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Illustration by The New York Times

King Kong vs. the Pirates of the Multiplex

A Look Inside the Digital Bootleggers' Jungle

By TIMOTHY L. O'BRIEN

SHORTLY before Christmas, Universal Pictures plans to unveil its $150 million remake of "King Kong," the 1933 sci-fi classic featuring an overgrown beast with a soft spot for blondes, a craggy, fog-shrouded island inhabited by dinosaurs and a squadron of biplanes buzzing the Empire State Building.

The new version, aimed squarely at the hearts, minds and wallets of the teenage-to-mid-30's set that Hollywood prizes, has blockbuster written all over it. Peter Jackson, the maestro behind the "Lord of the Rings" trilogy, is directing; Naomi Watts is stepping into Fay Wray's shoes as the imperiled, scantily clad heroine; and the film is rumored to be embroidered with mind-blowing special effects.

But even the mighty Kong may not be safe from the clutches of a nebulous, tech-savvy network of film pirates who specialize in stealing copies of first-run movies and distributing them globally on the Internet or on bootleg DVD's. While Hollywood has battled various forms of film looting for decades, this time seems different. Piracy in the digital era is more lucrative, sophisticated and elusive than ever — and poses a far bigger financial threat.

"Piracy has the very real potential of tipping movies into becoming an unprofitable industry, especially big-event films. If that happens, they will stop being made," said Mr. Jackson in an e-mail message from New Zealand, where he is putting the final touches on his version of "King Kong." "No studio is going to finance a film if the point is reached where their possible profit margin goes straight into criminals' pockets."

Film piracy is taking place against a larger backdrop of technological and demographic shifts that are also shaking Hollywood. Elaborate home theater components — like DVD players, advanced sound systems and flat-screen TV's — are helping to shrink theatrical attendance, as more and more film fans choose to watch while stretched out on their couches. And with the advent of high-speed Internet connections that can deliver large film files to personal computers, the movie business is confronted with the same thorny challenges that the music industry encountered several years ago with the emergence of file-sharing programs like Napster.

Hollywood reported global revenue of $84 billion in 2004, according to PricewaterhouseCoopers, the accounting firm. With most theatrical releases amounting

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GRETCHEN MORGENSON

A Hedge Fund Falls Off the Face of the Earth

"HELLO, this is Dan Marino," says a weary, raspy voice on an answering machine. Mr. Marino, the chief financial officer of the **Bayou Group**, a $400 million hedge-fund and brokerage firm that is under investigation by state and federal authorities in Connecticut, sounds beleaguered. "Please leave me a message," he goes on. "I am receiving lots of phone calls. I am unable to pick up every call, so if you do call, leave a message and a number. I will get back to you."

Bayou investors are dying to know why their money has not been returned as the firm promised last month. But if they're hoping for a return call, they are out of luck. "Sorry," says a chipper female voice on the tape. "You cannot leave a message now. This mailbox is full."

Those few, unsettling words are just about all that investors in the four Bayou funds have to go on right now. Money that was supposed to be wired to their accounts in mid-August after the funds wound down has not appeared. The funds' principals, its accountants and its lawyer are not talking. The funds' offices in Stamford stand empty.

All that Bayou's investors can do is wait, fret and wonder what went wrong at the funds, run by Samuel Israel III, a folksy Wall Street veteran who seemed to turn in a steady, if unspectacular, performance.

"What panicked me, when I sat back and thought about it, was I know practically nothing about these people," said John C. Siegesmund III, an investor in Denver who had never put money in a hedge fund before he sank $250,000 into Bayou in February 2003. "They had good returns, they seemed reputable, there's nothing sort of fly-by-night about them. But when the chips are down, you don't know what you're getting into."

The Federal Bureau of Investigation has joined Connecticut banking officials and federal prosecutors

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Good News, Bad News: Your Loan's Approved

By EDUARDO PORTER

ADAM GARDNER wasn't going to let limited resources stop him from buying a house. A 28-year-old appraiser's apprentice from Reno, Nev., he extended his search all the way to a new development 20 miles north of downtown. When he finally found a place — a two-bedroom, three-bath house — he took out two loans to finance 90 percent of the $253,850 price tag. And to keep his monthly payments within budget, he obtained what's known as an interest-only adjustable-rate mortgage.

"I moved out of Reno to find something I could afford. Even then I needed an interest-only adjustable mortgage," said Mr. Gardner, who closed on his new home in April. "First-time home buyers are being pushed out of the market entirely."

Actually, many first-time home buyers are being pushed into the embrace of creative financing. As the housing boom lifts the median home price way beyond the budget of huge numbers of Americans, middle-income home buyers like Mr. Gardner are increasingly turning to such mortgages — a decision that could well come back to haunt both them and the banks behind the loans later on.

Max Whittaker for The New York Times

Adam and Sunny Gardner got an interest-only loan for their home.

The newfangled mortgages have been heralded in the industry as useful tools for buyers who would otherwise be shut out of the surging real estate market. That's because they reduce borrowers' monthly payments by allowing them to pay only interest initially while charging a lower interest rate that remains fixed for a few years before starting to adjust annually for the rest of the term, typically 30 years.

But critics say they are riskier than standard mortgages, as they are prone to two payment spikes — one when the interest-only period expires and another when the fixed-rate period ends and the borrower faces potentially much higher interest rates.

Critics also worry that offering extra-risky financial products that permit financially vulnerable buyers to get ever bigger mortgages is particularly perilous now, when many experts say the housing bubble may be near a breaking point.

"We are in uncharted territory," said Susan M. Wachter, professor of real estate at the Wharton School of the University of Pennsylvania. "On the one hand, it is the case that these mortgages enable purchases of homes by higher-risk, poor-credit households who otherwise wouldn't be able to own a home. But on the other hand, they are riskier products, and we don't have historical

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