

Magellan – In The Know: Episode 50

Geopolitics and investment — the three hotspots to watch



Announcement ([00:00](#)):

The information contained in this podcast is for general information purposes and does not constitute investment advice. You should seek investment advice tailored to your circumstances before making an investment decision.

Host ([00:17](#)):

This is In The Know, a Monthly Investment Podcast brought to you by Magellan Asset Management.

Michael Morrell ([00:20](#)):

The conventional wisdom here is that there is a risk, a significant risk to that support from Donald Trump winning the election. No concern about that support if Vice President Harris were to win the election. The conventional view is that it would continue. I question that conventional wisdom, particularly as it relates to Donald Trump. I think he's actually more likely rather than less likely to continue the aid.

Host ([00:53](#)):

That's Michael Morrell, former acting director of the CIA, explaining what he thinks will happen to US support for Ukraine after November's presidential election. Welcome to Magellan In The Know.

[\(01:11\)](#):

With ongoing conflicts in Ukraine in the Middle East, and rising tensions in the South China Sea, we thought it would be a good time to check in with this leading geopolitical observer to give his frank and fascinating assessment of the global situation. In this episode, Magellan Head of Global Equities and Portfolio Manager Arvid Streimann discusses these conflicts and explores the potential impact on global trade, depending on how these situations unfold, given that geopolitical shocks are usually abrupt and most often negative for economies, it's an important time to study all potential scenarios. But first, here's a warm welcome from Arvid Streimann.

Arvid Streimann ([01:51](#)):

Welcome to the latest episode of Magellan's In The Know podcast. My name is Arvid Streimann. I'm the Head of Global Equities and also a portfolio manager, and today we're very happy to have Michael Morrell back on the podcast. As many of you will know, Michael is a former acting director of the Central Intelligence Agency and is also one of our geopolitical consultants, so welcome back, Michael.

Michael Morrell ([02:10](#)):

It's good to be with you, Arvid, always.

Arvid Streimann ([02:12](#)):

Yes, it sure is. And I just wanted to make a couple of comments about what we're going to talk about. We're obviously going to talk a little bit about geopolitics, and talking about geopolitics with you, Michael, is always very interesting. But on the podcast, we like to focus on what the investment

implications are. And I do think that as investors, when I'm thinking about geopolitics, it's really about the ways that geopolitics can impact supply chains. And what I think is really important here is that those impacts can be fast, they can be large, and they're usually negative. And I think the classic example here is the oil market and the Middle East, but it could also be things like trade or financial sanctions. I think that falls into that bucket.

[\(02:51\)](#):

Another thing I would mention here is that they could also be positive. So we can think about things like the fall of the Berlin Wall or maybe the opening up of China through their ascension to the World Trade Organisation. Those things took a little bit longer to unfold, but they were indeed quite positive things. So I just want to put things into perspective of why we're talking about geopolitics. It's always really interesting. But as investors, I think we need to have a very strong view on why we're talking about these things.

Michael Morrell [\(03:16\)](#):

It's a little helpful that my background was an economic analyst, so it helps me a little bit in taking geopolitics to what matters for businesses, but you'll help me with the rest.

Arvid Streimann [\(03:26\)](#):

Okay. so maybe we'll get right into this. Now, let's start with the Middle East. And as investors, we are clearly concerned about what's happening in the Middle East because of the energy market. And I'd point out that when we're thinking about energy supply or energy security, some folks call it energy security, it's important to point out that there's actually two facets to this. And I think people focus on the first, but not so much the second. And the first one is the production of energy, and the second one is the transportation of energy, because you've got to get it out of the Middle East. And really, when we're thinking about energy supply, it's two of those things. Now, Michael, how are you seeing what's happening in the Middle East right now as it pertains to the geopolitics more generally, and also maybe the oil market in particular?

Michael Morrell [\(04:10\)](#):

Maybe the place to start, Arvid, is to say that all of the geopolitics post-October 7th when Hamas attacked Israel has not had an impact on the oil market, has not had an impact on oil prices, based on multiple studies that are out there. They haven't had an impact at all on supply. A bit of an impact on transportation thanks to the Houthi attacks in the Red Sea, Red Sea shipping. But even most of those attacks have been on the large container ships and less so on oil tankers, which seems to be almost a strategy of the Houthis. So just to emphasise that so far, very little to no impact on oil prices of what's happened since October 7th.

[\(05:07\)](#):

Now, since the last time you and I chatted, I've been to the Middle East. In fact, I just got back a couple of days ago. I was there for a couple of weeks and talking geopolitics the entire time, Arvid. And I walked away with some impressions based on those conversations. And the first impression is that there is going to be no near-term ceasefire in Gaza or Hostage release. That is sometime in the future. It's not near-term, despite US hopes for that happening prior to the election and prior to President Biden leaving office so he can have some sort of positive legacy. It's just not in the cards, it seems. What that means, Arvid, is that the fighting in Gaza is going to continue. It may even ramp up over the next couple of months, and that means two things that are important here.

[\(06:11\)](#):

One is the humanitarian situation in Gaza is going to remain bad and it is bad. There is virtually no aid getting into today. And then for financial purposes, the second implication of continuing combat in Gaza is that the risk of the war spreading, while at this point probably in the 20 to 25% range, continues, and will continue as long as the combat in Gaza continues. If that were to stop, the risk of a wider war would drop to near zero. But as long as that war is going on and as long as there's sporadic fighting and other places, that risk will remain. And that risk includes a wider war between Israel and Hezbollah and Lebanon and even a possible war between Israel and Iran that could draw the United States in. And that's where the risk, I think, to oil prices is.

Arvid Streimann (07:09):

Yeah. Okay, so that's really interesting. Let me just unpack one of the things that you just mentioned there, which is the conflict which is going on in Gaza is really driving the probabilities of a spread of the conflict into the other regional theatres. The probability of a wider conflict seems to be rooted in what's happening in Gaza, but the Israeli army has been operating in Gaza for a long time. And if I just read the papers, it does seem as though they've cleared a lot of that territory of the threat. Would it be correct to say or imply that the probability, that 20 to 25%, of a broader conflict is actually a transitory probability and probably is going to pass over a period of time?

Michael Morrell (07:53):

My strong sense, Arvid, is that while Israel has cleared territory, they haven't held territory. They haven't tried to hold territory, so they've cleared and moved on. And in every case, Hamas has come back. And Hamas retains some significant capabilities. So that suggests to me that Israel is unlikely to stop until they feel that those capabilities have been degraded to a place where Hamas is no longer a threat. And I'm not sure they feel that way at this moment.

Arvid Streimann (08:30):

And so when we are thinking about that risk scenario or the 20 to 25% of the conflict broadening, is it most likely to broaden into Hezbollah on the northern border of Israel or is it a possibility here that it jumps straight to a direct Iranian conflict?

Michael Morrell (08:47):

No, I think a couple of things. One is the most likely jump is to Lebanon first. And because Hezbollah is so important to Iran, Iran sees it as one of the pillars of Iran's deterring an Israeli attack or a US attack on Iran, that Iran would react in a pretty significant way to an Israeli attack on Hezbollah. So I think the risk goes Gaza, Lebanon, and then to Iran.

Arvid Streimann (09:19):

And is there a negotiated solution here potentially where the Hezbollah militias pull back to the northern side of the river? I know this is talked about a lot. Is that acceptable or is that unacceptable?

Michael Morrell (09:33):

Yeah, so I think it depends. The fundamental problem is that since October 7th, because Hezbollah has been firing mortars and rockets into Israel, that Israelis who live in northern Israel have not been able to return to their homes. One problem here is to push Hezbollah back so that their rockets and mortars can't reach those homes so that people can return home. That's one problem. I think there's a unanimous view in Israel that Israel needs to do that. There's no way they're going to leave those houses and those homes unoccupied and tell those people to live somewhere else. It's not going to happen. There is a negotiated settlement, there's a potential negotiated settlement to that problem, Arvid, and

people are working on that. There are people in the region. The United States is working on that. There are people working on that, so that is possible. That kind of negotiated settlement of Hezbollah pulling back far enough so that there doesn't need to be a war is possible, maybe even 50/50.

[\(10:41\)](#):

The other issue is that there are individuals and maybe even groups of individuals in Israel that want to go further in a battle with Hezbollah that is more than allowing Israelis to return home to northern Israel. And that view is, look what Hamas did to us on October 7th. Hezbollah's got much more capability than Hamas did on October 7th. Maybe it's time we significantly degraded that, so that that is not a day-to-day risk to us, which I don't think it is because I think Hezbollah is deterred, but there are people in Israel who are calling for that. So even if you had a negotiated settlement, there is a possibility to get to a broader war against Hezbollah, which would absolutely, definitely draw in Iran in my view.

Arvid Streimann ([11:29](#)):

Let me take a step back here, and here's how I think about these types of scenarios, and we're talking about the Middle East and we'll talk about some other areas in a moment. But my broad framework about thinking about these types of things is to go, okay, does everyone in this area want to avoid a war? And if they do, then I would call that a stable equilibrium, in the sense that if we are worried a war and we're worried about threats to energy supply, then it's a much lower probability if no one actually wants that. And that's why I would call it a stable equilibrium. So would you say that this is a stable equilibrium in the way that I've defined it?

Michael Morrell ([12:08](#)):

I worry that it's not. In general, it is, but I worry that it's not. The reason that the stable equilibrium may have become unstable is the horror of October 7th. The massive killing, the rapes, the kidnappings, the brutality, the evil. And that has changed the psychology in Israel. It changed the psychology initially to revenge. And now as the thinking takes over for revenge, it's affecting the psychology in the sense that we need to reestablish security. And that means not only reestablishing it with Hamas, which clearly failed on October 7th, and it also means reestablishing it with Hezbollah. So that's the unstable dynamic here, is that with regard to a war with Hezbollah, Israel may indeed want that. I'm not saying they do. I'm not saying I know that, but they may indeed want that. That would be the unstable particle here, right?

Arvid Streimann ([13:13](#)):

Yeah, I get you. And from the other side, does Hezbollah or Iran want a war?

Michael Morrell ([13:18](#)):

No, they do not.

Arvid Streimann ([13:20](#)):

So it may not be completely stable, but it's not unstable either. It's somewhere maybe in the middle.

Michael Morrell ([13:25](#)):

Right, which is why in the two different scenarios in Lebanon, the first being we just want Israelis to go home, the stability there would be, okay, there's a deal to be had here. We'll pull back. No fighting. But if Israel wants a more significant war with Hezbollah, then a negotiated settlement is very difficult, if not impossible.

Arvid Streimann ([13:49](#)):

And then it becomes just a question of how much Iran wants to protect that buffer militia that's in between it and Israel.

Michael Morrell ([13:56](#)):

Yeah, for sure.

Arvid Streimann ([13:57](#)):

And thinking more broadly, is there anything that might happen that you think about, that you worry about, that could change these scenarios that you're talking about?

Michael Morrell ([14:07](#)):

Netanyahu leaving office. I think Netanyahu leaving office and being replaced by, say, a Benny Gantz or the defence minister, Gallant, I think would be a significant step in returning overall stability, bringing Israel back into the stability equation. They'd be much less likely to do a broad-scale attack on Lebanon, so that's a big one in the positive direction. In the negative direction, it's something getting out of hand. And the way something gets out of hand is a large number of Israelis die, which again galvanises the nation towards something significant, and revenge, which spins the whole thing out of proportion, which almost happened in April when Iran tried a very significant attack on Israel. And luckily, with the help of its Arab neighbours and with the help of the United States, not a single one of those missiles, drones, cruise missiles hit a target. Had they, there could have been a war overnight.

Arvid Streimann ([15:13](#)):

Yeah, it was interesting, that strike, and I was reading about it the next day. And it seemed as though a lot of those projectiles had to fly over Iraq, and that gives Israel a fair amount of warning as to what's coming. So maybe they have some natural defence in that geographical perspective.

([15:29](#)):

Maybe let's turn to Russia's invasion of Ukraine, another area where there's a war going on. What do you think are the possible scenarios here? And Michael, we always like to talk in terms of scenarios and probabilities, so maybe you could attach some probabilities to those scenarios as well when you're describing this.

Michael Morrell ([15:46](#)):

Sure. There's been a lot of talk in the United States, a lot of op-eds written in the United States over the last few days, saying that Russia is winning the war of attrition. And my reaction to those pieces, Arvid, as you and I've talked before, my reaction to those pieces is that's been the case all along. A long war of attrition is in Russia's favour and nothing's changed in the last couple of months to change that. I think where we are, Arvid, is the possibility of Russia reaching its maximalist goals, which was to take the entire country and either make it a vassal state or incorporate it into Russia. The probability of that is probably less than 5%. The probability of Ukraine reaching its Maximalist goals, which is taking back all the territory that Russia has taken since 2022, and all the territory it took in 2014, the probability of that is near zero.

([16:48](#)):

And the most likely outcome here is one of two things. One is a frozen conflict. So at some point, both sides don't want to fight anymore, which usually happens in these kind of affairs. Neither side wants to fight anymore, but they don't want to negotiate either, so they just stop fighting and they're staring at

each other across a line. And they do that for a long period of time, just like Russia and Georgia has done since 2008.

Arvid Streimann (17:17):

And also, the Koreans. The Korean Peninsula sounds like this as well.

Michael Morrell (17:21):

Exactly, and that's been going on for 50 years. Between that and a negotiated solution is probably 30% frozen conflict, 70% negotiated solution. So in the 70% negotiated solution category, you've got two possible outcomes. One is there's a negotiated settlement and Russia is seen as the winner. And the other is there's a negotiated settlement and Ukraine is seen as the winner. What does a negotiated settlement with Russia winning look like? They keep the territory that they've taken, and they've got such influence in Kyiv that Ukraine's options for choosing its own future are minimal, so they can't join NATO, they can't join the EU, and they're stuck in this Russian orbit with very little economic potential.

(18:21):

So, what does a Ukraine victory look like in a negotiated settlement? They get back some significant percentage of the territory that they've lost, and they can determine their own future. So they can determine whether or not to join the EU, which they almost certainly would, and they can determine if offered to join NATO, which maybe that offer would never come. Now, who gets to win a negotiated settlement depends on the situation on the battlefield. And this is where the attrition comes in, because Russia can bring a lot more to this. More people, more weapons. They're getting a lot from North Korea, they're getting a lot from Iran. What the West can offer is more limited. Putin's created a wartime economy with industries that used to produce something else now producing weapons.

(19:08):

So over time, you would think that time is not on Ukraine's side in terms of having a negotiated settlement that benefits them. But I would say one thing in response to somebody saying that to me, but the Ukrainian will to fight remains strong. And I just had a very good friend who spent a couple of weeks there and he did not talk to a single person who said, "Maybe we should negotiate." Everybody wanted to continue to fight. Everybody's entire being was focused on fighting and getting their territory back, so that's where we are.

Arvid Streimann (19:42):

One other potential scenario which you didn't mention, I presume it's a very low probability, is that the conflict gets worse, spreads or increases in intensity. The reason why I bring that up is because the Ukrainians have actually crossed the border and are sitting in Russia in parts of Russia and occupying that. I know Putin has said in the past that when Russia is threatened that it would consider the use of nuclear weapons or that's one of the scenarios where we'd use nuclear weapons, and using nuclear weapons would obviously be a very bad thing. It hasn't happened since World War Two, of course. So I'm wondering what's the probability of expansion in the conflict and the use of nuclear weapons? It seems to be, from what I'm hearing here, that you think that's a fairly low probability. Is that how I should take that?

Michael Morrell (20:29):

Yes, I think it's a low probability, but when you have a low probability, high-impact outcome or possibility, you got to pay attention to it. So I'd say less than 1% that Putin would use nuclear weapons, but that would be such a significant thing that you'll be foolish not to focus on it, but I think it's low. I think one of the things that we've learned in this conflict is every time Putin draws a red line and it gets

crossed, he said, "No attack guns." He said, "No fighter jets." He said, "If my territory ever gets crossed..." And every time one of these red lines have been crossed, he doesn't deliver on his threat.

Arvid Streimann ([21:12](#)):

And why do you think that is? Because we can talk about Putin's power and that eventually is going to erode at some point, but why do you think he's not reacting?

Michael Morrell ([21:20](#)):

Because he doesn't want a war with NATO any more than we want to war with him. He knows that a conventional conflict between NATO and Russia, he will lose. His forces have been significantly degraded since the start of the Ukraine war. NATO's weapons are much more advanced. And he also knows that a nuclear war could result in a global thermonuclear war, and so he understands the risks as well as we do. He's a bully and he blusters, but as with most bullies, ultimately you back down.

Arvid Streimann ([22:01](#)):

Okay, so it sounds to me as though you're describing what we were talking about before, which is that this is a stable equilibrium. And if that's the case, then what could make it an unstable equilibrium?

Michael Morrell ([22:12](#)):

That's a great question. I'd say first the overthrow of Putin by an even more nationalistic figure than he is. Most of the criticism domestically against him has been not from the left, not from the democrats, not from the liberals, small L, but from the right, the people who want him to use all of Russia's power in Ukraine, which they feel he hasn't done for the reasons we just talked about. So if he were overthrown by somebody further to the right than he is, then maybe that probability would inch up a little bit about taking on NATO more directly, maybe seriously considering the use of nuclear weapons, whereas I think he's just been rhetoric. So, that's one thing.

([23:03](#)):

The overthrow of Zelensky by a more pro-Russian figure, so think about a coup in Ukraine where you've got somebody who's willing to negotiate now, might take us to the negotiating table in a way that would benefit Russia, and essentially Ukraine would be lost to Russia for some extended period of time. That's another probably low probability, but high-impact outcome. So I think the ones I can think of would take us to even less war, or in one case, take us to more war, which would probably then force some kind of negotiation, or take us to less war.

Arvid Streimann ([23:44](#)):

And when we're thinking about Putin and all leaders, I think you can always make the case that there's going to be a change in leadership at some point, and so that is a statement you can make with certainty. But there's always uncertainty in the world. And when I'm thinking about things like this, I go, well, the uncertainty is the timing and the uncertainty is also who replaces them. I think this is your point. Do you have a view on Putin's potential replacement, whether it is someone who's more nationalistic, or is it someone who's potentially the other way?

Michael Morrell ([24:16](#)):

Yeah, I think, look, this is a little hard because he's an authoritarian leader, and authoritarian leaders, the thing they're most afraid of is their own people and the people around them. They got to where they were by not playing by the rules, and so they got to worry about other people not playing by the rules. So just as we woke up one day a year ago, maybe even a little longer than a year now, and he was

being challenged by Wagner, we could wake up tomorrow to a similar kind of thing, or even the announcement that Putin's been killed and there's a new leader of Russia. So, that's possible, the very quick change. If that doesn't play out between now and when the end of this war happens, his political future I think will be a direct result of the outcome of those negotiations. If Russia is seen as the loser, he's gone either from the right or the left. I think if Russia is seen as the winner, he solidifies his position.

Arvid Streimann (25:15):

Okay. And I want to touch on something that you were talking about earlier, which is the Western support for Ukraine. Obviously, the US is a major donor to the Ukrainian war effort. Clearly there's an election coming up in a couple of months' time. How much do you think that this American support for the Ukrainian war effort depends on that election, which is coming up?

Michael Morrell (25:36):

Yeah, so the conventional wisdom here, and maybe in the rest of the world, the conventional wisdom here is that there is a significant risk to that support from Donald Trump winning the election. No concern about that support if Vice President Harris were to win the election. The conventional view is that it would continue with the Biden policy. I question that conventional wisdom, particularly as it relates to Donald Trump. I think he's actually more likely rather than less likely to continue the aid, and I base that on a couple of things. One is it's really easy to oppose an incumbent's policies when you are not in power. It gets very difficult to choose a path that's not in the interests of the United States when you are in power. So I think we'd see a lot of rhetoric now about Ukraine and solving it in one day, and his vice presidential candidate, JD Vance, has outlined what that would look like. But once you're in power, it gets much harder to sustain that.

[\(26:55\):](#)

And two, it's really interesting. So Barack Obama after 2014 did not give the Ukrainians any weapons, no offensive weapons and no defensive weapons, to defend themselves against the Russians in 2014. The person to change that policy and to start giving weapons to Ukraine was Donald Trump during his presidency, so you got to remember the history a little bit. And all of that despite his weird relationship with Vladimir Putin and the words of flattery by both of them. Despite that, he had a pretty tough policy on Russia. Sanctions on Russia, weapons to Ukraine. So that's another.

[\(27:35\):](#)

And then the third thing I would point to is that when it looked like the Republicans were going to vote no on additional aid to Ukraine several months ago, and it looked like it was going to stop several months ago, the Speaker of the House, Mike Johnson, had his mind changed, and he went from a hard no to a hard yes. And when he got to a hard yes, he got in a plane and he went to Mar-a-Lago to meet with Trump, and he came back and he rallied his troops. He rallied Republicans to vote in favour and the aid continued, so maybe we'd be surprised in a Trump presidency that the aid would in fact continue.

Arvid Streimann (28:17):

Yeah, interesting. I like it when I hear the almost counter-views to the prevailing consensus. That's really interesting. Now, one last question or the last part of this conversation. I wanted to ask you, what other geopolitical hotspots do you think people should be talking about? We've talked about the Middle East, we've talked about Russia and Ukraine. What other area of the world do you think could be a hotspot, which could have an investment impact?

Michael Morrell (28:42):

Arvid, I think from a geopolitical perspective, I think the most likely is the South China Sea, where the Chinese continue to get more aggressive with the Philippines in the Thomas Shoal. Every time we turn around, there's another water cannon, ships are getting bumped, Philippine sailors are getting hurt. We've got US Navy patrols now in that area. We've got Japanese patrols now in that area. Nobody wants conflict here, which is why the Chinese use Coast Guard vessels, not their Navy vessels. So nobody wants conflict, but it's possible that something could spin out of control. It's possible that a bunch of Chinese sailors on Coast Guard vessels get killed and the Chinese react in a significant way, and then it's harder to contain. So it's still a very low probability, but in all the places on the planet where there's a geopolitical risk with an economic consequence, given the amount of trade that flows through that area on a daily basis in just massive, probably the most significant sea lanes in the world, that's something to pay attention to, I think.

Arvid Streimann (29:53):

Yeah, and I was thinking as you were talking about that, there was that border skirmish between India and China, which led to some deaths on both sides. And fortunately, that was something which didn't spiral out of control, but you could imagine if temperatures are raised to a certain level, that it could spiral out of control.

Michael Morrell (30:12):

Yeah, it's also in the middle of nowhere. So even if it spiralled out of control there, it might be a little difficult spiralling into somewhere else.

Arvid Streimann (30:22):

Yeah. Okay, great. I think we might leave it there. Michael, it's always great to chat with you. We really enjoy speaking to you and getting your views on the world, and I do really like it how you put the probabilities on the different scenarios. I find that very useful and-

Michael Morrell (30:36):

Well, I learned that from you, Arvid. I learned that from you asking me about that all the time.

Arvid Streimann (30:41):

Well, I'm not sure that that's really the case. I'll tell you later somewhere else, but I'll take the compliment nevertheless. But thanks very much for being on the podcast today, Michael, and I look forward to speaking to you again.

Michael Morrell (30:50):

Absolutely, Arvid. Me too.

Host (30:53):

That was Magellan's Head of Global Equities and Portfolio Manager, Arvid Streimann speaking with Michael Morrell, the former acting director of the CIA. We trust you've enjoyed this episode. For more information on previous episodes, visit magellangroup.com.au/podcast, where you can also sign up to receive our regular investment insights programme. Thanks for listening.

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