from a designated list of telephone numbers.

Since 1996, SWBell has been offering certain local services on a "wholesale" basis to competitors, as well as providing elements of its networks on an "unbundled" basis for local competition. These services are being offered as specified by the Telecom Act and state actions and interconnection agreements. The Telecom Act and the regulations promulgated by federal and state agencies to implement it have resulted in SWBell facing increased competition in significant portions of its business. At December 31, 1998, SWBell provided wholesale services to more than 524,000 access lines. Management cannot quantify the impact to SWBell's business in 1999 from local exchange competition, as uncertainty exists as to the breadth and scope of competitors' offering of local exchange services to all portions of the market in-region, and as certain regulations, tariffs and negotiations governing such competition are not yet finalized, but expects continued increases in local exchange services competition.

Operating Segments

In June 1997, the Financial Accounting Standards Board issued Statement No. 131, "Disclosures About Segments of an Enterprise and Related Information" (FAS 131), which establishes standards for the way that public business enterprises report information about operating segments in quarterly and annual financial statements. FAS 131 changes segment reporting from an industry segment basis to an operating segment basis defined based on how the business is managed. As SWBell operates in only one of SBC's segments, wireline telecommunications services, separate segment reporting does not apply to SWBell.

GOVERNMENT REGULATION

In the five-state area, SWBell is subject to regulation by state commissions which have the power to regulate, in varying degrees, intrastate rates and services, including local, long distance and network access services. SWBell is also subject to the jurisdiction of the FCC with respect to international and interstate rates and services, including interstate access charges. Access charges are designed to compensate SWBell for the use of its facilities for the origination or termination of long distance and other communications by other carriers.

Additional information relating to federal and state regulation of SWBell is contained in Item 7, Management's Discussion and Analysis of Results of Operations of this report under the heading "Regulatory Environment" beginning on page 13.

MAJOR CUSTOMER

Approximately 9% in 1998, 11% in 1997 and 12% in 1996 of SWBell's revenues were from services provided to AT&T. No other customer accounted for more than 10% of total revenues.

COMPETITION

Information relating to competition in the telecommunications industry is contained in Item 7, Management's Discussion and Analysis of Results of Operations of this report under the heading "Competition" beginning on page 17.

Customer Premises Equipment and Other Equipment Sales

SWBell faces significant competition from numerous companies in marketing its telecommunications equipment.

RESEARCH AND DEVELOPMENT

Certain company-sponsored basic and applied research was conducted at Bell Communications Research, Inc. (Bellcore). SWBell owned a one-seventh interest in Bellcore and another affiliate of SBC owned a one-seventh interest, with the remainder owned by the other four remaining RHCs. In November 1997, the RHCs sold Bellcore to a third party but continue to have a research agreement with Bellcore. The RHCs have retained the activities of Bellcore that coordinate the Federal Government's telecommunications requirements for national security and emergency preparedness.

Applied research is also conducted at SBC Technology Resources, Inc. (TRI), a subsidiary of SBC. TRI provides research, technology planning and evaluation services to SBC and its subsidiaries, including SWBell.

EMPLOYEES

As of December 31, 1998, SWBell employed approximately 50,700 persons. Approximately three-fourths of the employees are represented by the Communications Workers of America (CWA). A new agreement between the CWA and SWBell was reached on April 7, 1998, covering an estimated 39,000 employees through April 1, 2001. Among other items, the agreement specifies an 11% increase in wages over the life of the contract.

ITEM 2. PROPERTIES

The properties of SWBell do not lend themselves to description by character and location of principal units. At December 31, 1998, network access lines represented 44% of SWBell's investment in telephone plant; central office equipment represented 40%; land and buildings represented 9%; other miscellaneous property, comprised principally of furniture and office equipment and vehicles and other work equipment, represented 6%; and information origination/termination equipment represented 1%.

ITEM 3. LEGAL PROCEEDINGS

Six putative class actions in Texas, Missouri, Oklahoma, and Kansas that involved the provision by SWBell of maintenance and trouble diagnosis services relating to telephone inside wire located on customer premises have been settled in 1998. These actions alleged that SWBell's sales practices in connection with these services violated antitrust, fraud and/or deceptive trade practices statutes. The trial court has approved the settlement, which is not expected to materially affect the financial results of SWBell.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

Omitted pursuant to General Instruction I(2).

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Not applicable.

ITEM 6. SELECTED FINANCIAL AND OPERATING DATA

At December 31, or for the year ended	**1998**	1997
Debt Ratio (debt, including current maturities, as a percentage of total capital)	**65.48%**	64.44%
Network access lines in service (000)	**16,462**	15,741
Access minutes of use (000,000)	**62,853**	59,395
Resold lines (000)	**524**	267
Number of employees	**50,700**	50,500

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS

Dollars in millions

This discussion should be read in conjunction with the financial statements and the accompanying notes.

RESULTS OF OPERATIONS

Summary

Financial results, including percentage changes from the prior year, are summarized as follows:

	1998	1997	Percent Change 1998 vs. 1997
Operating revenues	**$ 10,752**	$ 10,116	6.3%
Operating expenses	**$ 7,958**	$ 7,924	0.4%
Net income	**$ 1,527**	$ 1,187	28.6%

SWBell's net income in 1998 includes $13 of an after-tax benefit associated with an adjustment of a postemployment benefits accrual and in 1997 includes after-tax charges of $237 reflecting strategic initiatives resulting from SBC's merger with PAC, the impact of several regulatory rulings and ongoing merger initiatives during 1997, as well as a gain on the sale of SWBell's interest in Bellcore (see Note 2 of Notes to Financial Statements for further discussion of merger integration costs). Excluding these 1998 and 1997 benefit and charges, SWBell reported normalized net income of $1,514 for 1998, 6.3% higher than 1997 normalized net income of $1,424.

Excluding these items, the primary factor contributing to the increase in net income in 1998 was growth in demand for services and products.

Items affecting the comparison of the operating results between 1998 and 1997 are discussed in the following sections.

Operating Revenues

Operating revenues were $10,752 in 1998 compared with $10,116 in 1997, a 6.3% increase. Components of operating revenues including percentage changes from the prior year, are as follows:

	1998	1997	Percent Change 1998 vs. 1997
Local service	**$ 5,397**	$ 5,045	7.0%
Network access:			
Interstate	**2,305**	2,176	5.9
Intrastate	**1,095**	1,078	1.6
Long distance service	**770**	803	(4.1)
Other	**1,185**	1,014	16.9
Total	**$ 10,752**	$ 10,116	6.3%

Local Service revenues increased $352, or 7.0%, in 1998 due primarily to increases in demand totaling more than $324, including increases in access lines, vertical services, and data-related services revenues. The number of access lines increased by 4.6% since 1997, of which over two-thirds was due to growth in Texas. Approximately 30% of access line growth was due to sales of additional access lines to existing residential customers. Vertical services revenues, which include custom calling services, call control options, Caller ID and other services, increased by 14% totaling more than $950 for 1998.

Additionally, local service revenues increased as a result of regulatory actions that also had the effect of decreasing one or more types of operating revenues. In 1998, federal payphone deregulation and the introduction and deployment of extended local area service plans collectively increased local service revenues by approximately $83 and decreased long distance revenue by approximately $10 and interstate network access approximately $12. The net effect on total operating revenue for these items was an increase of nearly $69. The local service increases were partially offset by decreases of approximately $71 resulting from cellular interconnection rate reductions implemented in the third quarter of 1997.

Network Access Interstate network access revenues for 1997 reflect charges of $52 due to the adverse impacts of several regulatory issues. These issues include among other items, recovery of certain employee-related expenses and the productivity factor adjustment in the Federal price cap filing. Without these charges, total interstate network access revenues increased $77, or 3.5%, in 1998 due largely to increases in demand for access services by interexchange carriers, including special access, and growth in revenues from end-user charges attributable to an increasing access line base totaling approximately $224. Partially offsetting these increases were the effects of rate reductions of approximately $95 related to the federal productivity factor adjustment, access reform and other changes, and regulatory shifts related to payphone deregulation of approximately $12 as noted in local service. Additional decreases in 1998 totaling approximately $38 resulted from an increase in universal service fund net payments implemented in the first quarter of 1998 that exceeded the 1997 net payments of long-term support. The net federal universal fund payments and receipts will be exogenous factors in future federal price cap filings.

Intrastate network access revenues increased slightly in 1998 as increases in demand totaling approximately $38, including usage by alternative intraLATA toll carriers, were partially offset by state regulatory rate reductions totaling approximately $19.

Long Distance Service revenues decreased $33, or 4.1%, in 1998. This resulted from decreased demand and the effect of price competition from alternative intraLATA toll carriers totaling approximately $23. As discussed above under local service, long distance revenues decreased by approximately $10 due to the introduction and deployment of extended area local service plans.

Other operating revenues increased $171, or 16.9%, in 1998. Approximately $107 of this increase was due to increased demand for nonregulated services and products, including consumer equipment and network integration services. Also contributing to the increase was the repricing of maintenance and trouble diagnosis services related to inside wire located on customers' premises during 1998 of approximately $30 and an increase in state universal funds net receipts of approximately $15.

Operating Expenses

Management's Discussion and Analysis, continued
Dollars in millions

Components of operating expenses, including percentage changes from the prior year, are as follows:

	1998	1997	Percent Change 1998 vs. 1997
Operations and support	**$ 5,940**	$ 5,997	(1.0)%
Depreciation and amortization	**2,018**	1,927	4.7
Total operating expenses	**$ 7,958**	$ 7,924	0.4 %

As discussed in Note 2 of Notes to Financial Statements, SWBell's operating expenses in 1998 reflect $20 in benefits associated with an adjustment of postemployment benefits accrual and in 1997 reflect $328 of adjustments for charges related to SBC's strategic initiatives, a comprehensive review of operations of the merged company, the impact of several regulatory rulings and ongoing merger integration costs. SWBell manages its financial and business operations excluding these items and refers to these adjusted expenses as normalized operating expenses. Excluding these 1998 and 1997 adjustments, SWBell's normalized operating expenses increased $382, or 5.0%, for 1998.

Operations and Support expenses reflect $20 of a benefit in 1998 and $289 of charges in 1997 referred to above. Excluding these adjustments, normalized operations and support in 1998 were $5,960, an increase of $252, or 4.4%, over the normalized total in 1997 of $5,708.

The increase was due primarily to merger implementation costs in 1998 of approximately $178 related to progression in the merger implementation process including charges from support functions throughout SBC, and other merger initiatives. Operations and support also increased in 1998 due to increased costs associated with reciprocal compensation for the termination of Internet traffic of approximately $68. Wages, salaries and benefits increased approximately $91 and right to use fees and materials increased approximately $45. These increases were partially offset by reductions in the use of contract labor of approximately $121 and net reductions to agent commissions, research and development and customer number portability costs totaling approximately $65.

Depreciation and amortization expense for 1997 reflects one-time charges of approximately $39 for the write off of voice dial equipment that was discontinued and other adjustments. Excluding these adjustments, depreciation and amortization increased $130, or 6.9%, in 1998. The net increase was due primarily to increased depreciation expense of approximately $104 resulting from overall higher plant levels and rate variances related to the net impact of revised composite rates of depreciation of approximately $27.

Interest Expense increased $31, or 9.0%, in 1998 due primarily to higher average debt levels.

Other Income (Expense) - Net was net income of $39 in 1997 and included a gain recognized for the sale of SWBell's interest in Bellcore of $24.

Income Taxes for 1997 reflect the tax effect of charges for strategic initiatives resulting from SBC's merger with PAC, the impact of several regulatory rulings and the gain on sale of SWBell's interest in Bellcore. Excluding these items, income taxes for 1997 would have been $835. Income taxes for 1998 were higher due primarily to higher income before income taxes.

Operating Environment and Trends Of The Business

Regulatory Environment

Overview

The telecommunications industry is in a period of dynamic transition from a tightly regulated industry overseen by multiple regulatory bodies to a market-driven industry monitored by state and federal agencies. SWBell remains subject to regulation by the five-state regulatory commissions for intrastate services and by the FCC for interstate services.

Consolidation of companies is occurring within the marketplace for local telephone service and across other telecommunications services, such as long distance, cellular, cable television, Internet and other data transmission services. Companies operating in some of these markets are also expanding into others, such as the provision of local service by long distance companies. Additionally, new technologies are also affecting the way people view and use communications services.

SWBell is aggressively representing its interests before federal and state regulatory bodies, courts, Congress and state legislatures. SWBell will continue to evaluate the increasingly competitive nature of its business, and develop appropriate competitive, legislative and regulatory strategies.

Federal Regulation

Under the Telecom Act, before being permitted to offer landline interLATA long distance service in any state within the regulated operating areas, SWBell must apply for and obtain state-specific approval from the FCC. The FCC's approval, which involves consultation with the United States Department of Justice and appropriate state commissions, requires favorable determinations that SWBell has entered into interconnection agreement(s) that satisfy a 14-point "competitive checklist" with predominantly facilities-based carrier(s) that serve residential and business customers or, alternatively, that SWBell has a statement of terms and conditions effective in that state under which they offer the "competitive checklist" items. The FCC must also make favorable public interest and structural separation determinations in connection with such applications. See "State Regulation" for status of the state applications.

In December 1997, in the United States District Court for the Northern District of Texas ruled that parts of the Telecom Act were unconstitutional on the grounds that they improperly discriminate against SWBell by imposing restrictions that prohibit SWBell by name from offering interLATA long distance and other services that other Local Exchange Carriers (LECs) are free to provide. In September 1998, the United States Court of Appeals for the Fifth Circuit (5th Circuit) reversed this decision and ruled that the challenged provisions of the Telecom Act were constitutional. In January 1999, the United States Supreme Court (Supreme Court) declined to hear an appeal of the 5th Circuit's decision.

Interconnection In August 1996, the FCC issued rules by which competitors could connect with LECs' networks, including those of SWBell. Among other things, the rules addressed unbundling of network elements, pricing for interconnection and unbundled elements, and resale of retail telecommunications services. The FCC rules were appealed by numerous parties, including SBC.

In July 1997, the United States Court of Appeals for the Eighth Circuit (8th Circuit) held that the FCC did not have the authority to promulgate rules related to the pricing of local intrastate telecommunications and that its rules in that regard were invalid. The 8th Circuit also overturned the FCC's rules which allowed competitors to "pick and choose" among the terms and conditions of approved interconnection agreements. In October 1997, the 8th Circuit issued a subsequent decision clarifying that the Telecom Act does not require the incumbent LECs to deliver network elements to competitors in anything other than completely unbundled form.

In September 1997, a number of parties including SBC, filed petitions to enforce the July 1997 ruling of the 8th Circuit that the right to set local exchange prices, including the pricing methodology used, is reserved exclusively to the states. The petitions responded to the FCC's rejection of Ameritech Corporation's interLATA long distance application in Michigan in which the FCC stated it intended to apply its own pricing standards to RHC interLATA applications. The petitioners asserted the FCC was violating state authority. On January 22, 1998, the 8th Circuit ordered the FCC to abide by the July 1997 ruling and reiterated that the FCC cannot use interLATA long distance applications made by SBC and other RHC wireline subsidiaries wishing to provide interLATA long distance to attempt to re-impose the pricing standards ruled invalid in July 1997 by the 8th Circuit.

In January 1999, the Supreme Court ruled on an appeal of the 8th Circuit's order. The ruling held that the Telecom Act gives the FCC the authority to set guidelines for states to follow in setting prices under the Telecom Act, and reinstated the FCC rules allowing those seeking to interconnect to "pick and choose" specific provisions from previous interconnection agreements. Because the 8th Circuit's decision did not address the lawfulness of the content of the FCC pricing guidelines, the Supreme Court remanded that issue to the 8th Circuit for further consideration. The ruling also upheld FCC rules forbidding incumbent LECs from separating already combined network elements, but remanded back to the FCC its determination of which network elements must be made available. The Supreme Court also held that, before the FCC could require telecommunications carriers to make a particular network element available to requesting carriers, the FCC must first consider as to proprietary elements, whether access to the elements was necessary and whether the failure to provide access to a particular element would impair the requesting carrier's ability to provide the service it seeks to offer. The effect of this ruling on SWBell cannot be determined at this time.

Reciprocal Compensation Reciprocal compensation is billed to SWBell by Competitive Local Exchange Carriers (CLECs) for the termination of certain local exchange traffic to CLEC customers. Several state commissions have taken the position that Internet communications is intrastate or local traffic and ordered SWBell to pay reciprocal compensation to certain CLECs pursuant to then existing contracts. State commissions in the five-state area other than Kansas have issued orders finding that SWBell is required to pay reciprocal compensation to certain CLECs. In June 1998, a U.S. District Court in Texas affirmed the Texas Public Utility Commission's (TPUC) determination, and upheld payment of reciprocal compensation, holding that an Internet call is comprised of two portions, and that the TPUC has jurisdiction over the local portion of the traffic and the FCC over the Internet component. SWBell has sought review or reconsideration of these cases.

In February 1999, the FCC ruled that a substantial portion of Internet communications is interstate traffic and therefore subject to federal jurisdiction. The FCC noted that carriers were bound by existing interconnection contracts as interpreted by state commissions. The FCC will issue rules determining the extent, if any, such communications are subject to reciprocal compensation. The FCC also ruled that, in the context of interpreting particular interconnection agreements, the state commissions might determine that reciprocal compensation was appropriately based on the agreement of the parties or other factors. SBC believes that the FCC ruling should prevent state commissions from imposing reciprocal compensation on this traffic.

Asymmetrical Digital Subscriber Line ADSL is a high-speed data service principally used for Internet access. In June 1998, SBC filed with the FCC a petition requesting relief for ADSL from pricing, unbundling and resale regulatory restrictions. The FCC denied the petition and declared that incumbents must offer such services for resale at a discount and must offer unbundled access to the equipment used in ADSL provisioning to the extent possible. SBC has filed with the FCC a petition for reconsideration of this order. The FCC sought comments on offering the incumbent LECs the option of providing deregulated advanced services through an affiliate with appropriate safeguards.

The effects of the FCC decisions on the above topics are dependent on many factors including, but not limited to, the ultimate resolution of the pending appeals; the number and nature of competitors requesting interconnection, unbundling or resale; and the results of the state regulatory commissions' review and handling of related matters within their jurisdictions. Accordingly, SWBell is not able to assess the impact of the FCC orders and proposed rulemaking at this time.

Dollars in millions

State Regulation

The following provides an overview of state regulation in the five states in which SWBell operated at December 31, 1998.

State	Alternative Regulation [1]	Dialing Parity [2]	Number of Signed Wireline Interconnection Agreements [3]	Long Distance Application Status
Arkansas	Yes, Indefinite	Presently not required prior to long distance authorization	54	Decision Expected in 1999 [4]
Kansas	Yes, Indefinite	Commission ordered implementation by 2/1999; state statute presently prohibits requirement before long distance authorization	55	Decision Expected in 1999 [4]
Missouri	Yes, Indefinite	Proceeding pending	61	Decision Expected in 1999 [4]
Oklahoma	Yes, Ends 2/2001	Ordered by 3/1999	52	Decision Expected in 1999 [4]
Texas	Yes, Ends 9/2001	TPUC deferred its decision pending FCC issuance of new dialing parity rules; state statute presently prohibits requirement before long distance authorization	175	Decision Expected in 1999 [4]

Other significant notes:

1 Alternative regulation is other than rate of return regulation.

2 In a January 1999 decision, the Supreme Court ruled that the FCC had the authority to issue rules implementing intrastate and intraLATA dialing parity. Several interexchange carriers are arguing in pending state proceedings that the ruling requires immediate implementation of dialing parity, preempting state requirements. SWBell takes the position that dialing parity requirements should be consistent with state laws and that they should not be required to provide intraLATA toll dialing parity prior to receiving authorization to provide interLATA long distance services. In states where dialing parity exists, customers are able to subscribe to an intraLATA toll carrier just as they do for long distance services.

3 Interconnection agreements are signed with CLECs for the purpose of allowing the CLECs to exchange local calls with the incumbent telephone company.

4 Awaiting determination by state commissions on SWBell's compliance with the 14-point competitive checklist. FCC approval is required subsequent to state determination.

The following presents highlights of certain regulatory developments.

Texas Under the Public Utility Regulatory Act, which became effective in May 1995 (PURA), SWBell elected to move from rate of return regulation to price regulation with elimination of earnings sharing. Basic local service rates are capped at existing levels for four years following the election, i.e., until September 1999. The TPUC is prohibited from reducing switched access rates charged by LECs to interexchange carriers while rates are capped.

LECs electing price regulation are committed to network and infrastructure improvement goals, including expansion of digital switching and advanced high-speed services to qualifying public institutions, such as schools, libraries and hospitals, requesting the services. PURA also established an infrastructure grant fund for use by public institutions in upgrading their communications and computer technology. The 1997 Texas legislative session changed the funding for this infrastructure grant fund from annually collecting $150 for ten years to a fixed percent (1.25%) applied to all telecommunications providers' sales taxable revenues. The law also provides a cap of $1,500 for the life of the fund. SWBell's annual payments were approximately $36 in 1997 and $56 in 1998. Due to the industry's growth in revenues, the fund should be completely funded before the original ten years.

PURA establishes local exchange competition by allowing companies that desire to provide local exchange services to apply for certification by the TPUC, subject to certain build-out requirements, resale restrictions and minimum service requirements. PURA provides that SWBell will remain the default carrier of "1 plus" intraLATA long distance traffic in its territory until SWBell is allowed to carry interLATA long distance. In 1996, MCI WorldCom, Inc. (MCI WorldCom) and AT&T sued the state of Texas, alleging that PURA violates the Texas state constitution, and claiming that PURA establishes anticompetitive barriers designed to prevent MCI WorldCom, AT&T and Sprint Corporation from providing local services within Texas. The FCC, also in response to petitions filed by AT&T and MCI WorldCom, preempted and voided portions of PURA that required certain buildout requirements. Furthermore, the FCC also preempted rules that excluded competitors from entering markets with fewer than 31,000 access lines and which made resale of Centrex phone services subject to a limited property restriction. AT&T and MCI WorldCom have dismissed their suits regarding this matter. In October 1997, SWBell filed with the FCC a petition for reconsideration regarding the preemption of the property restriction for Centrex services. This issue is still pending before the FCC.

Missouri Effective September 26, 1997, the Missouri Public Service Commission (MPSC) determined that SWBell is subject to price cap regulation. Prices in effect as of December 31, 1996 are the initial maximum allowable rates for services and cannot be adjusted until January 1, 2000 for basic and access services and on January 1, 1999 for non-basic services. On an exchange basis where a competitor began operations, the freeze on maximum allowable rates for non-basic services was removed. After January 1, 2000, caps for basic and access services may be adjusted based on one of two government indices. After January 1, 1999, caps for non-basic services may be increased up to 8% per year. In an exchange where competition for basic local service exists for five years, services will be declared competitive and subject to market pricing unless the MPSC finds effective competition does not exist. The Office of Public Counsel and MCI WorldCom sought judicial review of the MPSC determination and in May 1998 the state circuit court affirmed the MPSC decision.

Competition

Competition continues to increase for telecommunication and information services. Recent changes in legislation and regulation have increased the opportunities for alternative service providers offering telecommunications services. Technological advances have expanded the types and uses of services and products available. As a result, SWBell faces increasing competition as well as new opportunities in significant portions of its business.

Recent state legislative and regulatory developments also allow increased competition for local exchange services. Companies wishing to provide competitive local service have filed numerous applications with state commissions throughout SWBell's five-state area, and the commissions of each state have been approving these applications since late 1996. Under the Telecom Act, companies seeking to interconnect to SWBell's networks and exchange local calls must enter into interconnection agreements with SWBell. These agreements are then subject to approval by the appropriate state commissions. SWBell has reached approximately 397 interconnection and resale agreements with competitive local service providers, and most have been approved by the relevant state commissions. AT&T, MCI WorldCom and other competitors are reselling SWBell's local exchange services, and as of December 31, 1998, there were more than 520,000 SWBell access lines supporting services being sold by resale competitors throughout SWBell's five-state area, most of them in Texas. Many competitors have placed facilities in service, and have begun advertising campaigns and offering services. SWBell also was granted facilities-based and resale operating authority in certain territories served by other LECs and now offers local exchange service offerings to these areas.

In Texas, the TPUC set rates in December 1997 that SWBell may charge for access and interconnection to its telephone network. The TPUC decision sets pricing for dozens of network components and completes a consolidated arbitration between SWBell and six of its wholesale customers, including AT&T and MCI WorldCom.

In Missouri, the MPSC issued orders on a consolidated arbitration hearing with AT&T and MCI WorldCom and on selected items with Metropolitan Fiber Systems. Among other terms, the orders established discount rates for resale of SWBell services and prices for unbundled network elements. SWBell appealed the interconnection agreement resulting from the first arbitration proceeding on November 5, 1997; a decision is still pending. A second arbitration process to address other interconnection issues with AT&T has concluded, and the MPSC ordered that a conforming interconnection agreement be filed. SWBell appealed this order in April 1998.

SWBell expects increased competitive pressure in 1999 and beyond from multiple providers in various markets, including facilities-based CLECs, interexchange carriers and resellers. At this time, management is unable to assess the effect of competition on SWBell, but expects both losses of market share in local service and gains resulting from new business initiatives, vertical services and new service areas. In addition, if intraLATA toll dialing parity is required, competition in intraLATA long distance markets is expected to increase.

OTHER BUSINESS MATTERS

New Accounting Standards In June 1998, the Financial Accounting Standards Board issued Statement No. 133, "Accounting for Derivative Instruments and Hedging Activities" (FAS 133), which will require all derivatives to be recorded on the balance sheet at fair value, and will require changes in the fair value of the derivatives to be recorded in net income or comprehensive income. FAS 133 must be adopted for years beginning after June 15, 1999, with earlier adoption permitted. Management is currently evaluating the impact of the change in accounting required by FAS 133, but is not able to quantify the effect at this time.

See Note 1 of Notes to Financial Statements for a discussion of the new accounting standard on software costs.

SBC's Year 2000 Project SBC and its subsidiaries and affiliates, including SWBell, operate numerous date-sensitive computer applications and systems throughout its businesses. Since 1996, SBC has been working to upgrade its networks and computer systems to properly recognize the Year 2000 and continue to process critical operational and financial information. Companywide teams are in place to address and resolve Year 2000 issues and processes are under way to evaluate and manage the risks and costs associated with preparing SBC's date-impacted systems and networks for the new millennium.

SBC is using a four-step methodology to address the issue. The methodology consists of inventory and assessment, hardware and software fixes, testing and deployment. SBC measures its progress by tracking the number of completed hardware and software applications, network components, personal computers and building facilities that can correctly process Year 2000 dates.

Inventory and assessment is estimated to require 20% of the overall effort and includes the identification of items (i.e., line-by-line review of software code, switch generics, vendor products, etc.) that could be impacted by the Year 2000 and the determination of the work effort required to ensure compliance. The inventory and assessment phase has been completed. This process involved reviewing over 340 million lines of software code, 1,200 central office switches, 7,000 company buildings, conducting an inventory and assessment of 117,000 personal computers, and coordinating with 1,300 suppliers of 14,000 products to obtain adequate assurance they will be Year 2000 compliant or determine and address any appropriate contingency plans or backup systems.

Making the hardware and software fixes is the second phase of the process and is estimated to require 25% of the overall effort. This activity involves modifying program code, upgrading computer software and upgrading or replacing hardware. As of December 31, 1998, the hardware and software fixes were substantially complete.

Testing involves ensuring that hardware and software fixes will work properly in 1999 and beyond and occurs both before and after deployment. Testing is estimated to comprise 45% of the overall effort. Testing began early in 1998, is more than two-thirds complete, and will continue through 1999 to allow for thorough testing before the Year 2000. Contingency plans and backup systems are currently being written.

Deployment involves placing the "fixed" systems into a live environment to ensure they are working properly. Additional testing is done after deployment as well. Deployment is estimated to require 10% of the overall effort. More than half of the deployment phase was completed as of December 31, 1998.

SBC expects to spend approximately $265 on the entire project, with approximately $140 spent through December 31, 1998. As testing and hardware and software fixes are estimated to require most of the expenditures, there is not a strict correlation between expenditures and project completion.

The activities involved in SBC's Year 2000 project necessarily require estimates and projections, as described above, of activities and resources that will be required in the future. These estimates and projections could change as work progresses on the project.

Dollars in millions

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market Risk

SWBell's capital costs are managed by SBC, and are directly linked to financial and business risks. SBC seeks to manage the potential negative effects from market volatility and market risk. Certain financial instruments used to obtain capital are subject to market risks from fluctuations in market interest rates. The majority of SBC's financial instruments are medium- and long-term fixed rate notes and debentures. Fluctuations in market interest rates can lead to significant fluctuations in the fair value of these notes and debentures. It is the policy of SBC to manage its debt structure and foreign exchange exposure in order to manage capital costs, control financial risks and maintain financial flexibility over the long term. Where appropriate, SBC will take actions to limit the negative effect of interest and foreign exchange rates, liquidity and counterparty risks on shareowner value.

Quantitative Information about Market Risk

Interest Rate Sensitivity

The principal amount by expected maturity, average interest rate and fair values of SWBell's liabilities that are exposed to interest rate risk are described in Notes 4 and 5 of Notes to Financial Statements. Following are SWBell's interest rate derivatives subject to interest rate risk (none of these derivatives mature in 2000 through 2003):

	Maturity			
	1999	After 2003	Total	Fair Value 12/31/98
Interest Rate Derivatives				
Interest Rate Swaps				
Receive Variable/Pay Fixed Notional Amount [1]	-	$13	$13	($1)
Fixed Rate Payable	6.7%	6.7%		
Weighted Average Variable Rate Receivable [2]	5.0%	5.5%		

Notes:
[1] Receive Variable/Pay Fixed amount offsets $13 in lease obligation due after 2003 with an average interest rate of 5.8% and a fair value of $13.
[2] Weighted Average Variable Rate Receivable based on current and the implied forward rates in the yield curve at the reporting date for One Month LIBOR.

As a result of interest rate fluctuations, if SWBell were to terminate the contracts, it would be required to pay $1 to replace the fixed rate flows or "unwind" the interest swaps.

There has been no material change in the updated market risks since December 31, 1997.

Qualitative Information about Market Risk

Interest Rate Risk

SWBell's interest rate risk is managed by SBC. SBC issues debt in fixed and floating rate instruments. Interest rate swaps are used for the purpose of controlling interest expense by fixing the interest rate of floating rate debt. When market conditions favor issuing debt in floating rate instruments, and SBC prefers not to take the risk of floating rates, SBC will enter interest rate swap contracts to obtain floating rate payments to service the debt in exchange for paying a fixed rate. SBC does not seek to make a profit from changes in interest rates. SBC manages interest rate sensitivity by measuring potential increases in interest expense that would result from a probable change in interest rates. When the potential increase in interest expense exceeds an acceptable amount, SBC reduces risk through the issuance of fixed rate instruments and purchasing derivatives.

CAUTIONARY LANGUAGE CONCERNING FORWARD-LOOKING STATEMENTS

Information set forth in this report contains forward-looking statements that are subject to risks and uncertainties. SWBell claims the protection of the safe harbor for forward-looking statements provided by the Private Securities Litigation Reform Act of 1995.

The following factors could cause SWBell's future results to differ materially from those expressed in the forward-looking statements: (1) adverse economic changes in the markets served by SWBell or changes in available technology; (2) the final outcome of various FCC rulemakings and judicial review, if any, of such rulemakings; (3) the final outcome of various state regulatory proceedings in SWBell's five-state area, and judicial review, if any, of such proceedings; and (4) the timing of entry and the extent of competition in the local and intraLATA toll markets in SWBell's five-state area. Readers are cautioned that other factors discussed in this report, although not enumerated here, also could materially impact SWBell's future earnings.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Report of Independent Auditors

The Board of Directors
Southwestern Bell Telephone Company

We have audited the accompanying balance sheets of Southwestern Bell Telephone Company (a wholly-owned subsidiary of SBC Communications Inc.) as of December 31, 1998 and 1997, and the related statements of income, shareowner's equity and cash flows for each of the three years in the period ended December 31, 1998. Our audits also included the financial statement schedules listed in the Index at Item 14 (a). These financial statements and schedules are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedules based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes 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.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Company at December 31, 1998 and 1997, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 1998, in conformity with generally accepted accounting principles. Also, in our opinion, the related financial statement schedules, when considered in relation to the basic financial statements taken as a whole, present fairly in all material respects the information set forth therein.

ERNST & YOUNG LLP

San Antonio, Texas
February 12, 1999

SOUTHWESTERN BELL TELEPHONE COMPANY

STATEMENTS OF INCOME

Dollars in millions

	1998	1997	1996
Operating Revenues			
Local service	$ **5,397**	$ 5,045	$ 4,537
Network access:			
Interstate	**2,305**	2,176	2,145
Intrastate	**1,095**	1,078	1,099
Long distance service	**770**	803	883
Other	**1,185**	1,014	885
Total operating revenues	**10,752**	10,116	9,549
Operating Expenses			
Operations and support	**5,940**	5,997	5,264
Depreciation and amortization	**2,018**	1,927	1,795
Total operating expenses	**7,958**	7,924	7,059
Operating Income	**2,794**	2,192	2,490
Other Income (Expense)			
Interest expense	**(374)**	(343)	(327)
Other income (expense) - net	**(10)**	39	5
Total other income (expense)	**(384)**	(304)	(322)
Income Before Income Taxes	**2,410**	1,888	2,168
Income Taxes	**883**	701	799
Net Income	$ **1,527**	$ 1,187	$ 1,369

The accompanying notes are an integral part of the financial statements.

SOUTHWESTERN BELL TELEPHONE COMPANY

BALANCE SHEETS

Dollars in millions

	December 31, 1998		1997
Assets			
Current Assets			
Cash and cash equivalents	**60**	$	79
Accounts receivable - net of allowances for uncollectibles of $47 and $33	**1,953**		1,819
Prepaid expenses	**174**		156
Deferred charges	**34**		39
Deferred income taxes	**152**		192
Other current assets	**165**		167
Total current assets	**2,538**		2,452
Property, Plant and Equipment - at cost	**32,602**		31,011
Less: Accumulated depreciation and amortization	**19,398**		18,460
Property, Plant and Equipment - Net	**13,204**		12,551
Other Assets	**37**		11
Total Assets	**15,779**	$	15,014
Liabilities and Shareowner's Equity			
Current Liabilities			
Intercompany loans	**1,766**	$	473
Current portion of long-term obligations	**64**		172
Total debt maturing within one year	**1,830**		645
Accrued taxes	**526**		442
Accounts payable and accrued liabilities	**2,323**		2,599
Total current liabilities	**4,679**		3,686
Long-Term Debt	**4,358**		4,824
Deferred Credits and Other Noncurrent Liabilities			
Deferred income taxes	**461**		383
Postemployment benefit obligation	**2,528**		2,574
Unamortized investment tax credits	**193**		224
Other noncurrent liabilities	**298**		305
Total deferred credits and other noncurrent liabilities	**3,480**		3,486
Shareowner's Equity			
Common stock - one share, no par value	**1**		1
Paid-in surplus	**2,545**		2,745
Retained earnings	**716**		272
Total shareowner's equity	**3,262**		3,018
Total Liabilities and Shareowner's Equity	**15,779**	$	15,014

The accompanying notes are an integral part of the financial statements.

SOUTHWESTERN BELL TELEPHONE COMPANY

STATEMENTS OF CASH FLOWS

Dollars in millions, increase (decrease) in cash and cash equivalents

	1998	1997	1996
Operating Activities			
Net income	$ **1,527**	$ 1,187	$ 1,369
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	**2,018**	1,927	1,795
Provision for uncollectible accounts	**133**	123	102
Amortization of investment tax credits	**(31)**	(31)	(31)
Deferred income taxes	**120**	81	95
Changes in operating assets and liabilities:			
Accounts receivable	**(268)**	(268)	(267)
Other current assets	**(10)**	(22)	(96)
Accounts payable and accrued liabilities	**(192)**	523	228
Other - net	**(172)**	(127)	71
Total adjustments	**1,598**	2,206	1,897
Net Cash Provided by Operating Activities	**3,125**	3,393	3,266
Investing Activities			
Construction and capital expenditures	**(2,566)**	(2,649)	(2,305)
Dispositions	**-**	65	-
Other	**-**	(25)	-
Net Cash Used in Investing Activities	**(2,566)**	(2,609)	(2,305)
Financing Activities			
Net change in short-term borrowings with original maturities of three months or less	**1,293**	(252)	176
Issuance of other short-term borrowings	**-**	120	209
Repayment of other short-term borrowings	**-**	(195)	(134)
Issuance of long-term debt	**196**	729	166
Repayment of long-term debt	**(784)**	(121)	(201)
Dividends paid	**(1,383)**	(1,395)	(1,350)
Net equity received from parent	**100**	340	199
Net Cash Used in Financing Activities	**(578)**	(774)	(935)
Net increase (decrease) in cash and cash equivalents	**(19)**	10	26
Cash and cash equivalents beginning of year	**79**	69	43
Cash and Cash Equivalents End of Year	$ **60**	$ 79	$ 69

The accompanying notes are an integral part of the financial statements.

SOUTHWESTERN BELL TELEPHONE COMPANY

STATEMENTS OF SHAREOWNER'S EQUITY

Dollars in millions

	Common Stock	Paid-in Surplus	Retained Earnings (Deficit)
Balance, December 31, 1995	$ 1	$ 4,838	$ (2,171)
Net income	-	-	1,369
Dividend to shareowner	-	(1,350	-
Equity from parent	-	199	-
Balance, December 31, 1996	1	3,687	(802)
Net income	-	-	1,187
Dividend to shareowner	-	(1,282	(113)
Equity from parent	-	340	-
Balance, December 31, 1997	1	$ 2,745	$ 272
Net income	-	-	1,527
Dividend to shareowner	-	(300	(1,083)
Equity from parent	-	100	-
Balance, December 31, 1998	**$ 1**	**$ 2,545**	**$ 716**

The accompanying notes are an integral part of the financial statements.